Annual Report 2012

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 29 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 2012

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Bank Leumi le-Israel B.M.
Board of Directors

David Brodet, Chairman

David Avner

Rami Avraham Guzman(1)

Prof. Arieh Gans(1)

Moshe Dovrat

Yehuda Drori

Doron Cohen

Adv. Miriyam (Miri) Katz

Yoav Nardi

Adv. Haim Samet(2)

Zipporah Samet

Amos Sapir

Prof. Efraim Sadka(1)

Professor Yedidya Zvi Stern (1)

Prof. Gabriela Shalev

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(1) Elected as director at the General Meeting held on 1 August 2012. The term of office of Mr. Rami Avraham Guzman took effect on 1 November 2012. The term of office of Professor Yedidya Zvi Stern took effect on 30 October 2012.
Prof. Arieh Gans and Prof. Efraim Sadka were re-elected at the Annual General Meeting of the Bank held on 1 August 2012.

It should be noted that until 15 August 2012, Ms. Zipora Gal-Yam served as director in the Bank.

(2) Elected as external director pursuant to section 239 of the Companies Law, 1999, at the General Meeting held on 1 August 2012, for a three-year period commencing 10 October 2012.

It should be noted that Mr. Reuven Adler served as external director until 24 July 2012.

Bank Leumi le-Israel B.M.
Members of Management and their Positions*

Rakefet Russak-Aminoach, C.P.A. (Isr.)(1)
President and Chief Executive Officer

Prof. Daniel Tsiddon
Deputy Chief Executive Officer, Head of Capital Markets Division

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

Yaacov (Kobi) Haber(2) (7)
First Executive Vice President, Head of Corporate Division

Dan Cohen
First Executive Vice President, Head of Human Resources Division

Menachem Schwartz, C.P.A. (Isr.) (3)
First Executive Vice President, Chief Accounting Officer, Head of Accounting Division

Dr. Hedva Ber
Executive Vice President, Chief Risk Officer, Head of Risk Management Division

Adv. Nomi Sandhaus
Executive Vice President, Chief Legal Advisor, Head of Legal Division, Manager of Legal Risks

Ms. Tamar Yassur(4)
Executive Vice President, Head of Banking Division

Mr. Dan Yerushalmi(5)
Executive Vice President, Head of Operations and Information Systems Division

Mr. Yoel Mintz(2) (6)
Executive Vice President, Head of Structured Finance and Real Estate Division

Mr. Ron Fainaro C.P.A. (Isr.)(7)
Deputy Chief Executive Officer, Head of Economics and Finance Division

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Sasson Mordecai
Executive Vice President, Chief Internal Auditor, Head of Internal Audit Division

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

Somekh Chaikin Kost Forer Gabbay & Kasierer
Joint Auditors of the Bank

(1) On 1 January 2012, Ms. Galia Maor, informed the Board of Directors of the Bank that she intended to retire from her position as President and Chief Executive Officer of the Group in the second quarter of 2012. On 30 April 2012, Ms. Maor retired from her position as Chief Executive Officer and left the Bank on 31 January 2013.
On 12 February 2012, the Board of Directors of the Bank appointed Ms. Rakefet Russak-Aminoach as President and Chief Executive Officer of the Group. Ms. Russak-Aminoach commenced her term of office on 1 May 2012, after receiving the confirmation of the Supervisor of Banks that he had no objection to the appointment.
Until 30 April 2012, Ms. Russak-Aminoach served in the position of Senior Deputy Chief Executive Officer Deputy Chief Executive Officer, and Acting CEO in the absence of the President and CEO and as Head of the Corporate Division.

(2) With effect from 1 January 2013, Mr. Yaacov (Kobi) Haber serves as Head of Corporate Division. With effect from 1 May 2012, and until the commencement of Mr. Haber's term of office as Head of Corporate Division, Mr. Yoel Mintz, Head of Structured Finance and Real Estate Division, and the heads of the units in the Corporate Division, Mr. Yitzhak Naor and Mr. Malchiel Shahar, reported directly to the President and Chief Executive Officer.

(3) Mr. Menachem Schwartz will serve in the position of Chief Accounting Officer and Head of Accounting Division until 31 March 2013. With effect from 1 April 2013, Mr. Shlomo Goldfarb will serve in the position of Chief Accounting Officer and Head of Accounting Division.

(4) With effect from 1 January 2013, Ms. Tamar Yassur serves as Head of Banking Division. Until 31 December 2012, Mr. Baruch Lederman served as Head of Banking Division.

(5) With effect from 1 March 2013, Mr. Dan Yerushalmi serves as Head of Operations and Information Systems Division. Until 31 December 2012, Mr. Yitzhak Malach served as Head of Operations and Information Systems Division. With effect from 1 January 2013, and until the commencement of Mr. Yerushalmi's term of office, Mr. Moshe Wolf served as Head of Operations and Information Systems Division.

(6) With effect from 1 May 2012, Mr. Yoel Mintz serves as Head of Structured Finance and Real Estate Division.

(7) With effect from 1 July 2012, Mr. Mr. Ron Fainaro serves as member of management and Executive Vice-President. With effect from 1 November 2012, Mr. Fainaro serves as Head of Economics and Finance Division. Until 31 October 2012, Mr. Yaakov (Kobi) Haber served as Head of Economics and Finance Division.

* On 30 June 2012, Mr. Zvi Itskovitch, Deputy Chief Executive Officer and Head of International and Private Banking Division stepped down from his position and retired from the Bank on 31 January 2013.

Bank Leumi le-Israel B.M. and Investee Companies

Directors' Report

The following is the sixty-second annual report of Bank Leumi le-Israel B.M. and the one hundred and eleventh report of the business, founded in 1902. This report will be presented to the Bank's Annual General Meeting. This report is based on an analysis of the data included in the Bank's Financial Statements and Management Review, and on additional data as required. This report is prepared in accordance with the public reporting directives of the Supervisor of Banks at 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 111 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 by 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 and subsidiaries and companies included on equity basis, through 278 branches located throughout Israel, and through 60 branches, agencies and representative offices in 17 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 highly sophisticated investment solutions; 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 Law (Temporary Provision), 1993. On 3 September 2007, the company ceased to be an interested party 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 (until the company's merger with Leumi), 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, food, retail trade and the chemical industry. The management of the non-banking investment portfolio is conducted through the subsidiary, Leumi Partners Ltd.

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, for example, insurance companies and other institutional entities.

2012 was typified by a continuation in the global economic slowdown resulting from a further deterioration in the economic position of some European countries, in particular, Italy, Ireland, Greece, Spain and Portugal. The Israeli economy grew in real terms by some 3.1%, compared to 4.6% in 2011. For details, see the Economic Review below.

Total assets under management of the Group (both balance sheet and off-balance sheet*) amounted to NIS 989 billion as at 31 December 2012, as compared with NIS 898 billion at the end of 2011, an increase of some 10.1%, resulting primarily from an increase in the scope of activity and in market values.

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

The following table presents principal data as at:

	2012	2011	2010	2009	2008
Assets and liabilities at end of period (NIS millions):					
Total assets (total balance sheet)	**376,160**	365,854	328,322	321,910	311,008
Credit to the public, net	**241,264**	241,320	223,981	204,669	213,215
Securities	**56,408**	47,936	55,791	57,505	44,910
Cash and deposits with banks	**54,621**	53,044	30,052	42,933	33,130
Investment in companies included on equity basis	**2,129**	2,270	1,924	2,178	1,842
Deposits of the public	**289,538**	279,404	249,584	250,418	244,783
Debentures, notes, and subordinated notes	**27,525**	29,999	26,939	25,261	20,636
Equity attributable to shareholders of the banking corporation	**24,921**	23,374	23,293	21,532	18,267

The following table presents principal data for years ended 31 December:

	2012	2011 (a)	2010 (a)	2009 (a)	2008 (a)
Income, expenses and profit (in NIS millions):					
Net interest income	**7,408**	7,107	6,972	6,511	7,366
Expenses in respect of credit losses	**1,236**	734	584	1,521	2,145
Total non-interest income	**4,774**	4,175	4,767	5,107	2,064
Of which: commissions	**4,199**	4,116	4,129	3,890	3,881
Total operating and other expenses	**9,100**	8,341	7,961	6,781	7,003
Of which: salary expenses	**5,290**	5,061	4,686	3,896	4,118
Profit before taxes	**1,846**	2,207	3,194	376	3,194
Provision for taxes	**811**	418	1,241	1,272	421
Profit for the period attributable to shareholders of the banking corporation	**931**	1,891	2,334	2,089	92
Net profit per share attributable to shareholders of the banking corporation (in NIS)	**0.63**	1.28	1.58	1.42	0.06

(a) Data for 2008-2011 have been reclassified in accordance with the directives of the Supervisor of Banks. See Note 1D.1.

The following table presents principal financial ratios as at 31 December 2012 (in %):

	2012	2011*	2010*	2009*	2008*
Credit to the public, net, to total balance sheet	**64.1**	66.0	68.2	63.6	68.6
Securities to total balance sheet	**15.0**	13.1	17.0	17.9	17.0
Deposits of the public to total balance sheet	**77.0**	76.4	76.0	77.8	78.7
Deposits of the public to net credit	**120.0**	115.8	111.4	122.4	114.8
Total equity to risk assets according to Basel II (a)	**14.87**	14.34	14.96	13.90	11.34
Tier I capital to risk assets according to Basel II	**8.55**	8.07	8.43	8.20	7.35
Equity (excluding non-controlling interests) to balance sheet	**6.6**	6.4	7.1	6.7	5.9
Net profit to average equity (excluding non-controlling interests)	**3.8**	8.3	10.3	10.8	0.5
Rate of provision for tax on the net profit	**43.9**	18.9	38.9	38.4	149.3
Expenses in respect of credit losses to credit to the public, net	**0.51**	0.30	0.26	0.74	1.01
Of which: expenses in respect of collective allowance to credit to the public, net	**0.13**	0.15	0.02	(0.02)	0.03
Expenses in respect of credit losses to total risk of credit to the public	**0.34**	0.20	0.34		
Net interest income to total balance sheet	**1.97**	1.94	2.12	2.02	2.37
Total income to total assets (b)	**3.24**	3.08	3.58	3.61	3.03
Total income to total assets managed by the Group (b) (c)	**1.23**	1.68	1.77	1.99	1.93
Total operating and other expenses to total assets	**2.42**	2.28	2.42	2.11	2.25
Total expenses to total assets managed by the Group (c)	**0.92**	1.24	1.20	1.16	1.44
Net profit to total average assets (c) (d)	**0.26**	0.56	0.73	0.58	0.03
Interest margin including income and expenses from derivative financial instruments	**1.29**	1.00	1.22	1.10	1.63
Operating and other expenses to total income (b)	**72.0**	73.9	67.8	58.4	74.3
Non-interest income to operating and other expenses	**54.4**	50.1	59.9	75.3	29.5
Non-interest income to total income (b)	**39.2**	37.0	40.6	44.0	21.9

* Data for 2008-2011 have been reclassified in accordance with the directives of the Supervisor of Banks. See Note 1D.1.

(a) Capital – with the addition of noncontrolling interests, net of investments in the capital of companies included on equity basis and sundry adjustments.
(b) Total income – net interest income and noninterest income.
(c) Including off balance sheet activity.
(d) Average assets are total income-producing and other balance sheet assets.

The following table presents principal data for the three-month periods ended 31 December:

	2012	2011
Income, expenses and profit (NIS millions)		
Interest income, net	**1,784**	1,679
Expenses in respect of credit losses	**386**	385
Total noninterest income	**1,394**	1,203
Of which: Commissions	**1,107**	1,007
Total operating and other expenses	**2,611**	2,121
Of which: Salary expenses	**1,314**	1,196
Profit before taxes	**181**	376
Provision for taxes (tax benefit)	**233**	(246)
Net profit (loss) for the period attributable to shareholders of the banking corporation	**(259)**	618
Earnings (loss) per share attributable to shareholders of the banking corporation (in NIS)	**(0.18)**	0.42

Net profit attributable to the shareholders of the banking corporation (hereinafter: the net profit) amounted to NIS 931 million in 2012 compared to NIS 1,891 million in 2011, a fall of 50.8%.

The decrease in net profit is mainly explained by an increase in operating and other expenses amounting to NIS 759 million, of which NIS 400 million is in respect of expenses that were and are likely to be incurred in connection with the U.S. customers, an increase in credit loss expenses amounting to NIS 502 million, an increase in the provision for tax amounting to NIS 393 million, and a decrease in the profitability of the companies included on equity basis amounting to NIS 215 million. On the other hand, an increase in net interest income amounting to NIS 301 million and an increase in noninterest income, amounting to NIS 599 million, partially offset the abovementioned effects.

The loss in the fourth quarter of 2012 amounted to NIS 259 million, compared to a profit of NIS 618 million in the corresponding period last year. The decrease is mainly explained by a fall in the profitability companies included on equity basis amounting to NIS 202 million, net, and by an increase in operating and other expenses amounting to NIS 490 million, of which NIS 360 million was in respect of expenses that were and are likely to be in connection with the U.S. customers and an increase in the provision for tax amounting to NIS 479 million. On the other hand, the increase in net interest income, amounting to NIS 105 million and an increase in noninterest income, amounting to NIS 191 million, partially offset the abovementioned effects.

The increase in the value of the securities in the available-for-sale portfolio in 2012, which was carried to capital, amounted to NIS 713 million, net (after tax), compared with a fall in value of NIS 686 million, net (after tax), in 2011.

Net profit per share attributable to the shareholders of the banking corporation was NIS 0.63 in 2012, compared with NIS 1.28 in 2011, and NIS (0.18) in the fourth quarter of the year, compared with NIS 0.42 in the corresponding period last year.

Net profit including changes in a capital reserve for available-for-sale securities (other comprehensive income) amounted to NIS 1,644 million, compared to NIS 1,205 million.

Based on the data of the banking system as at 30 September 2012, as published by the Bank of Israel, the share of Leumi Group of the banking system was as follows:

	30.9.2012	31.12.2011	31.12.2010	31.12.2009	31.12.2008	31.12.2007
	%					
Total assets	**29.3**	29.6	29.3	29.6	29.3	30.00
Credit to the public, net	**28.7**	29.2	28.9	28.3	29.1	29.7
Deposits of the public	**29.9**	29.9	29.5	29.9	29.8	30.2
Net profit attributable to the shareholders of the banking corporation	**23.1**	26.0	34.5	36.6	7.3 (1)	36.5

(1) After canceling the effect of credit losses of Bank Hapoalim.

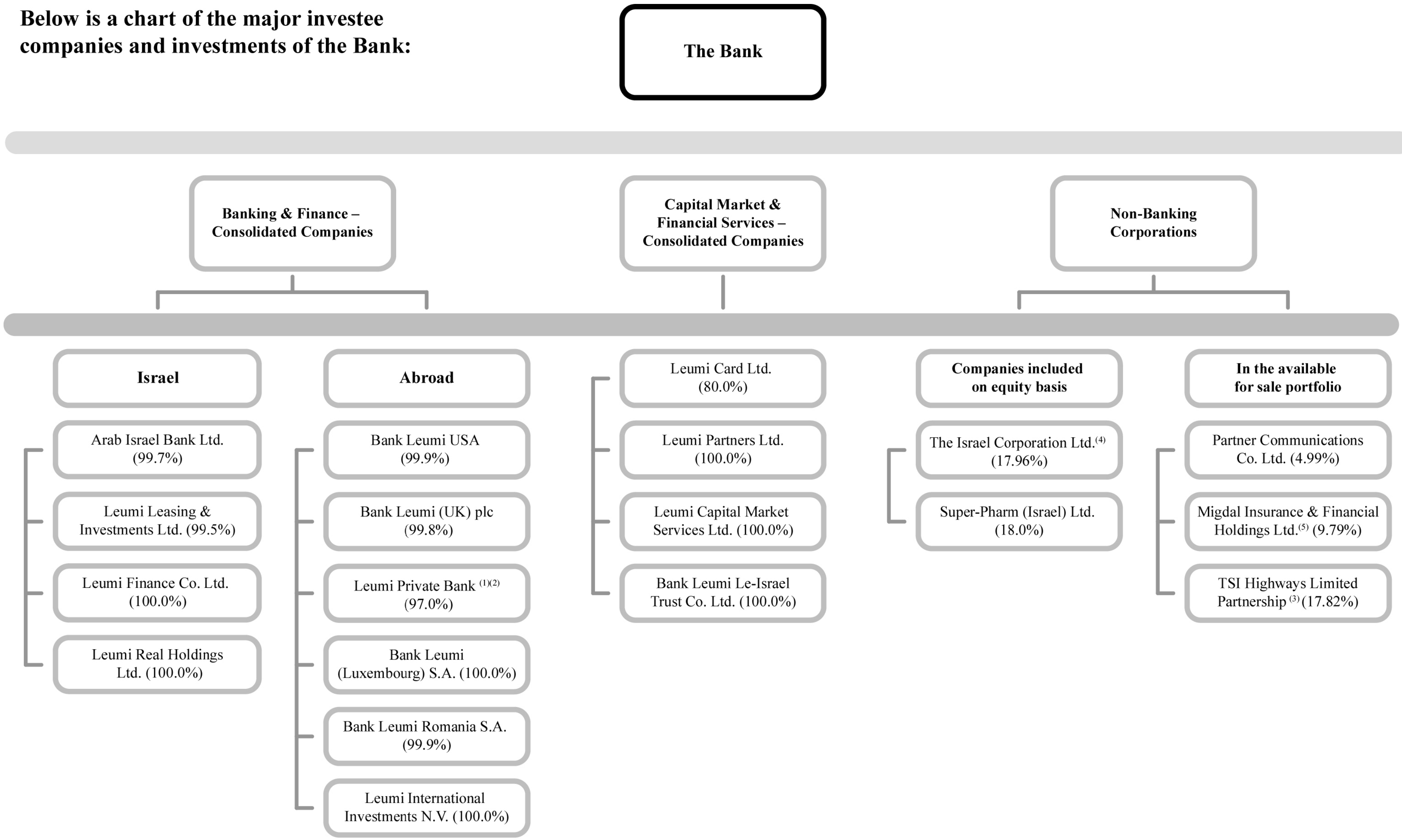
For a discussion of the financial results and additional details, see Chapter D below.

The following table presents the contribution of the profit centers in the Group to the net profit attributable to the shareholders of the banking corporation:

	2012		2011	
	Total investment	Contribution to net profit	Total investment	Contribution to net profit
	NIS billions	NIS millions	NIS billions	NIS millions
The Bank (1)	**13.5**	**330**	9.6	959
Subsidiary companies in Israel (2) (3)	**4.8**	**562**	7.1	432
Overseas subsidiary companies	**4.9**	**143**	4.8	395
Companies included on equity basis	**1.8**	**(104)**	1.8	105
Total	**25.0**	**931**	23.3	1,891

(1) Total investment includes the activity of Leumi Mortgage Bank which merged with Leumi on 31 December 2012.
(2) Contribution to net profit includes the profits of Leumi Mortgage Bank which merged with Leumi on 31 December 2012.
(3) Includes the profit and/or loss of companies included on equity basis of Leumi Partners.

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



(1) Until 3 January 2012, the name of the bank was Bank Leumi (Switzerland) Limited. On 3 January 2012, Banque Safdié was merged with Bank Leumi (Switzerland). The name of the merged bank was changed to Leumi Private Bank.
(2) 99.2% in voting rights.
(3) The partnership purchased 50% in Derech Eretz Highways (1997) Ltd.
(4) 18.13% in voting rights.
(5) On 8 January 2013, the percentage held was 4.71%.

Basel II General (Table 1 – Basel II)

a. Bank Leumi Le-Israel Ltd. ("Leumi") whose office is situated in Tel Aviv, Israel, is the parent company of the Leumi Group.

b. The table on the previous page presents a chart indicating the structure of the Group and its principal investee companies.

For further details in respect thereof, see the chapter below, "Description of the Group's Business according to Segment and Area of Operations" and Note 6 to the financial statements.

The consolidation of the consolidated companies and the recording of the equity value of the companies included on equity basis are in accordance with generally accepted accounting principles and in accordance with the regulations of the Bank of Israel. However, in calculating the regulatory capital, goodwill and intangible assets and investments in unconsolidated banking and financial subsidiaries (some NIS 451 million) are deducted from the accounting capital.

c. The main regulatory limits on the transfer of liquid funds between Group companies in Israel and abroad are:

1. The Bank of Israel does not limit the placement of deposits by the Bank in Group companies in Israel and abroad. However, it has placed restrictions on capital investments by the Bank in companies in Israel and abroad. Every material investment requires the prior approval of the Bank of Israel.

2. Directives of authorities in the United States restrict local banks in the extent of their exposure of any kind *vis-à-vis* related companies. The maximum rate of exposure to a related company is 10% of the Bank's capital in the United States, and *vis-à-vis* the group of which the Bank is a member in the United States, the maximum rate is 20% of its capital.

3. Directives of the authorities in the United Kingdom restrict local banks in the amount of their deposits in each company in a group and in all of them together to a maximum rate of 25% of the Bank's capital in the UK.

4. Directives of the authorities in Switzerland require the bank in Switzerland to deduct deposits in the group from the capital by amounts exceeding 25% of the Bank's capital in Switzerland.

Merger between the Bank and Leumi Mortgage Bank Ltd. ("Leumi Mortgage Bank")

On 9 September 2012, the Board of Directors of the Bank approved the merger of Leumi Mortgage Bank with the Bank. On 10 September 2012, the Board of Directors of Leumi Mortgage Bank approved the implementation of the said merger. The merger took place on 31 December 2012 ("the Merger Date"). See Immediate Reports dated 10 September 2012 (ref. no. 2012-01-234537 and 2012-01-234585).

According to the merger agreement, Leumi Mortgage Bank, which is wholly owned and controlled by the Bank, is to merge with the Bank.

As at 31 December 2012, the merger was completed and was registered with the Registrar of Companies, after all of the preconditions for its conclusion had been fulfilled.

The merger which was executed is a statutory merger, whereby Leumi Mortgage transferred its assets and liabilities to the Bank, and Leumi Mortgage was dissolved without liquidation, pursuant to the provisions of Chapter 1 of the Eighth Part of the Companies Law, 1999, and subject to the provisions of Chapter 2, Part E2 of the Income Tax Ordinance, such that on completion of the merger, Leumi Mortgage ceased to exist.

With effect from 15 January 2013, the banking license of Leumi Mortgage Bank was canceled.

Aims of the merger:

The merger serves both a business and an economic purpose, viz., to enable the Leumi Group to increase the level of group synergy between retail and mortgage operations, and to expand the potential for increasing the profit of the Leumi Group. The purpose of the move is to allow the Bank to provide retail customers with a value proposition appropriate to all of their needs, *inter alia*, in view of the improvement in the level of the product offered to customers, with an emphasis on providing a variety of services to the customer, while reducing Group expenses and utilizing the sales floor more effectively.

The merger includes a restructuring which was carried out in the following two stages:

- In the first phase, the Trust Company transferred its holdings (0.84%) in Leumi Mortgage to the Bank, without consideration and in accordance with Section 104C of the Income Tax Ordinance (New Version), 1961 ("the Ordinance").
- In the second stage, a statutory merger took place between the Bank and Leumi Mortgage, in which Leumi Mortgage Bank transferred its assets and liabilities to the Bank, in accordance with Section 103B of the Ordinance, by winding up Leumi Mortgage without its liquidation, in accordance with the provisions of Chapter I of Part VIII of the Companies Law, 1999, and subject to the provisions of the Chapter II of Part 2E of the Ordinance.

Pursuant to the merger, all the employees of Leumi Mortgage Bank became employees of the Bank together with Leumi Mortgage Bank's liabilities in respect of employees transferred in accordance with Section 103P of the Ordinance.

As part of the restructuring, no consideration was or will be given, directly or indirectly, in money or in kind, to any of the parties involved.

Some 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 54 below.

The ruling of the Israel Tax Authority on 10 September 2012 was as follows:

On 10 September 2012, a ruling was given by the Israel Tax Authority certifying that the details of the merger plan as submitted in the request filed with the Israel Tax Authority, and subject to the conditions specified in the Ordinance and tax ruling, meet the conditions set forth in Sections 103C and 104C of the Ordinance. The main points of the tax ruling are as follows:

1. Regarding the transfer of shares of Leumi Mortgage from the Trust Company to the Bank -

1.1 The transfer of the shares to the Bank will not be taxable at the time of restructuring, in accordance with the provisions of Section 104C of the Ordinance, and subject to the submission of forms and documents required under Section 104G of the Ordinance within 30 days of the date of the tax ruling and subject to compliance with all the conditions of Part II of the Ordinance, and the conditions set forth in the tax ruling. The forms required under Section 104G have been submitted as required.

1.2 The date of transfer of the shares was determined at 31 December 2012.

1.3 The transfer of shares shall be carried out without consideration. If it becomes apparent that any consideration was given, directly or indirectly, for the transfer of the shares, including by way of debit and credit between the companies, the tax ruling shall be rescinded retroactively.

1.4 For the first sale that is not under tax exemption of the shares belonging to the Trust Company that were in existence at the time of transfer of the shares, the original price of the shares belonging to the Trust Company will be zero, and the date of acquisition will be the date of transfer of the shares.

1.5 In respect of the transfer of shares, no loss shall be claimed by the Bank and/or any related party.

2. With regard to the merger –

2.1 The date of the merger was determined at 31 December 2012.

2.2 No new rights in the Bank will be allocated in respect of the merger to its shareholders and/or the nominee company of the Bank. Accordingly, on sale of shares of the Bank, there will be no addition to the original price of the said shares for the cost of investment in shares of Leumi Mortgage Bank (including for the holding of 0.84% by the Trust Company). The cost of investment will be canceled and not allowed for tax purposes in any way, directly or indirectly. Additionally, the assets transferred to the Bank as part of the merger will be subject to the provisions of Section 103E of the Ordinance, and no additional amount will be attributed to them above their original price.

2.3 No expense and/or loss will be allowed for tax purposes for the Bank and/or any related party due to the merger.

2.4 Any expense or deduction accrued by Leumi Mortgage Bank up to the date of the merger and not allowed for tax purposes by that date ("the expenses"), but would have been deductible if a loss had been created at the merger date, will be considered as part of the losses of Leumi Mortgage and/or the Bank, as applicable, up to the date of the merger, and shall be subject to the provisions of Section 103H of the Ordinance, if allowed as a deduction for tax purposes within two years from the date of the merger.

For this purpose, an "expense or deduction accrued" is to include any provisions and/or liabilities not allowed as a deduction for tax purposes, which if they had been deductible for tax purposes at the time of the merger, would have created a loss, except for impaired debts as stipulated in the Agreement of Principles for Impaired Debts dated 14 February 2012.

It has been clarified that this clause does not derogate from the provisions of Section 103H of the Ordinance. The abovementioned is only in respect of the allocation of losses and how they are offset, and in no way determine whether the expense, deduction or offset is allowed for tax purposes, issues that may be examined by the Assessing Officer.

2.5 If it becomes apparent that any of the conditions specified in Section 103C of the Ordinance did not take place on time, the Bank and Leumi Mortgage will be charged taxes and mandatory payments from which they were granted exemption, plus linkage differences and interest from the date of the merger until the date of payment, in accordance with the provisions of Section 103J of the Ordinance. In such a case, expert valuations of Leumi Mortgage Bank as at the date of the merger shall be submitted to the Assessing Officer immediately following the date of the violation, in accordance with the Income Tax Rules (Application for Prior Approval of a Merger Plan), 1995. Such valuations will require the approval and consent of the Assessing Officer.

2.6 The Bank undertakes to notify the Property Taxes Directorate of the provision of this tax ruling, including the transfer of real estate property owned by Leumi Mortgage Bank (at 31-37 Montefiore Street, Tel-Aviv) and pay purchase tax at the rate of 0.5%, within 40 days from the date of the merger.

2.7 The Bank and Leumi Mortgage undertake to transfer the valuation of land property rights owned by Leumi Mortgage Bank to the Property Taxes Directorate within 30 days of the date of the merger.

2.8 The Bank undertakes to transfer, within 30 days from the end of two years from the date of the restructuring, confirmation to the Property Taxes Directorate that it has complied with all the conditions of Part II of the Ordinance, and the terms of the tax ruling.

2.9 The tax ruling is contingent upon full compliance with the other conditions stipulated in the Ordinance and the tax ruling, including conditions that relate to the period required, as defined in section 103 of the Ordinance, beginning on the date of the merger.

3. Regarding the transfer of Leumi Mortgage employees to the Bank –

3.1 The transfer of employees was approved under the provisions of Section 103P of the Ordinance.

3.2 The transfer of ownership of all funds transferred in the name of the employees transferred from Leumi Mortgage to the Bank was approved under the exemption from withholding tax at source under Regulation 2(a)(6) of the Income Tax Rules (Tax Exemption for Transfer and Change of Designation of Funds in Provident Funds), 1990.

3.3 Continuity of rights to compensation will be conferred to the employees under section 103P of the Ordinance, and upon their retirement from the Bank, will be taken into account for the purpose of calculating the exemption of severance payments for the period of work at the Bank and at Leumi Mortgage Bank.

3.4 In the event an employee who retired prior to the date of the merger, or as a result of the merger, received an exempt severance payment from Leumi Mortgage Bank under the provisions of section 9(7A) of the Ordinance, and returned to work at the Bank within six months from the date of retirement, the retirement grant received by such employee shall be deemed to be wages, and in this case the Bank will deduct tax as required.

3.5 Any payment to employees of the merging companies resulting from the said merger, will be considered income from employment and tax will be deducted in accordance with Income Tax Regulations (Deduction from Salary and Wages and Payment of Employers' Tax), 1993.

4. General explanations –

4.1 The Bank and Leumi Mortgage Bank have undertaken to include in the financial statements and reconciliation reports for tax purposes, a note on the implementation of the restructuring, detailing the conditions of the tax ruling. The Note is to be shown commencing from the first reports published following the tax ruling.

4.2 The tax ruling is not deemed as a tax assessment and/or confirmation of the facts presented by the Bank. The said facts presented may be examined by the Assessing Officer.

4.3 It is clarified that the tax ruling was given based on the representations and documents given to the Israel Tax Authority in writing and orally, including those set forth in the tax ruling, and subject to the conditions set out in Part II of the Ordinance. The tax ruling will be canceled retroactively, if it is found that the information and facts given in the application are incorrect or incomplete in a material manner, or it appears that material details listed do not exist or that the conditions stipulated by the Israel Tax Authority in the tax ruling were not met.

4.4 No deduction will be allowed, either directly or indirectly, as a deduction or as an expense under Section 17 of the Ordinance, for the parties participating in the restructuring set forth in the tax ruling and/or to their related party, for all the expenses involved, directly and/or indirectly in the restructuring, including legal expenses, audit expenses, experts, consultants and fees of all kinds.

4.5 The Bank and Leumi Mortgage Bank undertook, jointly and severally, to confirm in writing to the Mergers and Splits Department in the Israel Tax Authority and to the Assessing Officer, within 30 days of receiving the tax ruling, that they agree to accept all terms of the tax ruling, *verbatim*, and without reservation. The said confirmations were submitted as required.

Business Strategy

Leumi's Vision

Leumi management has devised a multi-year business strategy, which is based on the revised vision:

- To be a stable banking group supplying the financial requirements of all of its customers, relying on values of fairness, transparency, professionalism and innovation.

- To be the most profitable banking group in Israel (in terms of risk-adjusted return) over the long term, operating to create value for its stakeholders.

- To be the first choice of its employees, by being a solid and stable work-place that cares for its human resources and encourages excellence.

- To be a banking group that maintains proper corporate governance, and is socially responsible, being involved in, and contributing to, to the welfare of the community in which it operates.

- To be an Israeli group with an international presence, adapting to its customers' needs.

Background Conditions

The competitive and business environment in which the Bank operates is complex and influenced by many varied exogenic factors. The financial markets around the world and in Israel, regulation in Israel and abroad, and changes and trends in areas such as technology and the customers' preferences affect Group activity and the strategy derived as a result thereof.

Macro-economic environment

The situation worldwide

The trends that accompanied the macro-economic environment in recent years, post-crisis trends typified by uncertainty, pessimistic growth forecasts in Western economies and changes in the global equilibrium gathered momentum in 2012.

The relatively high level of pessimism with regard to the global economy remained unchanged, with the effect of a combination of factors, including a continued worsening of the European debt crisis and weak performances of the large emerging states, particularly China, India and Brazil, compared to previously. Against this backdrop, the global growth forecast was reduced and the growth rate of the overall worldwide product in 2012 was 3%. This compares with 5% for the years 2004-2007, 5.1% in 2010, and 3.7% in 2011. The large difference in the rate of growth among the various countries of the world continued, with growth of a mere 1.3% in the OECD countries in 2012, compared with 5% in less developed, non-OECD countries. With a view to 2013, a significant acceleration in economic growth is not anticipated, with Europe remaining in or on the verge of recession, and the United States growing, but at a relatively lower than the potential rate.

The situation in Israel

According to the estimate of the Central Statistical Bureau, GDP rose in 2012 by 3.3% and the business sector product rose by 3.2%. The slowdown in the rate of expansion of GDP in Israel, compared with 2010-2011, reflects the adverse changes in global economic conditions, greater caution on the part of households and firms and the specific effects of restrictions on finance relevant to certain sections within the business sector in Israel. The moderation of the growth rate, together with the continuing high level of uncertainty and the increasing regulation constitute far-reaching challenges for the economic environment in which Leumi operates.

Increased regulation

The impact of regulation on the banking sector is intensifying and expanding in Israel and throughout the world. The financial crisis has further increased the power of the regulator and all the various aspects of supervision and has become 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. In 2011 the provisions of Basel III were published, further toughening the capital adequacy requirements and adding more requirements for maintenance of liquidity. Additional laws have been published affecting the international banking model. An example is the Foreign Account Tax Compliance Act (FATCA), which was enacted in the United States and requires banks around the world, including those in Israel, to report on the accounts and assets of American customers. In addition, a strengthening in the enforcement of legislation of various countries on cross-border activity and activity *vis-à-vis* foreign residents was felt.

Public pressure and the characteristics of a macro-economic environment also give entrepreneurs unprecedented scope on the part of the regulators in Israel. Major initiatives include the Zaken Committee for the Encouragement of Competition, which led to decisions whose implementation is of great significance to the banks' activity, the Concentration Law, which passed its first reading, and if enacted, is likely to result in future years in changes in ownership and control of financial and non-bank entities and in the banks' ability to invest in non-banks entities and the reform that the Israeli Securities Authority is promoting to reduce and restrict distribution fees.

In addition, to the restrictions on the income side, increased regulation creates material pressures for banks in terms of costs and 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 on their ability to expand activity through acquisitions and mergers or to enter into new areas of operation.

The consumer environment

The consumer today, even more than in the past, expects availability, clarity, personalization and multi-channel communication in interacting with the Bank. He has high consumer awareness and is linked to other consumers, particularly through social networks, and he is also aware of his purchasing experience, a fact which gives him know-how and a large amount of bargaining power.

The social protest which erupted in the summer of 2011 raised awareness for possibilities currently facing consumers, both among consumers themselves and among firms in the market, and it apparent that its results will continue to affect the business environment in 2013 as well.

Competitive environment

Domestic banks

In 2012, the trend of increase in the level of competition in all of the banking sectors of activity continued. The domestic banks continue to take steps to enroll new customers and increase the scope of activity, and focus efforts on identifying profit centers and future growth engines, to develop technological tools for improving the customer experience, to establish new multi-channel service models and improve their operating efficiency.

Competing non-banks

- Loans by institutional entities – Despite the fact that volumes of finance by the capital market has stagnated in recent years, at the same time, in the last few years, there has been a massive increase in loans of institutional entities to the business sector, mostly in favor of specific projects. These loans are characterized by large amounts, and are therefore, in most cases, designated for large corporations. Against the backdrop of the increase in volume of activity, the Ministry of Finance announced the setting up of a committee for regulating activity out of a desire to "protect savers' money". The committee will operate with the object of defining rules for activities involving the provision of loans starting through the stages of extending a loan, the day-today-day treatment and the repayment.

- Activity in the capital market and in brokerage – Traditionally, most of the competition in these areas of activity is on the part of investment houses and other managing entities (provident funds, training funds, insurance, etc.). The competition is focused on institutional customers, companies and business customers and private banking/affluent customers. In recent years, the banks have begun to re-establish their status in the area, particularly with institutional and business customers, in light of their ability to offer customers an overall value proposal, with this trend continuing to the following year.
  Among the investment houses, there was a marked trend of consolidation, with investment houses merging, and their number in the market continuing to fall. It is estimated that in view of the erosion in the rate of profitability of the investment houses from their traditional activity, they are likely to look for new channels of activity, and even compete directly and more significantly in areas that have traditionally been controlled by the banks.

- Technology-based players – In recent years, with the expansion in the use of advanced technology by consumers (particularly smart mobile phones), the supply and quality of ventures/developments offering high-tech based financial services are becoming greater and greater. These ventures do not represent overall competition to the traditional banks, but certainly they gnaw away at the banks' share in certain areas of activity – payments, money transfer, financial investments and securities trading, loans, savings and financial management services.

Leumi's strategy

In order to realize Leumi's vision, and in accordance with the changes in the business environment, in 2011, the Leumi Group set multi-year strategic goals to create value for all of its interested parties. Analysis of the trends and changes in the past year in the near and distant activity environment, mapping Leumi's abilities and understanding the central challenges in each central line of the Group's business have led to a reexamination and revision to nine targets, which were defined in 2011, as set forth 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 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 reasonable yields and require relatively little capital, while taking steps to improve profitability in areas where such level is lower. Additionally, Leumi is investing in building-up its abilities in order to ensure good results in the long-term.

Leumi's main strategic goals, as determined by the Board of Directors, are:

1. To position Leumi at the forefront of retail banking in Israel, centering on increasing the market share in growth segments and small businesses, basing itself on an effective and focused operating model, consulting and selling, and on advanced and innovative technological infrastructures.

2. To expand the scope and range of Leumi's activities *vis-à-vis* institutional customers through the implementation of a focused management model which adapts their customers' unique needs.

3. To make significant improvements in the flexibility of human resource management, adapting its size to the needs of the organization and improving the efficiency of the IT, procurement, construction and maintenance systems.

4. To nurture the human resource in the Group through optimal personnel management and the assimilation of the values of excellence and transparency over the long term, adapted to the changing environment.

5. To strengthen Leumi's leading status in the middle market area by upgrading the overall and distinct value proposition through the development of advanced technological tools and infrastructures.

6. To strengthen international activity, focusing on raising the profitability of the existing offices and adapting international private banking activity for changes in the market.

7. To continue the upgrade of management, measurement and pricing ability of Group risk, furthering the development of advanced methods and models and streamlining of the risk assets, to ensure the Bank's preparedness for challenges in the changing risk and regulatory environment, and stable profitability over the long term.

8. To exhaust the Group's synergy potential, while, at the same time, assimilating a company culture of cooperation, intensifying administrative focus and measurement, with the aim of ensuring much more flexibility in the ability to withstand changing situations.

9. To expand the dialogue between Leumi and its customers, to increase their satisfaction and develop the social awareness of the Bank and its employees.

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 III.

For details of risk factors in Group activity, see page 187.

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.

Savings and efficiency

A central pillar in Leumi Group's work program in future years is the streamlining plan which is intended to lead to material savings in the Group's operating expenses and an improvement in its efficiency ratio.

The plan includes steps in the area of human resources and in other material expenditure areas including:

- An anticipated reduction in the workforce based on natural retirement and a reduction in the intake of employees, which is a consequence of streamlining measures and structural measures, such as the "Advancing Together" project, in which back-office activities have been transferred from the branches to the centers of expertise.
  The streamlining measures and the reduction in the workforce will also make possible a corresponding reduction in the amount of space the Bank uses and the related expense through the sale of assets that become redundant and the evacuation of rented properties.

- In addition to a reduction in the area used by the Bank, steps will be taken to utilize areas effectively, including examining the location of the bank's sites for optimization of rents and municipal rates.

- Restraint in routine expenditure and investments in all expense bases, inflicting minimal damage to businesses.

- Improvement in procedures including improvement in procurement procedures, reduction of content and creation of a consistent process at Group level.

Realization of the streamlining program is likely to involve changes, *inter alia*, as a result of economic developments in Israel and around the world, changes in the business environment and changes in legislation and regulation.

Some 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 54 below.

Control of the Bank

Bank without a controlling core

On 19 March 2012, the Banking Law (Legislative Amendments), 2012 was published. The law amended the Banking Law (Licensing), the Banking Ordinance and Section 37 of the Securities Law (hereinafter "**the Amendment**"). The main purpose of the Amendment is the adaptation of the law to the supervisory framework required in the case of a banking corporation without a controlling core (a banking corporation in which all the holders of the means of control do not require a permit under the Banking Law) including the proposal, appointment and term of office of directors in a banking corporation without a controlling core.

On 23 March 2012, the term of office of the Bank Shares Committee, established by virtue of the Bank Shares in the Arrangement Law (Temporary Provision), 1993 (hereinafter "**the Bank Shares Law**"), ended. The said committee had been authorized to use, for and on behalf of the State, the voting rights accorded by the State's holdings in the Bank. In light of the Amendment, effective 24 March 2012, the Bank is defined, pursuant to the provisions of the law, as a bank without a controlling core and with no shareholder specified as the controlling shareholder in the Bank.

Since the Bank became a bank without a controlling core, the only people entitled to propose to a general meeting candidates for election as director are the following: a statutory committee set up within the framework of the Amendment for the proposal and appointment of directors in a banking corporation; and a shareholder holding more than 2.5% of the means of control in the bank (as defined in the Amendment – "substantial holder") or a "body of holders" of shareholders (as defined in the Amendment). A candidate for the office of director in a bank must comply with a number of conditions, restrictions and limitations stipulated in the law that guarantee that he is not involved with the bank and/or to shareholders holding more than 2.5% of the means of control in the bank. In addition, a shareholder who holds more than 1% of a certain class of the means of control in a bank is obliged to report his holdings to the bank and to the Supervisor of Banks, and the bank must report to the public on every shareholder who holds more than 2.5% of a certain class of the means of control in the bank. The obligation to report to the public will also apply with regard to a shareholder who holds between 1% and 2.5% of the means of control in the bank, if the said shareholder consents to publication to the public as aforesaid, and if he does not so consent, he will not be entitled to join a body of holders for the purpose of proposing candidates for the office of director to the general meeting. For reporting on the holdings in a bank, see report, as aforesaid, dated 5 April 2012 ref. no. 2012-01-095220, report dated 25 April 2012 ref. no. 2012-01-109203, report dated 6 June 2012 ref, no. 2012-01-149412 and report dated 13 December 2012 ref no. 2012-01-309828.

For further information regarding the election of directors, see the chapter "Annual General Meeting and Election of Directors" below.
For further details regarding the Amendment and the implications of the Bank being a bank without a controlling core, see the chapter "Economic Environment and Effect of External Factors on Activity, Banking Legislation" below.

The State of Israel's holdings in the shares of the Bank

On 31 October 1993, the State of Israel became a shareholder of the Bank, under the Bank Shares Arrangement and the Bank Shares Law. Pursuant to the provisions of the Bank Shares Arrangement Law, the transfer of the shares of the Bank to the State and the use of the rights by virtue thereof pursuant to this law, are not subject to a permit pursuant to the Banking Law (Licensing), 1981.

On 31 December 2012, the State of Israel held 6.028% of the issued share capital and 6.46% of the voting rights in the Bank.

In accordance with the provisions of the Bank Shares (Arrangement Shares) (Temporary Provision) (Use of Voting Rights Accorded by Virtue of the Share in Bank Leumi Le'Israel Ltd.), 2012, which was published in the Official Gazette (*Reshumot*) on 6 June 2012, with effect from the end of the term of office of the Shares Committee, as stated above, the voting rights accorded by virtue of the shares of the Bank held by M.I. Properties Ltd. will be used.

Pursuant to the provisions of an outline prospectus dated 6 April 2011 regarding the sale of 0.43% of the Bank's issued capital by the State to its employees, during the period when the shares sold to the Group's employees are blocked, and as long as the State's shareholding percentage in the Bank exceeds 5%, an irrevocable power of attorney may be granted to the State to vote by virtue of the shares sold to the Group's employees as aforesaid, and to use the right to appoint directors by virtue of the shares.

Interested party transactions

On 18 October 2012, the Bank was notified by interested parties in the Bank, Shlomo Eliahu Holdings Ltd. and Eliahu Insurance Company Ltd., which are controlled by Mr. Shlomo Eliahu, (collectively, "Eliahu"), that Eliahu Insurance Company Ltd. had sold off-market 16,326,531 ordinary shares of NIS 1 par value each of the Bank. Following this sale, Eliahu held some 8.49% of the Bank's share capital ("the direct holdings in the Bank").

The acquisition of control in Migdal Holdings Insurance and Finance Ltd. ("Migdal" and the "Migdal transaction" as applicable) by Eliahu:

On 29 October 2012, Eliahu provided notice to the Bank regarding the completion of the transaction to acquire control in Migdal, and accordingly on the effective date of the permit and the trust deed, as set forth below:

Further to the report received from Eliahu, published in an Immediate Report by the Bank on 29 August 2012 (ref. no. 2012-01-222393), Mr. Shlomo Eliahu, the controlling owner of Eliahu, entered into an agreement whereby, subject to receiving various regulatory approvals, he is to acquire (on his own and/or through corporations under his control) control of Migdal, which is an insurance corporation and which has, and/or companies under its control have, directly or indirect holdings in the Bank.

Further to a report received from Eliahu, the Bank published, in an immediate report on 21 October 2012 (ref. no. 2012-01-259875), details of the trust deed and irrevocable authorization whereby, on completion of the Migdal transaction, the direct holdings in the Bank will be put into trust or will be subject to trust ("the trust deed"). In addition, further to a report received from Eliahu, the Bank published, in an Immediate Report on 24 October 2012 (ref. no. 2012-01-262707) the permit received by Mr. Shlomo Eliahu and Ms. Chaya Eliahu from the Bank of Israel to hold means of control in the Bank of up to 13.49% of any type of means of control, including the direct holdings in the Bank and the holdings of Migdal in the Bank ("the Permit").

In accordance with paragraph 5 of the permit, during the two trust periods as detailed below, the direct holdings in the Bank do not confer a right to participate in General Meetings of the Bank and a right to vote therein, and do not confer a right to propose candidates to serve as directors of the Bank, and other rights granted to holders by virtue of their holdings of the relevant means of control, apart from the right to dividends to be distributed, to the extent they are distributed, by the Bank, and the right to consideration for the sale of the direct holdings in the Bank. In light of the above, the votes of other shareholders at the general meetings of the Bank will be affected, such that they will actually be relatively higher.

It is further provided in the permit and in the trust deed that, during the course of the first trust period – up until the end of a three-year period from the date of completing the Migdal transaction, the direct holdings in the Bank will be sold on the stock exchange or to one or more unrelated third parties, subject to the receipt of a permit from the Governor of the Bank of Israel, if required. As long as all of the direct holdings in the Bank have not been sold by that date, they will be sold in this way by the trustee by the end of the second trust period – one year after the end of the first trust period.

On 29 October 2012, on completion of the Migdal transaction, the transaction between the Bank and Eliahu to extend credit of NIS 2 billion to Eliahu for financing part of the transaction for purchasing controlling shares in Migdal was also completed.

For more information, see the Bank's Immediate Reports dated 29 October 2012 (ref. nos. 2012-01-266478 and 2012-01-266487).

For updated information regarding the holdings of Eliahu and Migdal in the Bank, see the Bank's Immediate Report on the holdings of interested parties and senior officers, dated 7 March 2013 (ref. no 2013-01-057156).

Annual General Meeting and Election of Directors

Pursuant to the Bank's Regulations, at the Annual General Meeting of the Bank, four directors, Mr. Reuven Adler (external director), Ms. Zipora Gal-Yam, Professor Arieh Gans and Professor Efraim Sadka retired by rotation.

On 1 August 2012, the Annual General Meeting of the Bank was held at which the incumbent directors, Professor Arieh Gans, Professor Efraim Sadka, Mr. Rami Avraham Guzman and Professor Yedidya Stern were elected or re-elected, all as external directors pursuant to Regulation 301 of the Supervisor of Banks for a period of three years.

In addition, at the abovementioned Annual General Meeting, Adv. Haim Samet, was elected as external director pursuant to Section 239 of the Companies Law, 1999, for a period of three years.

The abovementioned, Messrs. Gans, Sadka, and Samet were proposed for election at the Annual General Meeting by the committee appointed pursuant to Section 4 of the Banking Law (Legislative Amendments), 2012, in accordance with the provisions of sections 11D(a)(1) and (2) of the Banking Ordinance, 1941 ("the Banking Ordinance"). Professor Yedidya Stern was proposed for election at the General Meeting by Otzar Hityashvut Hayehudim Ltd., a shareholder in the Bank that is entitled to propose a candidate for the office of director in the Bank, pursuant to the provisions of Section 11D(a)(3) of the Banking Ordinance.

The Supervisor of Banks confirmed the absence of any objection on his part to the service of the directors elected at the said General Meeting.

At the said General Meeting, resolutions were passed on a number of other topics, *inter alia*:

- It was resolved to approve an increase in the Bank's authorized capital to a total of NIS 3,215,000,000 by the creation of 1 billion ordinary shares of NIS 1 par value each, to be converted into stock after being issued and paid in full, and the amendment of a resolution passed at the General Meeting on 7 October 2008, such that the 500,000,000 ordinary shares of NIS 1 par value each created in the same resolution of 7 October 2008 will be used only for the purpose of issuing compound deferred capital notes.
- It was resolved to amend Regulation 143 of the Bank's regulations regarding insurance, indemnification and exemption with the aim of enabling the Bank to indemnify and/or insure officers of the Bank pursuant to and subject to provisions of the Antitrust Law, 1988, as amended by the Antitrust Law (Amendment no. 13).
- It was resolved to approve an amendment to the version of the letter of indemnification granted by the Bank to the directors, pursuant to which the obligation for advance indemnification will also be in respect of expenses according to and subject to the stipulations laid down in the Antitrust Law, 1988.
- It was resolved to approve and authorize the Bank to purchase an insurance policy in respect of the "run-off" liability of directors and other officers in the Bank and in the Group without requiring additional approval of the general meeting (rather reporting at the next general meeting following the purchase of the policy, if one is so purchased), all subject to the terms set out in the resolution.
- It was resolved to approve raising the salary of the Chairman of the Board of Directors, Mr. David Brodet, by 3.7%, with effect from 1 January 2012.

For information regarding all of the resolutions passed at the General Meeting, see the Bank's Immediate Report on the results of the General Meeting of 2 August 2012 (ref. no. 2012-01-200217).

Description of Operating Segments

The Bank in Israel is organized into five lines of business. 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. The aim of the retail banking is to provide a multi-channel, integrative customer experience in the branch channel and in the direct channels (Leumi CALL, the Internet, cellular, electronic terminals, information booths and ATM's), supported on a modern, operational service model, adapted to customer requirements. The main strategic goals of retail banking are expanding the customer base in activity segments with potential, and increasing levels of activity with customers through constant improvement of the level of service and the adaptation of value proposals to the needs of the customer in accordance with his way of life.

Commercial banking deals with middle-market business customers and their interested 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 project support and financing of the segment of large business customers and the multi-national corporations, including entrepreneurial and contract companies involved in large projects in the area of real estate and infrastructure. Among those managed in the corporate division and complex finance and real estate division are customers whose business activity is complex, whose business is international and/or whose activity is managed in several of the Bank's overseas subsidiaries. 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 required 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 wealthy private clients in the Group in Israel and abroad. 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 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. The Bank's foreign subsidiaries and representative offices operate by virtue of permits of the Banking Supervision Department in the Bank of Israel, and are also subject to local regulation in their own country.

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 in Israel 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, at every stage of life.
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 interested 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 foreign financial institutions, including the operating results of investments in (non-banking) companies included on equity basis and investment in shares in the available-for-sale portfolio.
7. Others	-	activities not assigned to other segments. This includes other activities of the Group, none of which constitutes a profit segment according to the directives of the Supervisor of Banks

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, capital market and real estate.

For further details, see page 120 below and Note 27 to the Financial Statements.

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

Business Customers:

Division/segment	Scope of obligo	Business turnover of borrower
Corporate	above NIS 120 million*	above NIS 400 million
Commercial	above NIS 10 million and up to NIS 120 million (inclusive)*	above NIS 20 million and up to NIS 400 million
Small businesses	up to NIS 10 million (inclusive)	up to NIS 20 million

(*) The corporate division will also deal with customers with an obligo of more than NIS 80 million, where they have an overall obligo in the banking system exceeding NIS 250 million.

Private Customers:

Division/segment	Israeli residents	Overseas residents
	Financial wealth	
Private Banking	above NIS 6 million	above US$ 0.5 million
Households	up to NIS 6 million	up to US$ 0.5 million
Commercial	up to NIS 6 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 – e.g. 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. As long as segmentation has not been carried out among the segments, the segmental classification does not change, and the financial results in respect of the customer are recorded in the segment in which the customer's account actually operates.

b. Banking Subsidiaries have been attributed to the operating segments as follows:

- The Arab Israel Bank Ltd. – to households, to small businesses, to commercial banking and to financial management.
- Leumi USA – to commercial banking, to private banking and to financial management.
- Leumi Switzerland and Luxembourg – to private banking.
- Leumi UK – to households, to commercial banking, to corporate banking and to private banking.
- Leumi Romania – to households, to small businesses, to commercial banking and to 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

Objectives of the system:

- 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 way in which income and expenses are attributed by activity segment in the Bank is obtained as follows:

The basis of the Bank's existing system ("the Bahan 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 constituting a "non-autonomous unit".

Net interest income **-** The profit center is credited with the interest received from the loans that it extended 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, 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 in respect of the Tier 1 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 2 capital. In this way, the available capital attributed to the segment 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 interest income from the management of the *nostro* is reflected in the financial management and capital markets segment.

Expenses in respect of credit losses are charged to the profit center in which the customer's account is managed. The same applies to the collective allowance required pursuant to the directives of the Bank of Israel.

Noninterest income

All of the noninterest income (noninterest financing income commissions and other income), which 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

Expenses are attributed to the lines of business (division of the Bank) according to the segmental association of the customers dealt with in those lines of business.

In a minority of cases in which a line of business operates in several operational segments, expenses of lines of business are attributed to relevant segments and products on the basis of the multi-dimensional pricing of transactions.

Pricing is a system in which the cost of the transaction is calculated taking into account the type of transaction, the type of customer making it and the channel in which the transaction is executed.

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

For further details regarding operating segments, see page 120 below and Note 27 to the Financial Statements.

Measuring the return on capital

Pursuant to the intensification of measurement of the performance of units and its adjustment to the unique risk characteristics for each unit, the rate of return on risk-adjusted capital (RORAC) of operational segments and their contribution to the Group's profit (economic value added -EVA) is measured, taking into account the cost of capital according to the multi-year return approved by the Board of Directors. The allocation of capital to risk components among the segments was done in accordance with the various risk characteristics inherent in each segment, in accordance with Basel II.

The allocation of First Pillar capital (in respect of credit, market and operational risks) is according to Basel II approach. Credit risks on the basis of weighted risk assets in the units, market risks and operating risks are calculated according to the standardized measurement method (from 31 December 2011).

Second Pillar Capital is allocated to the units divided into its various components according to models designed by the Bank.

The profit of the operational segments is adjusted for the risk capital in each segment. The risk-adjusted return was calculated as a ratio of the adjusted profit to the average shareholders' equity allocated to the sector, which constitutes a part of the risk capital allocated (First Pillar capital, Second Pillar capital and the balance of the capital in respect of extreme scenarios and retained earnings).

For each segment, the profit is calculated, taking into account the cost of Tier 1 and Tier 2 risk capital allocated to each segment. At the Group level, the value added for the shares (EVA) is the net profit, calculated as aforesaid, less the cost of the shareholders' equity, according to the required long-term return over the shareholders' equity, as determined by the Board of Directors.

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 Leumi's strategic program.

Among other things, the following are measured within the BSC framework: finance and risk management (targets such as return-adjusted return, savings and efficiency and capital management), customer satisfaction, processes, capabilities and infrastructure.

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 of the business lines and the other divisions in the Bank.

In the context of the focus on the subject of savings and efficiency which was implemented in 2012-2013, the measurement of relevant targets, for this subject in the BSC, was enhanced.

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 Capital Adequacy

Capital attributable to the Shareholders of the Banking Corporation as at 31 December 2012 amounted to NIS 24,921 million, compared with NIS 23,374 million at the end of 2011, an increase of 6.6%. The increase in shareholders' equity mainly derives from the profit for the year and an increase in the value of available-for-sale securities portfolio which was carried to a capital reserve.

The securities portfolio (nostro) mainly holds debentures of governments, banks and foreign financial institutions, 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 recorded in a separate item in shareholders' equity, following the deduction of the effect of related taxes.

The total net accrued balance of adjustments in respect of securities held in the available-for-sale portfolio at fair value as of 31 December 2012 amounted to a negative sum of NIS 495 million (after the effect of tax), compared with a negative sum of NIS 218 million (after tax) as at 31 December 2011.

In 2012, an increase in the value of the securities available-for-sale portfolio of NIS 713 million, net, was recorded in shareholders' equity, compared with a decrease in value amounting to NIS 686 million in 2011 (all of the amounts are net after the effect of related taxes).

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

	31 December 2012	31 December 2011
	NIS million	
Tier 1 capital:		
Share capital	**7,059**	7,059
Premium	**1,129**	1,129
Retained earnings	**16,296**	15,406
Other capital reserves	**58**	50
Adjustments from translation of financial statements of investee companies	**(85)**	(21)
Capital reserve in respect of share-based payments and loans to employees for the purchase of shares of the Bank	**(31)**	(31)
Non-controlling interests in capital	**307**	254
Amounts deducted from Tier 1, including goodwill, investments and other intangible assets	**(421)**	(403)
Unrealized net losses from adjustments to fair value of available-for-sale securities	**-**	(218)
Total Tier 1 capital	**24,312**	23,225
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	**333**	-
General provision for doubtful debts	**428**	428
Innovative and non-innovative compound capital instruments	**6,071**	6,012
Subordinated notes	**11,227**	11,646
Amounts deducted from Tier 2 capital	**(81)**	(66)
Total Tier 2 capital	**17,978**	18,020
Total capital base for purposes of capital adequacy	**42,290**	41,245

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

In accordance with Basel II directives, the components of capital in the Bank for the purposes of calculating capital adequacy are divided into two tiers, Tier 1 capital and Tier 2 capital. 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 share capital, accumulated reserves, premium, capital reserve in respect of share-based payment transactions and others, other funds in respect of companies included on equity basis, 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 rights not conferring control of capital (minority interests) and less goodwill, intangible and other assets and unrealized net losses (after tax) in respect of adjustments to fair value of available-for-sale securities. Tier 1 capital can include compound capital instruments. There are no compound capital instruments in this Tier in the Leumi Group.

Tier 1 capital without compound capital instruments – hereinafter: "core 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, compound capital instruments (Upper Tier 2 capital) up to 100% of Tier 1 capital and subordinated notes up to the level of 50% of total Tier 1 capital (Lower Tier 2 capital). Total Tier 2 capital (upper and lower) is limited to 100% of Tier 1 capital.

Capital instruments included in Upper Tier 2

- Non-innovative compound 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. The capital instruments will be issued by Leumi or by means of issues by Leumi Finance.

- Innovative compound capital instruments: capital notes which meet the definition of non-innovative compound 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 which were issued for a term of at least 5 years. Leumi raised subordinated notes directly, or by means of issues by Leumi Finance. 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 2012 reached 6.6% in comparison with 6.4% at 31 December 2011.

Capital adequacy structure

Equity to risk components ratio on 31 December 2012 was as follows:

According to Basel II - Pillar 1, the ratio of total equity to risk assets is 14.87% (compared to 14.34% at the end of 2011); the ratio of core capital to risk assets is 8.55%, compared to 8.07% at the end of 2011.

In addition to capital required for Pillar 1, there is a requirement under Pillar 2 of Basel II to keep "capital buffers" in respect of additional risks not taken into account in the framework of Pillar 1. "Capital buffers" provide a response to risks such as: large borrower concentrations, group borrowers, sectoral concentrations, country risk and various market risks. In addition, it is required that the overall capital adequacy ratio be higher than 9% on the materialization of a stress scenario.

The overall capital ratio of Leumi is higher than the minimal rate of 9%, as determined by the Supervisor of Banks. In addition, the core capital ratio is higher than the minimum rate of 7.5% which was prescribed in the interim period by the Supervisor of Banks.

The capital adequacy ratios of Leumi in future years will be adjusted to long-term targets in accordance with the "Basel III framework – minimum core capital ratios" directive published by the Supervisor of Banks on 28 March 2012 and the draft amendment to the Proper Conduct of Banking Business directive no. 202 "Measurement and Capital Adequacy – Regulatory Capital", published on 30 December 2012. For details see page 33 below.

Capital adequacy - (Table 3 Basel II):

	31 December 2012		31 December 2011	
Risk assets and capital requirements in respect of credit risk deriving from exposures of:	Risk assets	Capital requirements (3)	Risk assets	Capital requirements (3)
	NIS million		NIS million	
Sovereign debts	**937**	**84**	855	77
Debts of public sector entities	**1,981**	**178**	1,859	167
Debts of banking corporations	**4,690**	**422**	5,130	462
Debts of corporations	**146,452**	**13,181**	158,015	14,221
Debts collateralized by commercial real estate	**18,541**	**1,669**	19,002	1,710
Retail exposures to individuals	**23,728**	**2,136**	21,893	1,970
Loans to small business	**9,611**	**865**	9,716	874
Housing loans	**33,474**	**3,013**	29,831	2,685
Securitization	**864**	**78**	271	24
Other assets	**13,560**	**1,220**	12,029	1,083
Total in respect of credit risk (1)	**253,838**	**22,846**	258,601	23,273
Risk assets and capital requirements in respect of market risk (1)	**9,710**	**874**	9,011	811
Risk assets and capital requirements in respect of operational risk (2)	**20,841**	**1,876**	20,095	1,809
Total risk assets and capital requirements (4)	**284,389**	**25,596**	287,707	25,893
Total capital base for capital adequacy	**42,290**		41,245	
Total capital ratio	**14.87%**		14.34%	
Tier 1 capital ratio	**8.55%**		8.07%	

(1) Weighted risk assets according to the standardized approach in respect of the First Pillar only.
(2) Pursuant to the standardized approach.
(3) Calculated according to the 9% minimum requirement.
(4) Additional capital buffers have been calculated in respect of the Second Pillar

Below is the capital adequacy ratio on consolidated basis and for principal subsidiaries according to Basel II:

	31 December 2012	31 December 2011
Leumi – on consolidated basis	**14.87**	14.34
Leumi Mortgage Bank	**11.85**	12.88
Arab Israel Bank	**14.76**	15.60
Leumi Card	**16.00**	14.80
Bank Leumi U.S.A. (1)	**14.47**	13.23
Bank Leumi UK	**15.53**	13.87
Bank Leumi Switzerland	**24.24**	31.82

(1) The company is not required to be reported under Basel II principles, and the figures are according to United States regulations.
For further details in connection with the capital components, risk assets and the capital ratio of significant banking subsidiaries, see Note 13(C) to the financial statements.

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

Pursuant to the directive of the Supervisor of Banks, until the adoption of the Basel III directives, 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, each bank will determine internally the total "risk capital" required in respect of this pillar and for the purposes of withstanding stress scenarios. The Bank has acted accordingly and forwarded the data to the Bank of Israel in 2012. The revised data for 2013 are currently being prepared and the report will be submitted to the Bank of Israel as required in April 2013.

For purposes of calculating the risk bearing ability, an analysis is made of the coverage of risks.

First Pillar – calculated at 8% of the total risk assets.

Second Pillar -"capital buffers" are calculated in respect of risks that are not included in the context of the First Pillar, such as: large borrower concentrations, group borrowers, sectoral concentrations, country risk, and various market risks, as well as capital buffers in respect of risks including in the First Pillar but in respect of which expansion is required.

The results of the calculations according to the aforesaid indicate a higher capital adequacy than that required by the Supervisor of Banks.

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 the First Pillar are calculated according to the standardized 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 Adequacy Target

Group policy, approved by the Board of Directors, which expresses its risk appetite, is to hold a level of capital adequacy higher than the threshold determined from time to time by the Bank of Israel, and higher than the rate required according to the results of the ICAAP. In addition, targets that the Group wishes to meet in the event of a stress scenario are defined.

Following an analysis of the ICAAP risk map, the Board of Directors of the Bank decided to change the Leumi Group's overall capital adequacy target to be not less than 13.5% over the long term. This compares with the previous target of 14.0%-14.5%, which was in effect until 31 March 2012. This target is higher than the overall capital adequacy ratio required in order to comply with the regulatory directives, including the ICAAP, and is identical to the overall regulatory capital adequacy ratio which will apply to Leumi from 1 January 2017, in accordance with the draft from 30 December 2012, as set forth below.

In addition, to the aforesaid, pursuant to a circular of the Supervisor of Banks dated 30 June 2010, the banks are subject to a core capital ratio of not less than 7.5%.

On 28 March 2012, the Supervisor of Banks sent a directive to all banking corporations outlining his intention to set a higher minimum core capital ratio than that currently required. According to this directive, all banking corporations will be required to comply with a minimum core capital ratio of 9%, until 1 January 2015.

In addition, a large banking corporation, whose total balance sheet assets on a consolidated basis constitutes at least 20% of the balance sheet assets in the banking system in Israel, will be required to comply with a minimum core capital ratio of 10%, until 1 January 2017. This supplementary provision applies to Leumi.

On 30 December 2012, the Supervisor of Banks sent drafts for adoption of the Basel III recommendations in Israel, including a draft to the amendment of Proper Conduct of Banking Conduct directive no. 202 "Measurement and Capital Adequacy – Regulatory Capital".

Pursuant to this draft, all banking corporations in Israel will be required to comply with an overall capital ratio of 12.5%, until 1 January 2015.

In addition, a large banking corporation will be required to comply with an overall capital ratio of 13.5% by 1 January 2017.

The draft also includes reference to Tier 1 shareholders' equity targets, pursuant to a directive of March 2012.

The Bank is studying the expected requirements of the Supervisor of Banks as included in these drafts and it intends to make the requisite preparations in order to comply with the requirements that are prescribed.

For further information regarding Basel III, see below, Chapter "Exposure to Risks and Methods of Risk Management", "Basel Directives and Preparations in Leumi".

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 54.

Issue of Subordinated Notes

On 15 May 2011, in accordance with a permit received from the Israel Securities Authority, Leumi Finance published a shelf prospectus allowing it to issue up to 9 series of Debentures (Series 179 to 187) and up to 11 series of subordinated notes (series N to X), each of them at a nominal value of up to NIS 4 billion. In addition, the shelf prospectus allows the issue of NIS 2,950,000,000 par value of subordinated notes (Series M) and NIS 3,350,000,000 nominal value of subordinated notes (Series L) as part of an expansion of marketable series, initially issued through a shelf offer report dated 14 September 2010. The shelf prospectus dated 15 May 2011 is for two years from the date of its publication.

Pursuant to a shelf offer report dated 25 January 2012, Leumi Finance issued a total of NIS 2.3 billion Subordinated Notes in an expansion of Series M and an expansion of Series N, as follows:

Expansion of Series M subordinated notes in the amount of NIS 1,280,000,000 nominal value (aggregate proceeds of NIS 1,324,800,000). The Series M subordinated notes are due for repayment in one installment on 10 September 2017.

Expansion of Series N subordinated notes in the amount of NIS 1,010,000,000 nominal value (aggregate proceeds of NIS 1,021,110,000).

The Series N subordinated notes are due for repayment in one installment on 10 November 2020. The subordinated notes have been approved by the Bank of Israel as Lower Tier 2 capital.

Distribution of Dividends

a. Dividend for 2010

In accordance with the recommendations of the Board of Directors of the Bank, and with the approval of the General Meeting, the Bank distributed a cash dividend for 2010 amounting to NIS 1.4 billion. The dividend was paid in the following amounts and on the following dates: NIS 500 million in November 2010, NIS 500 million in January 2011 and NIS 400 million in June 2011.

b. The following table presents details of cash dividends declared and/or paid in the Group*:

**	**2012**	2011	2010
1. Bank Leumi le-Israel B.M. - in NIS millions**	**-**	-	1,400.0
2. The Arab Israel Bank Ltd. - in NIS millions***	**-**	-	60.0
3. Leumi Card – in NIS millions	**-**	40.0	10.0
4. Various companies - in NIS millions	**7.7**	119.2	59.6
5. Leumi Switzerland – in CHF millions	**-**	70.0	-
6. Leumi Re – in US$ millions	**-**	5.0	5.2
7. Bank Leumi Luxinvest – in US$ millions	**-**	-	18.6
8. Israel Corporation Ltd. – in NIS millions	**80.8**	43.3	-

* 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 for the fiscal year.

*** In January 2013, the Arab Israel Bank declared a dividend distribution in respect of 2012 amounting to NIS 80 million.

C. Other information

Principal Developments in the Economy[*]

General

In 2012, the Israeli economy grew at real rate of 3.1%, compared with a growth rate of 4.6% in 2011. The weakness of economic activity around the world which led to a particularly slow expansion in export of some 0.1% and expectations of households and businesses of the continuation of the slowdown, which led to an expansion of 2.7% in private consumption and 3.6% in fixed asset investment, led to moderate growth, In the fourth quarter of the year, the growth rate amounted to 2.4% in annual terms, compared with the third quarter. The slowdown in economic activity resulted in low tax collection amounting to NIS 18.5 billion, compared to the planned amount, and, as a consequence, together with an increase in public expenditure, the State budget deficit increased, reaching some 4.2% of GDP, compared with the original target deficit of 2% of GDP which appears in the Budget Book. Against the backdrop of the development of the deficit during the past year, the Government decided on a number of measures to reduce the deficit, including, inter alia, raising direct and indirect taxes.

The Consumer Price Index rose by 1.6% in 2012, a rate which is lower that the price stability target centre of 1%-3%. During the past year, the Bank of Israel lowered interest three times, by 0.25 points each time. The lowering of interest rates was explained as a negative turning-point in the global economy and by a desire to support growth within Israel. The interest rate, which at December 2012, stood at 2.0%, was reduced to 1.75%, by the decision for January 2013, and retained at this level by the February and March decisions.

The shares and convertible securities index rose during 2012 by some 4.5%, with the prices of debentures increasing at an even higher rate. In particular, government index-linked debentures were prominent, their prices increasing by some 9.4%, while the corporate index-linked debentures increased by some 10.3%.

Committee for Increasing Competition in the Economy

On 16 July 2012, the Knesset approved in First Reading the proposed Government Law for Promoting Competition and Reducing Concentrations, 2012. The first two parts of the Law, which deal with the allocation of assets of the public and pyramidal shareholding structures, are mostly new legislation, while the third part, which deals with joint holdings in non-bank and financial assets, makes indirect amendments to existing regulations.

The Global Economy

In January 2013, the International Monetary Fund revised its estimate of the development of worldwide economic activity for 2012 and its forecast for 2013. In the background, there are improved data for the third quarter of the past year, particularly in the emerging countries and in the United States, although it appears that the improvement arose from temporary factors. With regard to the Eurozone, short-term forecast was revised downwards due to the high uncertainty with regard to the solution of the crises in the states of the region. According to the Fund’s revised forecasts, growth in the United States and the Eurozone in 2012 amounted to 2.3% and (0.4%), respectively, while in 2013, growth in those areas is expected to be 2.0% and (0.2%), respectively.

Business Product and Economic Sectors

The business sector product expanded during 2012 by a real rate of 3.1%, following a growth rate of some 5.1% in 2011. The slowdown in economic activity in the global and domestic market led to a slow rate of expansion of GDP in most sectors of the economy. In the fourth quarter of 2012, GDP increased by an annual rate of 2.8%, compared to the third quarter. This result reflects the stability in the business sector's growth rate lower than that it was in the past, following the "downgrading" which occurred in 2011.

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

The State Budget and its Financing

During 2012, the Government had a budget deficit, excluding the net provision of credit, amounting to some NIS 39 billion (about 4.2% of GDP). This is in comparison to the planned deficit which was fixed at of NIS 18.3 billion (about 2.0% of GDP). The variance of the actual from the planned deficit is, as stated above, a consequence of lower than forecast income amounting to NIS 18.5 billion, which results from the slowdown in economic activity in the market. Government expenditure increased beyond the planned level by NIS 2.2 billion, as a result of the utilization of last year's surpluses.

On 30 July 2012, the Government decided on a number of measures to reduce the deficit and contend with the implications of the crisis in the world economy on the Israeli economy and a change in the order of priorities in the budget. The measures to reduce the deficit for the current year and for 2013, which were enacted at the beginning of August 2012, included, inter alia, the following tax increases (the source of these data was a press release by the Knesset Finance Committee), partly during 2012 and partly in 2013:

- An increase in the rate of VAT from 16% to 17%, with effect from 1 September 2012.
- The collection of taxes on trapped profits.
- The intensification of tax-collecting measures and the war on "black money".
- An increase in income tax in respect of income in excess of NIS 14,001 per month by 1%.
- An increase in purchase tax on cigarettes and beer.
- An increase in employer's provision for national insurance in three stages: 0.6% in 2013, 0.5% in 2014 and 0.5% in 2015.
- Capital appreciation tax – 2% on income in excess of NIS 800 thousand per annum.
- A revision of the "green taxation" formula.
- Extension of a temporary provision regarding acquisition tax.
- The three highest tax brackets will not be updated at the rate of the annual increase of the index.

Foreign Trade and Capital Movements

Israel’s aggregate trade deficit in the first nine months of 2012 amounted to some US$ 18.3 billion, an increase of some 25% compared with the deficit for 2011. The increase in the trade deficit is mostly due to a reduction in exports, against the background of a slowdown in economic activity around the world representing the source of demand for Israeli exports with imports also contracting, albeit minimally. In the fourth quarter of the year, there was an improvement in the trade deficit compared with the third quarter, due to a larger reduction in imports in relation to exports.

Foreign currency capital inflows of foreign residents were characterized in the 2012 by the realization of financial investments in Israel by foreign residents in the amount of some US$ 2.5 billion, mostly from the effect of the significant realization of government debentures and T-bills. On the other hand, the direct investments in Israel, via the banking system, amounted to some US$ 5.5 billion during the said period. In comparison, the volume of investments of Israeli residents abroad (direct investments through banks in Israel and financial investments) amounted to some US$ 5.8 billion, mostly financial investments. During 2012, the level of outflows was higher than inflows.

Exchange Rates and Foreign Currency Reserves

In 2012, there was an appreciation of some 2.3% in the rate of the shekel against the dollar, while the shekel appreciated slightly by some 0.4% against the euro. The cumulative appreciation in this period is due to the strengthening of the shekel against the dollar by some 4.6% in the fourth quarter of the year.

Foreign currency balances in the Bank of Israel at the end of December 2012 amounted to some US$ 75.9 billion. This compared with US$ 74.9 billion at the end of December 2011. During this period, the Bank of Israel refrained from purchasing foreign currency.

Inflation and Monetary Policy

During 2012, the Israeli consumer price index increased by some 1.6%, a rate which is under the Government's price stability target of between 1% and 3%. The largest contribution to the increase in the index in the past year was in the housing sector, which increased by some 3.3%, accounting for almost a half of the increase. On the other hand, two sub-items which contributed largely to the fall in the index were mobile telephone services (against a background of the reform in the sector) and education services (one of the effects of the Trajtenberg Committee), each of which contributed some 0.3% to the fall in the index.

Bank of Israel interest rates fell during 2012 by an aggregate of 0.75 percentage points. The rate, which in December 2011 stood at 2.75%, fell in each of the quarters: first, third and fourth by 0.25 percentage points and in December 2012, amounted to 2.0%. The Bank of Israel explained this to be a negative turnaround in the global economy and in the desire to support growth in Israel with the low inflationary environment, particularly at the year-end, being a factor that also supported the decisions. This trend, of lowering interest rates, continued into 2013, and in the interest rate decision for January 2013, the interest rate was lowered to 1.75%, against the background of the need to lend additional support to economic activity and the absence of inflationary pressures.

Capital Market

The shares and convertible securities index rose by some 4.5% in 2012, following a fall of some 22.1% in 2011. The TA-100 index rose by some 7.2% during the year. The main reasons for this relate to the low interest rates which reflected the continuation of expanding monetary policy in Israel and abroad and continuing growth in Israel, despite the slowdown at rates which were higher than in most advanced states.

Average daily trading volumes of shares and convertible securities fell in 2012 by some 38%, compared to the average for 2011, and amounted to some NIS 1,077 million. "It is apparent that capital market activity remained limited against a backdrop of the slowdown in economic activity in Israel and around the world and expectations that the weakness would continue in the near future.

The Government bond market in the past year was characterized by price rises. The price of index-linked government bond increased by some 9.4%, while unlinked debentures increased by 7.0% (the fixed interest (*Shahar*) bond indices rose by some 7.7% and the variable interest (*Gilon*) bond index increased by some 3.7%). This was reflected in a fall in the yield to redemption to record low levels.

In the index-linked non-government debenture market (corporate bonds), there were price increases of some 10.3%, mostly in the second half of the year. It appears that the increases were attributable to the improvement in the capital markets in Israel and around the world and less from the activity data of the companies.

Financial Assets held by the Public

The value of the portfolio of financial assets held by the public increased in 2012 by some 7.3% to some NIS 2,711 billion. This increase in the value of the portfolio derived from an increase in all its components. The weight of shares (in Israel and abroad) in the financial assets portfolio of the Israeli public reached some 21.6% at the end of December 2012, compared to 21.5% at the end of December 2011.

Total financial assets of the public managed by **the Group** (deposits of the public, debentures and capital notes, securities portfolios, including securities in the custody of mutual funds, provident and pension funds, and supplementary training funds for which operational management and custodial services, as well as pension counseling, are provided) amounted to some NIS 930 billion at the end of December 2012, compared to some NIS 842 billion at the end of December 2011, an increase of 10.5%.

Bank Credit

Bank credit in the economy granted to the private sector (before allowances for credit losses) increased in 2012 by some 2.7%. This was a consequence of an increase in credit extended to the household sector, particularly in housing credit, which expanded by some 9.5%, while non-housing credit (consumer credit) increased by some 2.2%. In contrast, there was a decrease of 0.9% in credit allocated to the business sector.

On 1 November 2012, the Supervisor of Banks published a directive on the Limitation of the Loan to Value (LTV) Ratio on Housing Loans, which will apply to loans for which approval in principle is given from 1 November 2012 and thereafter. The new directive is a continuation of previous measures taken by the Banking Supervision Department in the housing credit market.

In connection with the draft directives regarding housing real estate of 19 February 2013, see Chapter "Legislation relating to the Banking System".

Credit to the public, net, in **the Bank**, including Leumi Mortgage Bank, amounted to some NIS 207.9 billion at the end of December 2012, similar to the end of December 2011. Housing credit in Leumi Mortgages increased in 2012 by 10.8%, an increase of NIS 6.1 billion.

Foreign and local rating agencies' credit ratings

On 8 May 2012, Moody's credit rating agency announced that it was lowering the credit rating forecast of the Israeli banking system from "stable" to "negative". The announcement reflected the expected slowdown in economic activity and the geopolitical tension prevailing in the region, as well as the moderate capital levels, limiting the system's ability to absorb losses, and was not issued because of a change in the rating horizon or change of rating of an individual bank. On 31 January 2013, this decision was ratified.

On 5 August 2012, the credit rating company, Midroog, announced that it was lowering the horizon of the rating of Leumi and Hapoalim from "stable" to "negative". Nevertheless, the rating for these banks did not change, remaining higher than the rating of all other Israeli banks.

According to the announcement by Midroog, the change in Leumi's rating horizon reflects Midroog's assessment that the short-term profitability "cushion", which is not expected materially to change from its level in 2011, does not merit a perfect rating, in view of a challenging business environment and regulatory changes.

The table below shows Israel's and the Bank's credit ratings in March 2013:

	Rating agency	Short-term rating	Long-term rating	Long-term rating outlook
State of Israel's rating in foreign currency	Moody's	P-1	A1	stable
	S&P	A-1	A+	stable
	Fitch	F1	A	stable
Leumi's rating in foreign currency	Moody's	P-1	A2	stable
	S&P	A-2	BBB+	stable
	Fitch	F2	A-	stable
Leumi's rating in local currency	Moody's	P-1	A2	stable
Leumi's rating in local currency for debentures and standard deposits	Ma'alot	-*	AA+	stable
	Midroog	P-1	Aaa	negative
Leumi's rating in local currency for subordinated capital notes	Ma'alot	-*	AA	stable
	Midroog	-*	Aa1	negative
Leumi's rating in local currency for subordinated capital notes (Upper Tier II)	Ma'alot	-*	(A, AA-)**	stable
	Midroog	-*	Aa2	negative

* Not relevant

** A: Upper Tier II capital with compulsory conversion into shares of the principal.
AA-: "New" Upper Tier II capital, not convertible into shares.

Developments in Leumi Share Price

From the beginning of the year until 31 December 2012, the price of Leumi shares rose from 1,091 points to 1,267 points, a change of 16.1%. During this period, the Bank's market value rose from NIS 16.1 billion to NIS 18.7 billion.

From the end of December 2012 to 10 March 2013, the share price rose by 4.89%, the market value reaching NIS 19.58 billion.

The following table sets out details of changes in representative exchange rates and the CPI:

	December 31				
	2012	2011	2010	2009	2008
	NIS				
Exchange rate:					
U.S. dollar	**3.733**	3.821	3.549	3.775	3.802
Euro	**4.921**	4.938	4.738	5.442	5.297
Pound sterling	**6.036**	5.892	5.493	6.111	5.548
Swiss franc	**4.077**	4.062	3.788	3.667	3.565
Consumer Price Index:	(points)				
For November (the "known" index)	**105.5**	104.0	101.4	99.1	95.5
Index for December	**105.7**	104.0	101.8	99.1	95.4

Rates of change were as follows:

	December 31				
	2012	2011	2010	2009	2008
	in %				
Rate of change:					
U.S. dollar	**(2.3)**	7.7	(6.0)	(0.7)	(1.1)
Euro	**(0.3)**	4.2	(12.9)	2.7	(6.4)
Pound sterling	**2.4**	7.3	(10.1)	10.2	(28.0)
Swiss franc	**0.4**	7.2	3.3	2.9	4.2
Consumer price index:					
For November (the "known" index)	**1.4**	2.6	2.3	3.8	4.5
Index for December	**1.6**	2.2	2.7	3.9	3.8

Regulation, general environment and the effect of external factors in activity

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 54-.

Legislation and Regulation affecting the Banking System

Banking Law (Legislative Amendments), 2012

On 19 March 2012, the Banking Law (Legislative Amendments), 2012 was published in the Israel Government Gazette (*Reshumot*). The law completes the arrangements, which were added to the Banking Law (Licensing) and the Banking Ordinance, as part of Amendment 13 to the Banking Law (Licensing), 2004 (as a result of the recommendations of the Marani Committee) and which were intended, *inter alia*, to enable the State to realize the balance of its holdings in banks which were in the Shares Arrangement.

The law includes amendments to the Banking Law (Licensing), the Banking Ordinance and Section 37 of the Securities Law.

The main objective of the proposed law is further adaptation of the Banking Law (Licensing) and of the Banking Ordinance to the required supervision framework for the case of a banking corporation, all the holders of the means of control of which are not obliged in a permit pursuant to section 34(b) of the said law (hereinafter a banking corporation without a control core), and the law is focused mainly on the method of proposing and electing the directors, as aforesaid, balancing the right of the holders of the means of control to propose candidates for a term of office as directors and exercise their choice, with the desire to prevent actual control in the banking corporation without the receipt of the Bank of Israel permit.

- Pursuant to the law, a statutory committee will be set up for the appointment of directors in the banking corporation and for the proposal of candidates for the office of director in a banking corporation without a controlling core in a new composition as set forth below, instead of the existing committee. This committee would appoint directors in each banking corporation in which the number of the members of the board of directors falls to below the number prescribed by the board of directors as an appropriate number of directors in that banking corporation, and also in any banking corporation in which the composition of the board did not meet all of the legal requirements, and after the general meeting of that banking corporation had not succeeded in appointing directors as necessary, as aforesaid after two attempts. In a banking corporation without a controlling core, a notice will propose at every general meeting a number of candidates for the office of director equal to the number of vacant positions on the board, and a further 75% of the number of vacant positions rounded up.

- In a banking corporation without a controlling core, only the following will be entitled to propose to the general meeting candidates for election as director: the committee which proposes candidates as the number of vacant positions on the board of that banking corporation and a further 75% of the number of vacant positions rounded down, and whoever holds more than 2½% of a certain class of the means of control in the corporation, and a body of holders which will appointment two or three holders, each one of which holds more than 1% and not more than 2½%, and together not less than 2½ % and not more than 5% of a certain class of the means of control (hereinafter – body of holders), which will entitles to collaborate only for this purpose. A holder of more than 2½% of a certain class of the means of control will be entitled to propose one candidate for the office of director, and as long as the director appointed on his proposal serves, he will not be entitled to propose a further candidate (except for a proposal of a candidate who replaces a serving director who was appointed at his proposal), unless he has received a permit from the Governor after consultation in the License Committee. The aforesaid will also apply with regard to a body of holders, including each member of the body of holders.

The composition of the Statutory Committee will be as follows: the chairman of the committee will be a retired Supreme Court or District Court judge, who will be appointed at the proposal of the Minister of Justice after consultation with the President of the Supreme Court, two members will be people from the field of economics (in respect of whom conditions of eligibility will be demanded similar to those applicable to a director in a government corporation) or members (or former members) of senior academic staff in higher education institutions who will be proposed by the chairman of the committee after consultation with the chairman of the Securities Authority, and two members will be directors serving on the board of the relevant bank as external directors (as the term "external director" is defined in the Companies Law or in the Bank of Israel's Proper Conduct of Banking Business Directives), who will be proposed by the other members of the committee, in consultation with the Supervisor of Banks. A member of a committee who is an external director in a banking corporation will be appointed as aforesaid for terms of office of two years and as long as he serves as external director in that banking corporation, and he will be able to be re-appointed, providing that he does not serve on the committee continually for a period exceeding three years.

- In a banking corporation without a controlling core, a candidate for the office of director is be subject to provisions similar to those applicable to an external director pursuant to the Companies Law, for the purpose of the prohibition of interest, with some changes (*inter alia*, the appointment and term of office of a director who has an interest, by way of the holding of the means of control at a rate exceeding ¼% in a banking corporation or a shareholder who is entitled to propose candidates to the office of director in a corporation as aforesaid, as set forth above, is prohibited; the appointment and term of office of a director who has an interest for an office-holder in a banking corporation is prohibited); the candidate for the office of director proposed by the committee will be obliged to comply with additional restrictions and reservations for office which are applicable to the members of the committee, and in addition, they will be obliged to hold professional qualification or have accounting and financial expertise as required from a external director pursuant to the Companies Law.

- A shareholder holding more than 1% of a certain class of the means of control in a banking corporation without a controlling core is obliged to report to the banking corporation and to the Supervisor of Banks on his holdings, and the banking corporation will be obliged to report to the public on each shareholder holding more than 2½% of certain class of the means of control in a banking corporation. The duty to report to the public will also apply with regard to a shareholder holding more than 1% and up to 2½% of a certain class of the means of control in a banking corporation, if the aforesaid shareholder agreed to publish to the public as aforesaid, and if he has not so agreed, he will not be entitled to join the body of holders for the purpose of proposing candidates to the office of directors to the general meeting, Notwithstanding the aforesaid, the Supervisor of Banks will have the authority to establish that the publication of the duty to the public will also be in respect of a holder of between 1% and 2½%, for reasons that will be set forth.

- The tests that Supervisor of Banks uses when he considers the suitability of a candidate for a post in a banking corporation were expanded, particularly, the tests that he employs in examining candidates for the function of director. In addition, the provision requiring the receipt of early approval of the Supervisor of Banks for office as an officeholder in a banking corporation was expanded, such that it will also apply to the office of legal advisor of the banking corporation and the Supervisor of Banks was authorized to stipulate up to seven officeholders in each banking corporation to whom the provision requiring an approval procedure will apply.

- Provisions that will apply to banking corporations that are public companies (banking corporations with or without a controlling core) were established, notwithstanding any other legal provision in the law. *Inter alia*, it were established that, except for the appointment of a director for a short interim period in certain cases, the board of directors will not be entitled to appoint directors to the board or to propose candidates for the office of director to the Statutory Committee. (It is clarified that the board of directors of a banking corporation without a controlling core will not be entitled to appoint directors even for the said interim period); a provision further provides that for at least 21 days prior notice of the convening of a general meeting on the agenda of which is the appointment of directors; and other provisions on the matter of the appointment or discontinuance of office of directors at the meeting.

- Additional special provisions on the matter of the appointment and discontinuance of office of directors were provided, which will apply to a banking corporation without a controlling core, notwithstanding any other provision in the law. *Inter alia*, a provision stipulates that the vote on the appointment of directors will be only at the annual meeting or at a meeting that has been convened with the approval of the Supervisor; a provision limiting the period of office of a director who is not an external director to three years, and his cumulative period of office to nine years; and a provision stipulating that the number of directors to be replaced each year will not exceed half of the serving directors.

- In addition, according to the law, the Supervisor of Banks or an employee that has been empowered will be authorized to grant a permit for opening a branch of a bank (instead of the Governor), and to cancel the said permit, but for the purpose of the cancelation of a permit for a branch, authority is granted only to the Supervisor, and he cannot empower another Bank of Israel employee for this purpose.

- The law updates, from 1,000 to 5,000, the maximum number of customers of a bank or a foreign bank in its branches in Israel to which the prohibitions and restrictions regarding ownership and management of the assets of provident funds and mutual funds will not apply. Hence, a bank or foreign-bank with insignificant retail activity, will be considered a bank with up to 5,000 customers and it will be entitled, subject to the conditions provided by law, to be the owner and manage the assets of provident funds and mutual funds, in contrast to a bank with significant retail activity.

- In addition, the Supervisor of Banks was authorized to approve the appointment of an internal auditor in a banking corporation, who does not meet the requirements provided in Section 3(a)(5) of the Internal Audit Law. It is clarified that this mechanism also applies to a banking corporation that is a public company.

Antitrust Law (Amendment – Amendment No. 13) (Monetary Sanction), 2012

On 8 May 2012, the Antitrust Law (Amendment no. 13) (Monetary Sanction), 2012, which deals with the introduction of a mechanism for monetary sanction to the Antitrust Law, was approved in its second and third reading in the Knesset.

According to the Law, the Antitrust Commissioner will be authorized to impose a monetary sanction of up to NIS 24,000,000 on a person who breaches any of the main provisions of the Antitrust Law, 1988. Before a monetary sanction is imposed, a notice of intention to charge will be sent to the violator. The right of appeal will be accorded to him, and thereafter, the Commissioner will decide whether to impose a monetary sanction on the violator, and will send him a notice of the decision together with explanations. The decision regarding the imposition of a monetary sanction will be notified to the public. A violator will be entitled to submit an appeal to the Antitrust Tribunal regarding the payment of a monetary sanction.

The payment of a monetary sanction will not derogate from the criminal liability of a person due to a breach of the provisions of the law that constitutes an offense. However, if an indictment for the breach is served against a person, he will not be subject to a monetary sanction.

The law prohibits the making of arrangements for indemnification and insurance of potential violators in respect of a monetary sanction that may be levied pursuant thereto.

Cheques Without Cover Law (Amendment no. 9), 2012

On 14 May 2012, the Cheques Without Cover Law (Amendment no. 9), 2012 was published in the *Official Gazette*. Pursuant to the Law, in the event that a person makes a request to be added to an account as a joint account-holder or as a power of attorney, an existing account which is a restricted account, or an account one of whose holders is restricted, or an account in which five or more cheques have already been refused in the 12 months preceding the date he was added, the Bank is obliged to forward to him the following information on the account and on the existing holder:

1. The number of cheques refused in the account in the twelve months preceding the date he was added.

2. A restriction, which is not a special restriction, (i.e., an ordinary or serious restriction) which is imposed on the account or on its holder in the three years preceding the date he was added, and the type of restriction imposed, as applicable.

3. A special restriction imposed on the account or on its holder at the date he was added, in whole or in part.

The law is in effect from 14 September 2012, and transitional provisions have been made for the purpose of forwarding the information regarding historical restrictions on the account.

Companies Law (Amendment no. 19), 2012

On 17 July 2012, the Companies Law (Amendment no. 19), 2012, regulating the subject of the recovery of companies, was published in the *Official Gazette*. The main points of the law are:

- Relief for companies that receive an order for a stay of proceedings, including *ex parte*, and the option of extending it beyond nine months, with court approval.

- The possibility of appointing an officer in the company as the official with certain authorities, such as investigation responsibilities, examining the company's liens, delaying their realization and conversion. Due to concerns of a conflict of interests and a misuse of this appointment, the law provides that the court should appoint an outside supervisor over the officer who is a company official and allows the court to confer on him only some of the functions and authorities relevant to the officer, noting the prohibition of the conflict of interests between his function and the fact that he is an officer of the company.

- The grant of authority to the court to approve the company's receipt of new credit in connection with recovery proceedings, secured by lien, which can also be of an identical ranking or prefer the previous creditors. In addition, it will be possible to sell and pledge assets which have been pledged against "appropriate protection". The extension of new credit, as aforesaid, will be possible only as a last resort, if the court is convinced that there is a need to receive it.

- The grant of authority to the court to enforce a creditors' arrangement over a class of creditors that object, providing that conditions guaranteeing that the same class of creditors will not be impaired as a result of the approval of the arrangement are met.

- The grant of authority to the court to oblige providers of infrastructure service and other essential products and services for the company's operation, as well as parties to contracts in which the company is connected, to continue to supply the company with the product or service or to continue the performance of those contracts.

- The grant of secured creditor status to owners of an asset by virtue of an ownership preservation stipulation – the law provides that, similar to a secured creditor, who is prevented from realizing his securities and initiating proceedings during the period of the stay of proceedings, and also the owner of an asset by virtue of an ownership preservation stipulation will not be able to receive possession of the asset if the asset is required for the company's continued operation, if it is awarded "appropriate protection".

Companies Law (Amendment no. 20), 2012

On 12 November 2012, Amendment no. 20 to the Companies Law was published. The main purpose of the law is to regulate the remuneration policy for officers in public companies and debenture companies, and establish a special process for its approval.

- The amendment provides that the board of directors of a public company or a private company which is a debenture company is obliged to determine, within nine months of the commencement date, a policy regarding the conditions of the term of office and employment of its officers (hereinafter: "the remuneration policy"), after it has considered the recommendations of the remuneration committee.

- The amendment to the law provides that the remuneration policy is subject to the approval of the general meeting and regulations with regard to this matter have been stipulated, including the required majority. It is also provided that the board of directors has authority to approve the remuneration policy, even if the general meeting objects to it, providing the remuneration committee and subsequently, the board of directors, have decided on the basis of detailed explanations, and after they have discussed the remuneration policy again, that the approval of the policy is for the good of the company, notwithstanding the general meeting's objection.

- The remuneration policy will be determined in accordance with considerations, matters and regulations which must be referred to, which are set forth in the amendment to the law. The board of directors will examine the remuneration policy from time to time and adapt it to the provisions of the law, and it is obligatory to present the remuneration policy for approval at least once every three years, in the way in which the remuneration policy was determined.

- The board of directors should appoint a remuneration committee whose composition is stipulated in the amendment to the law, including at least three directors, and all of the external directors pursuant to the Companies Law will be members, who will make up a majority of its members, and which will be chaired by an external director pursuant to the provisions of the Companies Law.

- The committee's duties are to recommend the remuneration policy to the board of directors, update it from time to time, review its implementation and approve the continuation of its effectiveness.

- The amendment to the law further provides new regulations for the approval of individual transactions with officers with regard to the conditions of their terms of office and employment, including transactions that are not in accordance with the remuneration policy.

Uniform Contracts Law (Amendment no. 4), 2012

On 9 July 2012, the Proposed Law for Uniform Contracts (Amendment no. 4), 2012 was passed. Pursuant to the amendment, the presumption of a discriminatory condition was added to the law, if it is determined that the contract payments are to be linked to a certain index and a minimum rate is fixed for this index, such that a decrease or increase in the index below the minimum rate will not be in favour of the customer. With regard to the discriminatory condition, the relevant provisions will apply. The amendment will come into effect four months after the date it is published in *Reshumot* (the Official Gazette).

Proposed Law for the Regulation of Engagement in Investment Consulting, Investment Marketing and Investment Portfolio Management (Amendment no. 19) (General Investment Consulting and General Investment Marketing), 2012

The Proposed Law for the Regulation of Engagement in Investment Consulting, Investment Marketing and Investment Portfolio Management (Amendment no. 19) (General Investment Consulting and General Investment Marketing), 2012 was approved in a first reading in the Knesset plenum on 24 July 2012.

According to the proposed law, a distinction will be made between consulting/marketing pursuant to which consulting is given to a certain customer according to his personal needs and data, and general consulting/marketing pursuant to which uniform and non-specific consulting is given to a large number of people (sometimes to an unknown number), which has not been adapted to a customer's personal needs/data.

In addition, the proposed law prescribes obligations that will apply to general investment consulting, including an obligation to include a notice that it concerns general consulting or marketing that does not constitute a substitute for investment consulting/marketing that has been adapted to a customer's personal needs/data, disclosure as to whether the provider of the general consulting/marketing has a personal interest in the subject, and identifying details on the provider of the general consulting/marketing. It is proposed to grant the Finance Minister, with the approval of the Finance Committee of the Knesset, authority to determine the required details of the disclosure obligations and the aforesaid identifying details.

The proposed law also provides that the provision of consulting or marketing services, including referral to such services or in their advertisement must not include materially incorrect information, and that no misleading item should appear in a report, notice or document submitted pursuant to the law.

In addition, it is proposed to add breaches in respect of which penal sanctions may be imposed and breaches in respect of which the Authority will be authorized to impose a monetary sanction (both on an individual and on a corporation), with regard to the provision of general investment consulting/marketing and with regard to materially incorrect information or a misleading item.

Foreign Account Tax Compliance Act– FATCA

In March 2010, the Internal Revenue Code in the United States (the U.S. Income Tax Law) was amended such that it brings into effect a reporting regime which aims to compel foreign financial institutions (FFI) to transfer information regarding accounts held by U.S. customers. Thus, the law considerably expands the disclosure and reporting requirements imposed on FFI in relation to U.S. accounts. In February 2012, proposals for regulations were published by the United States Internal Revenue Service ("IRS"), providing operative directives for implementing the law. The U.S. authorities recently announced a six-month deferral of the effective date of the requirements of the law to 1 January 2014. The final regulations were published on 17 January 2013.

Pursuant to the law and regulations, an FFI is obliged to enter into an agreement with the IRS, whereby it will undertake, *inter alia*, to locate U.S. accounts, report on them to the IRS and deduct tax from customers who refuse to furnish the required information and documents. An FFI who does not sign an agreement with the IRS will be charged a deduction of tax in respect of income from U.S. sources.

In order to be prepared for the implementation of the law in Leumi Group, the Bank has set up a steering committee which is studying and monitoring developments in the law and regulations. Under its guidance, the Bank is taking steps to implement working procedures and to develop a system for complying with the FATCA requirements, in accordance with what is presently known regarding the IRS requirements. To date, the Bank has carried out a demarcation of the project, an examination of the Group companies relevant to FATCA and an impact analysis with regard to the FATCA requirements. In addition, the main working processes required for application of requirements of the law in the Bank has been analyzed and a work program for implementation has been determined.

In recent years, working procedures for dealing with U.S, customers have been established in the Bank and in the subsidiaries. In September 2011, a letter was sent to managers regarding the Bank's policies with regard to FATCA, reiterating and emphasizing the Bank's policy of not advising customers on taxation matters, particularly U.S. tax, and not assisting them in concealing their identity, and since then, additional procedures were issued regulating the area of identifying, locating and handling U.S. customers, as a complement to the procedures previously issued.

The IRS recently published a model of a trans-national agreement for the implementation of the FATCA regulations and issued other notices regarding special agreements for implementing the FATCA between the United States and the United Kingdom, Switzerland, and several other countries. Financial institutions and their customers located in a country, which is a signatory to the trans-national agreement for implementation of FATCA regulations, will enjoy certain reliefs within the framework of the FATCA requirements.

At the beginning of August 2012, the Finance Ministry announced the setting up of a team headed by the Commissioner of State Revue, to examine the implementation of the FATCA regulations in Israel, "including examining the possibility of implementing a bilateral agreement between the State of Israel and the United States, which is intended to give relief to the financial entities with regard to implementation". According to the announcement, the team includes representatives of the Finance Ministry, the Bank of Israel, the Securities Authority and the Justice Ministry.

Notwithstanding what is stated in the above paragraph, Bank Leumi continues to be prepared to deal with the implementation of the FATCA requirements in a format which is not an inter-country arrangement, until further notice from the relevant authorities in the State of Israel.

Interim Report of the Team to Examine How to Increase Competitiveness in the Banking System in Israel

On 16 July 2012, the Team to Examine How to Increase Competitiveness in the Banking System in Israel, headed by the Supervisor of Banks ("the Team"), which was appointed by the Governor of the Bank of Israel and the Finance Minister, following a recommendation of the Committee for Socioeconomic Change ("the Trajtenberg Committee"), published an interim report.

The Team examined and recommended various measures and procedures for increasing competition in the Israeli banking system, improving the power of households and small businesses, increasing customers' options, lowering the prices of services and improving service.

The Team's recommendations focused on three areas:

Increasing the number of players inside and outside the banking system, by encouraging the establishment of an Internet bank, encouraging the establishment of credit unions in Israel, examining a mechanism for financial routing of long-term savings of the public for increasing the supply of credit to households and small businesses;

Increasing competition among the existing players in the banking sector, *inter alia*, by opening accounts via the Internet and easing the process of closing a bank account, publicizing the actual existing interest rates and increasing accessibility to information sites for comparison purposes, providing a banking "identity card", including details of its assets and liabilities, yield and payments to a bank in an initiated manner for the customer, to include information regarding borrowers, changing the interest ceiling mechanism and applying it to banking corporations, etc.;

Supplementary measures – *inter alia*, imposing supervision of certain commissions and the cancelation of a number of commissions, increasing transparency in security commissions and re-pricing of the services, easing the transition between the banking system and the non-bank system in the area of securities, reducing commissions for small businesses, easing early repayment of business credit.

On 28 November 2012, the Supervisor of Banks published an amendment to the Banking Regulations (Service to the Customer) (Commissions), 2008 ("the Regulations"). The amendment cancels the securities management fee in respect of T-Bills and monetary funds, imposes limitations on banks' fees in respect of transactions in securities, and eliminates other commissions for households and small businesses. The amendment comes into force on 1 January 2013. In addition, the Supervisor of Banks instructs the banking system to conduct re-pricing procedures for commissions collected for activity in securities, in order to adapt them, as far as possible, to the price actually collected, this by 1 March 2013. The main commissions which have been eliminated or changes in the context of the amendment to the rules, and in the context of the directives related to the banking system are as follows:

1. Cancelation of securities management fees in respect of T-Bills and in respect of monetary funds.

2. Cancelation of the commission for a data card and a cash withdrawal card.

3. Commission for handling credit and collateral for non-housing loans – raising the exemption from NIS 50,000 to NIS 100,000.

4. Cancelation of the commission in respect of a change in the date for debiting a credit card.

5. Small business management fee – comparing the status of small businesses to households.

6. Changes in securities management commissions –
- Differential pricing in respect of securities activity in various channels;
- The banks' charge in setting a maximum commission for buying and selling securities;
- Cancelation of the minimum commissions in respect of managing securities deposit;
- Expanding the supervision on the transfer of a securities deposit to the transfer of a customer's deposit even outside of the banking system.

7. A demand from the banks to conduct a process of re-pricing of commissions in respect of securities activity, adjusting the amounts of the commissions, as far as possible, to the price actually collected, as well as the adjusting the commission rates for changes that have occurred in the commission structure in respect of securities activity in accordance with the new tariff charge-list (with effect 1 March 2013).

In addition, the following was provided:

8. An obligation of the banks to publish on their websites a direct link to the commission tariff charge-list, such that it will be available and accessible to customers.

9. Announcement of a service provided by a clearing agent to providers of discounting services, a service under supervision.

The implementation of the rules will result in a drop in the Bank's revenues from commissions and an increase the Bank's expenses for the development and adaptation of the automated systems to the new requirements. In addition, there may be indirect effects, which, at this stage, cannot be assessed.

Joint Investment Trust (Distribution Commission) (Amendment) - 2013

On 11 March 2013, the Knesset Finance Committee approved the proposal to amend the regulations determining the maximum distribution commissions that the distributors are allowed to charge mutual fund managers for the distribution of funds, such that the distribution commissions will be reduced by 20%. The regulations have yet to be published in *Reshumot*.

Outline of the regulation of the Securities Authority - Roadmap: Goals and plans for the coming years

On 4 September 2012, the Securities Authority published a roadmap, which includes its objectives and an outline of its activity for the coming years, based on three areas: regulation, deregulation and the development of the capital market.

With regard to regulation, the document includes details of major projects on the Authority's agenda, including certain areas which are currently not regulated, including - (a) trading floors (b) broker-dealer relations (c) credit rating agencies (d) advice to institutions (e) monitoring the work of the independent auditors (e) general investment consulting (analysis) (f) ETFs (g) changes in underwriting with the aim of restoring underwriting to the issues (h) amendment of legislation designed to establish an appropriate, professional and uniform process for applicants for a license (i) improving and shortening the financial statements (j) the prohibition of front-running (the prohibition of the unfair use of information regarding securities), etc.

With regard to the level of relief from regulation, the document includes an outline of reliefs for public comment, including, *inter alia*:

a. **Reliefs for all supervised entities:** Among the many reliefs considered by the Authority, the following are noteworthy: in corporations – extending the period for offering securities pursuant to a shelf prospectus from 24 months to 36 months, canceling various disclosure directives by virtue of financial statement regulations for which there is no longer any justification following the introduction of the IFRS. In the area of the license holders (investment consultants, investment marketers and portfolio managers), reexamining the Authority's directive to clarify the needs of the customer in order to obtain more effective and concise explanation, cancelation of the obligation for immediate delivery of documentation of the process and reducing the frequency of the obligation to carry out a procedure for clarifying customer requirements, such that it will be carried out every two years instead of every year.

b. **Reliefs for small companies:** The Authority has examined whether there is room to prepare a regulation hierarchy for large supervised entities and small supervised entities, beyond the one currently provided in the provisions of the law.

c. **Changes in the Authority's conduct:** The expansion of the public's participation in the legislation process, determination and publication processes of rules to assist supervised entities in assimilating the new legal provisions in an orderly and efficient manner, exploring the possibility of concentrating new publications on dates fixed by it in advance, in order to facilitate the monitoring and implementation of the publications.

With regard to market development: The Authority presented a number of projects, including the promotion of investments in public companies operating in the field of research and development; a system of voting by Internet; mutual recognition of prospectuses and current reports, setting up an inter-departmental team to examine tools for promoting and developing the securitization market in Israel; the regulation of activity of a new financial instrument known as the ETF Fund; the creation of an alternative distribution system that would compete with the mutual funds distribution system in use today; increasing competition in the brokerage market, etc.

Proposed Law to Amend the Banking Law (Service to the Customer) (Amendment no. 19), 2012

On 15 October 2012, the Knesset Economic Affairs Committee approved the Proposed Law to amend the Banking Law (Service to the Customer) (Amendment no. 19), 2012 (the proposed law) for a second and third reading.

According to the proposed law, a banking corporation must not make a loan for immediate repayment and must not start legal proceedings against a customer for non-compliance with the loan terms (except for a credit facility), including due to non-repayment of the loan, in part or in full, unless the customer has been furnished with written notice, 21 business days before taking any action regarding the loan in a way that the banking corporation is accustomed deliver notices to that customer, and by personal delivery to the customer's registered address with the banking corporation. The said notice should include various details as set forth in the proposed law. Nevertheless, a banking corporation will not be obliged to furnish such a notice if its delivery presents a tangible concern for the impairment in the banking corporation's ability to collect, due to an adverse change in the customer's repayment capacity or because of other conditions requiring immediate execution of an action with regard to the loan.

Pursuant to the proposed law, the commencement of the proposed arrangement is six months from the date the law is published in *Reshumot*, and it will be effective for loans made by the banking corporation before its commencement date.

Proposed Law for the Intensification of the Collection of Taxes and the Increase in Enforcement (Legislative Amendments), 2012

On 5 November 2012, the Proposed Law for the Intensification of the Collection of Taxes and the Increase in Enforcement (Legislative Amendments), 2012, was published, which, *inter alia*, amends the first addendum to the Law for the Prohibition of Money Laundering, and adds new predicate offenses pursuant to Section 220 of the Income Tax Ordinance, Section 98 (C2) of the Real Estate Taxation Law (Sections 117(B)(1), 117(B)(3) to (8) and 117(B1) of the Value Added Tax Law.

Draft Securities Regulations (Regulation regarding the Appointment of a Commissioner and his Function, Operation, Remuneration and Expenses), 2012

The Streamlining of Enforcement Procedures in the Securities Authority (Legislative Amendments), 2011 ("Administrative Enforcement Law") allows the imposition of a range of enforcement measures on an offender. Section 27ZZB(a) of this law provides an arrangement whereby a panel of an administrative enforcement committee is authorized to require an offender to pay an additional amount called "payment to the victim of the breach" the maximum amount of which is determined in the law.

The proposed version of the regulations provides that the beneficiary is responsible for defining the group of victims of the breach and the amount to be paid to them and to set out in its decision the general principles for entitlement to receive the payment and the way in which it is to be distributed among the victims. In addition, the proposed version provides, *inter alia*, the terms of eligibility for appointment as a commissioner, the way in which a commissioner must perform his duties, the reports that will be required to be furnished in connection with the performance of his duties to the panel and to the chairman of the Authority, the method for determining the Commissioner's salary and expenses, including the salaries of the Commissioner's employees or his office and the employment of external consultants and the method of publishing the notices to the victims of a breach.

Legislation and Regulation relating to pension counseling

Further to the details set out in the 2011 Annual Report, on 3 April 2012, the Supervisor of the Capital Market, Insurance and Savings Division in the Ministry of Finance (hereinafter "the Supervisor") published an amended version of a computerized graphic signature circular including directives for obtaining the signature of employers on pension counseling documents of their employees, and on 18 April 2012, he announced his intention to defer the effective date of the Adapted Monetary Saving Model for one year.

On 10 May 2012, the Supervisor published draft regulations including, *inter alia*, a revision of distribution commission rates in respect of the three types of pension products: provident funds, pension funds and managers insurance, such that the rate will be comprised of an annual rate of 0.20% of the total assets accrued to the credit of a customer in a pension product and a rate of 1.6% of current deposits. The draft regulations also include a proposal that the amount payable in respect of each of the components of the aforesaid distribution commission will be limited to the lower of the distribution commission permitted in each component and 40% of the amount of the management fees actually collected. (The draft regulations do not include any change with regard to distribution commission for counseling in respect of a training fund). It is further proposed in the draft regulations to provide that an institutional body which manages more than one pension product will be able to enter into a distribution agreement with a pension consultant, only if the distribution agreement includes all of the pension products of the institutional body, and that no distribution commission will be paid for a member or for a policy-holder with whom the connection has been discontinued.

On 25 June 2012, the Supervisor published a circular regarding management fees in pension savings instruments, which will come into force on 1 January 2013, providing, *inter alia*, rules regarding the minimum period for providing benefits in management fees (including cases wherein an institutional entity is entitled to raise management fees during this period) and provisions for increasing transparency with regard to management fees collected from members. On 31 December 2012, the Supervisor published an amended circular regarding management fees in pension savings instruments, in which the cases where an institutional entity is entitled to raise management fees during the course of the benefit period and the method used by the institutional entity to notify customers accordingly, were revised.

On 2 August 2012, the Commissioner published a draft circular on "A Uniform Structure for Transferring Data and Information in the Pension Savings Market – Amendment", pursuant to which updates were made regarding some of the interfaces and rules for the transfer of data and information. On 5 November 2012, a circular on "A Uniform Structure for Transferring Data and Information in the Pension Savings Market" was published and, on 7 January 2013, a further update of this circular was published, with the aim of establishing rules and regulations relating to the various interfaces intended for the transfer of data and information between the institutional entities and license holders and for changing the commencement date of the abovementioned interfaces.

On 15 August 2012, the Commissioner published a draft to amend the circular "Power of Attorney to a License Holder", which included among its main amendments, a revision of some of the dates published in the original circular, the granting to a banking corporation the possibility of obtaining the signature of a customer on a power of attorney form through its Internet site, and the updating of the version of power of attorney forms attached to the original circular. On 12 December 2012, the Supervisor published the circular "Power of Attorney to a License Holder Amendment", in which the provisions of the circular were updated, and the commencement date of the circular was changed to 1 May 2013.

On 15 August 2012, the Commissioner published an amendment to the circular "Obligation to Use a Central Pension Clearing System", which is intended to establish rules for the early preparedness of entities which will be obliged or entitled to use the system.

Further to the approval of the Supervision of Financial Services Regulations (Provident Fund) (Management Fees), 2012, ("**Management Fees Regulations**"), on 17 October 2012, the Commissioner published the draft Supervision of Financial Services Regulations (Provident Fund) (Management Fees) (Amendment), pursuant to which a management company is entitled to charge management fees at rates published in the Management Fees Regulations or in an amount not exceeding NIS 9 per month of the accumulated balance of the policyholder (whichever is higher). The amendment is expected to come into effect on 1 July 2013.

On 31 October 2012, the Commissioner published a draft circular of an explanatory document, which is intended to establish a focused and consistent structure for the explanatory and illustrative document, and which is expected to replace a number of circulars dealing with an explanatory document and other documents which license holders are required to forward to their customers in the course of marketing or pension consulting activity.

On 17 December 2012, a circular "Service to Customers, Agents and Consultants" was published, setting forth rules and regulations regarding the provision of service to customers by license holders, with effect from the date of engagement to the settlement of the claim. The effective date of the circular is 1 January 2014.

Consortium Arrangements for the Granting of Credit

On 28 March 2011, the managers of the banks and insurance companies were given notification by the Antitrust Commissioner, regarding the conditions that if fulfilled, the Antitrust Authority does not intend to enforce the provisions of the Antitrust Law, 1988 ("the Law"), regarding association between the banks and insurance companies and between them and themselves ("banks and institutional entities") in a credit consortium.

The notice of the Commissioner replaces the earlier notice regarding conditions on this matter dated 8 March 2007, whose effectiveness was extended on 4 January 2009 ("the previous conditions").

A summary of the conditions for forming a consortium for the provision of credit is as follows:

1. The formation of the credit consortium must be with the written consent of the customer on a separate form;

2. The customer is given the option of negotiating over the terms of the provision of credit with any one of the member parties in the consortium, including through another person on its behalf;

3. The formation of a consortium in which both Bank Hapoalim B.M. and Bank Leumi Le'Israel B.M. are members will be permitted only if the aggregate amount of the credit that the two banks are required to grant exceeds NIS 300 million (except for the case of a consortium arrangement whose purpose is the repayment of a debt deriving from credit provided by the aforesaid two banks before 18 August 2002 to the same person).

4. No information that is not required for the purpose of forming the specific consortium in respect of which the contacts are maintained may be transferred. Any transfer of information as aforesaid will be made in a way that minimizes any chance of impairment to competition between the parties.

5. The parties will prepare documentation that must include all of the data as outlined in the Commissioner's notice, both with regard to contacts made and/or information transferred between the parties on matters relating to the formation of a credit consortium, and with regard to a credit consortium that actually exists and with regard to contacts that did exist but have not actually resulted in a credit consortium. The documentation must be retained with each bank and/or institutional entity and transferred to the Authority within 30 days of the end of each calendar year, and on demand within 14 days of the demand.

The said validity of the Commissioner's notice was extended for an additional year until February 2014, unless another notice is issued before the end of the effective period.

Companies Tax

On 14 July 2009, the Knesset approved the Improved Economic Efficiency Law (Legislative Amendments for Implementation of the Economic Plan for 2009 and 2010), 2009, which, *inter alia*, gradually reduces company tax rates to 18% for the year 2016 and thereafter. Pursuant to the said amendments, company tax rates applicable in 2010 and 2011 are 25% and 24%, respectively.

On 5 December 2011, the Knesset approved the Change in the Tax Burden Law (Legislative Amendments), 2011 (hereinafter – the Law). Pursuant to the Law, the reduction in tax, provided in the Improved Economic Efficiency Law, as aforesaid, was canceled, and the company tax rate from 2012 and thereafter will stand at 25%.

For further details, see chapter "Description of Taxation Position" on page 251.

Value Added Tax and National Insurance

On 2 August 2012 a Value Added Tax Order was published updating the rate of value added tax on business and imported items to 17% from 1 September 2012.

On 30 August 2012, Value Added Tax Order (Tax Rate on Noninterest-Profit Organizations and Financial Institutions) (Amendment), 2012, was published in the Official Gazette (*Reshumot*), updating the rate of value added tax in respect of profit tax and payroll tax for financial institutions to 17% from 1 September 2012. As a result of the said change, the statutory tax rate, which applies to banking corporations, rose in 2012 from 35.34% to 35.53%, and in 2013, it will rise to 35.9%. In addition, the rate of payroll tax, which applies to financial institutions, increased to 17% with respect to salary payable for work from September 2012 and thereafter, instead of 16% for the whole of 2012 and 15.5% for 2013 and thereafter.

On 13 August 2012, the Deficit Reduction and Change in Tax Burden Law (Legislative Amendments), 2012 (hereinafter "the Law"), was published. Pursuant to the Law, with effect January 2013, the rate of national insurance fees collected from employers in respect of the portion of the salary exceeding 60% of the average salary in the economy increased from 5.9% to 6.5%. Furthermore, this rate will increase in January 2014 and January 2015 to 7% and 7.5%, respectively.

For further details see page 251.

Draft update of directives regarding real estate for housing

On 19 February 2013, the Supervisor of Banks published a draft update of directives regarding real estate for housing.

The main directives included in the new draft are as follows:

a. For the purpose of computing the capital Adequacy ratio, a housing loan is weighted at 35%, apart from a leveraged housing loan with a variable interest component, which from October 2010, is weighted at 100%. According to the new draft directive, the allocation of capital in respect of housing loans will be made according to the weighted rates below on loans made from 1 January 2013 and onwards:

- Housing loans where the rate of financing is up to 45% will be weighted at 35% - remains unchanged.
- Housing loans whose rate of financing is between 45% and 60% will be weighted at 50%, instead of 35%.
- Housing loans whose rate of financing is higher than 60% will be weighted at 75% for the purposes of capital requirement, instead of 35% or at 100% (see the following point).
- At the same time, the requirement (from October 2010) to weight loans at 100% whose rate of financing is higher than 60% and which are in excess of NIS 800 thousand and which have a variable rate of interest of 25%, will be canceled. Instead, as aforesaid, the weighting rate will be 75%.

b. The directives in the draft provide a requirement, with effect from the reports to the public for the first quarter of 2013, for an increase in the provision for doubtful debts in respect of housing loans, such that the ratio of the balance of the collective provision and the balance of the housing loans stands at a minimum rate of 0.35%. This does not apply to housing loans held for which there is a provision according to the extent of arrears or an individual provision.

c. In addition, the directives in the draft provide for a reduction in the allocation of the capital required in respect of Sales Law guarantees in the event that the apartment is already transferred to the home-buyer. These guarantees should be weighted by a credit conversion coefficient of 10% instead of 20%. This amendment will be applied retroactively.

Bank Leumi is examining the extent of the impact of the draft directives.

Deposits without movement

The Bank of Israel has published a draft proposal for an amendment to the existing arrangement for deposits without movement (which is currently based on the Companies Ordinance, 1941, and the Banking Order (Deposits Without Movement), 2000).

The main points of the proposed amendment are as follows: the imposition of duties that are more extensive than those currently in force in connection with the measures taken by banks to locate the holder of an account without movement; a change in the way the funds in an account without movement are invested for investing in T-Bills (currently the investment is in deposits of various types and in debentures); the provision of a duty to transfer the funds of an account without movement to the Custodian General after 10 years from the date of the account becoming an "account without movement"; and the imposition of duties to locate the heirs of an account-holder who has died.

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 with 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", "expected", "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 principal 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:

Allowances for credit losses and classification of problem debts

Directives for the measurement and disclosure of impaired debts, credit risk and allowance for credit losses

Collective allowance

A collective allowance for credit losses is applied for large groups of relatively small and homogenous debts, and in respect of debts that have been reviewed individually and found to be unimpaired. The measurement of the credit losses is based on the transitional provisions as set forth below. The allowance, which is assessed on a collective basis for off-balance sheet credit instruments, is based on the rates of allowance determined for balance sheet credit, taking into account the rate of recovery for the expected credit of off-balance sheet credit risk. The rate of realization for the credit is calculated by the Bank based on credit conversion coefficients, as provided in the Proper Conduct of Banking Business no. 203, Measurement and Capital Adequacy – Credit Risk – the Standardized Approach, with certain adjustments in cases where the Bank has past experience indicating the recovery rates of the credit.

For 2011-2013, a temporary provision was given ("transitional period") for calculating credit loss allowances on a collective basis. According to the temporary provision, the rate of credit loss allowance on a collective basis will be determined in the transitional period on the basis of the range of the historical rates of provision for doubtful debts in the years 2008-2010, in a breakdown by economy sector, and on the percentage of net accounting write-offs actually recorded since 1 January 2011. In addition to the calculation of the range of historical rate of loss in various economy sectors, as aforesaid, for the purposes of determining the fair rate of allowance the Bank takes into account additional information, including sectoral conditions, macro-economic data, a general assessment of the quality of the credit in the economy sector, changes in the volume and trend of balances in arrears and impaired balances and the effects of the changes in credit concentrations.

With regard to housing loans, a minimum allowance for doubtful debts is calculated according to the formula set by the Supervisor of Banks taking into account the extent of arrears, such that the rates of allowance increase as the arrears deepen. The application of the calculation of the allowance according to the extent of arrears formula refers to all housing loans, except for loans which are not repaid in periodic installments and loans which finance activity of a business nature. In addition, a collective allowance is made on the balance of the housing loans in which there are no arrears, based on past statistics.

The Bank examines the overall accuracy of the credit loss allowance based on management's discretion, which takes into account the risks inherent in the credit portfolio.

In addition, the Bank calculates a supplementary and general provision according to the policy for the doubtful debt provision before implementing the provisions regarding impaired debts, credit and credit loss allowance.

These provisions are used only as a sign with regard to the collective allowance, so that if the total collective allowance is less than the supplementary and general provision, the allowance should be made according to the higher of the two calculations.

Individual allowance

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, by the credit risk management units in the Corporate Division and the Commercial Division, by the Risk Management Division, as well as an objective evaluation of the difficulties that have been identified, in order to determine their risk level. In the Banking Division, customers with an obligo of more than NIS 500 thousand are individually identified and reviewed, and the remainder is dealt with as a group of homogenous and relatively small debts, making a collective allowance.

As part of the measures used by the Bank to manage credit risk, there is a methodology for identifying and classifying problem debts, and the Bank is implementing 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, as part of process of dealing with customer defined as "sensitive customers". In addition, a quarterly credit review process takes place in the Corporate Division , which deals with the larger customers of the Bank, as well as in the Commercial Banking Division, which deals with medium-sized business corporations, an examination is made of those borrowers whose risk rating is higher than that requiring inclusion in the customer population defines as sensitive. *Inter alia,* the methodology requires systematic examination of the appropriateness of the allowance for credit losses in respect of the debts regarding the collection of which the Bank has doubts, on the basis of criteria established for the manner in which the allowances for credit losses are to be calculated, determined in accordance with the directive. An examination of the accuracy of the allowance is made every quarter, for all lines of business, for customers classified as "impaired". The calculation is made in accordance with the characteristics of the debt, the evaluation future cash flows based on the customer's business situation 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, and all this, in the value of the capital of the discounted receipt and the fair value of the realization of the collateral, in the judgment of the Bank's Management. The credit risk management units in the Business and Corporate Division and the corporate credit branch in the Banking Division approve the examination of the appropriateness of the allowance. In addition, an examination is made of the ability to service the debt of customers classified by other debt indicators (debt under special mention and substandard debt).

The process described above for classifying debts and estimating potential losses in the credit portfolio involves subjective assessments in all matters connected to the classification of a loan as problematic and to the factors on which the calculations of allowances are based. The assumptions and estimates may have a material effect on the amount of provisions for credit losses.

Each quarter, the Bank's Doubtful Debts Committee, headed by the Chief Executive Officer, discusses the allowances required for the quarter and the recommendations for the classification of problem loans. Proposals for the quarterly allowances in excess of NIS 2 million required for customers are presented for discussion. In addition, the Audit Committee of the Board of Directors discusses the allowances for credit losses so as to approve their amount. Data on the debts and collateral of the major customers in respect of whom an allowance is required, as well as the amounts of allowance proposed by Management, are made available to the Directors as background material.

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

The allowances 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 allowances 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.

Derivatives

In accordance with the directives regarding financial reporting of the Supervisor of Banks, the Bank applies Financial Accounting Standards nos. 133, 138, 149 and 157, as amended, with regard to the treatment and presentation of derivatives.

Fair value is defined as an amount/price which would be received from the sale of an asset or would be paid for the transfer of a liability in a transaction between a willing buyer at the measurement date. Among other things, the standard requires for the purpose of the assessment of fair value to make maximum use of observed data and minimum use of unobserved data. Observed data represent information which available in the market received from independent sources, while unobserved data reflect the banking corporation's assumptions.

FAS 157 outlines a hierarchy of measurement techniques which are based on the determination of whether the data employed for determining the fair value are observed or unobserved, These kinds of data create a scale of fair value as set forth below:

- Level 1 data: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 data: quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or identical liabilities in inactive markets; prices derived from valuation models where all of the significant data is observed in a market or supported by observed market data.
- Level 3 data: Unobserved data for the asset or the liability deriving from valuation models, where one or more of the significant figures are unobserved.

This hierarchy requires the use of observed market data, where this information exists. When this is possible, the Bank weighs relevant observed market information as part of its assessment. The scope and freq of the transactions, the size of the gap between "bid" and "ask" prices and the size of the adjustment required when comparing similar transactions are all factors that are taken into account when establishing the liquidity level of markets and the relevant scope of observed prices in those markets.

The level in the fair value scale to which the fair value measurement of the financial instrument belongs will determined on the basis of the lowest level of the data which is significant to the measurement of the fair value in its entirety.

The standard requires that the banking corporation reflect the credit risk and the risk of non-performance risk in measuring the fair value of the debt, including derivative instruments, which were issued by it and measured\ at fair value. Non-performance risk includes the credit risk of the banking corporation.

In accordance with the transitional provisions for 2011, which were also extended to 2012, specific directives regarding the methodology and data to used in calculating the fair value of derivative instruments were determined. A banking corporation is not required to employ complex models including various scenarios of potential exposure in order to measure the credit risk component included in the fair value of derivative instruments. According to the abovementioned transitional provisions, and pursuant to the directives of the Supervisor of Banks, the Bank performs the calculation of the adjustment as aforesaid on a collective basis, using a credit quality index according to groups of similar counterparties, e.g., based on internal ratings.

In a few cases where the Bank does not have a mathematical model for revaluing 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 a transaction in a large amount.

For further details on determining fair value as from 2011, see Note 1(L).

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. With regard to foreign securities, most of the portfolio is calculated on a daily 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 dependent on the issuing houses or the marketing bodies. The calculation is based mainly on the transaction prices in active markets, and the revaluation 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 two valuation methods.

a. Valuation at the level of asset group: Most of the securities are valued using rates of return (capitalization) relating to the group of assets with similar characteristics and by country, sector, asset type, rating etc.). This mainly includes, a weighting of the existing information in the market, usually in relation to the relevant index.
b. Valuation and quotations for specific securities: The rest of the securities are valued individually (valuation of the issuer and the individual security), on the basis of direct price quotations of the security or for a specific issuer. A small portion of the assets in this group is valued only on the basis of price quotations from very active markets (mainly government debentures, whose market-0makers are active).

The CLO-portfolio, which constitutes some 2.43% of the securities portfolio, is valued using a model, which is used by the leading banks around the world. In order to use the model, the Bank employs aggregate data which is generally accepted for use in those institutions. The Bank validates the model and ensures a reasonable level of confidence of the correctness of the fair value. In non-tradable securities of companies in Israel, fair value is based on data received from the "Mirvach Hogen" company.

The total value of the assets according to the model is slightly lower than the value according to the valuation by "Mirvach Hogen". 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 derivative instruments), 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 99 of the Report.
For further details with regard to the determination of the fair value, see Note 1(g).

Each reporting period, the Bank examines the necessity for recording a provision for impairment of securities that is not of a temporary nature. The examination is carried out when there are signs which indicate the possibility that the value of the securities has been impaired. The criteria for determination as to whether an impairment is not of a permanent nature are based on considerations and tests as follows:

- An intention and an ability to strengthen the security until the predicted recovery of the full amount of the cost.
- The assets and collateral backing the security.
- The ratio of the impairment to the total cost of the security.
- The length of time for which the fair value has been lower than cost.
- An assessment of repayment ability.
- An adverse change in the situation of the issuer or in the situation of the entire market.

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, within a short time frame.

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 problem 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 is lower, by 35% or more, than the cost at the end of the reported period, as well as at a date prior to the publication of the report (regarding debentures – the 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. The definitions of "significant downgrading" and "significant impairment" have been determined by the Bank.

Obligations regarding Employee Rights

The Supervisor of Banks is currently reviewing the change in the accounting treatment of employee benefits. At this stage, it is not known which standards, if any, will be adopted, and what its method of recording and implementation date will be. The amounts of the obligations for pension and long-service grants are currently calculated according to actuarial models, using a capitalization rate of 4% (index-linked) determined by the Supervisor of Banks, which reflects the long-term average interest rate of government debentures. In addition, the actuarial computations take 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 0.8% and 7.2%.

A quantitative sensitivity analysis of the effect of the main assumptions in the computation of the actuarial liability.

Any 1.0% change in the rate of capitalization of the abovementioned obligations will cause an increase/decrease of some NIS 1.9 billion in the total of the obligations, a change of 1.0% in salary levels will cause an increase/decrease of some NIS 570 million in total obligations and a change in life expectancy of 5.0% will result in an increase of some NIS 104 million in obligations. All of the amounts are before the effect of tax.

The actuarial models include assumptions regarding life expectancy tables, disability rates, leaving rates, the rate of leaving with preferred conditions, the rate of utilization of pension rights, the rate of withdrawal of severance pay and provident fund monies, etc. Although the parameters have been determined with appropriate care and professional expertise, a change in any or some of the actuarial parameters and/or the capitalization rate and/or the rate of increase in pay will cause a change in the level of the Bank's obligations.

The 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 July 2012, the Capital Market, Insurance and Savings Department in the Ministry of Finance published a draft position paper concerning the update of demographic assumptions in pension funds and life insurance, including a possible update of mortality tables. In accordance with instructions of the Banking Supervision Department on the measurement of liabilities in respect of employee rights, assumptions regarding mortality and disability are to be updated in the statements for the second quarter of 2012, according to the best information available to the banking corporation. For this purpose, use is to be made, *inter alia*, of the draft mortality and disability tables published recently by the Ministry of Finance.

In accordance with the aforesaid, in the financial statements at 30 June 2012, the Bank updated its evaluation of demographic variables, based on the updated estimates of life expectancy included in the draft position paper. As a consequence, the Bank increased the liability for pension by some NIS 25 million before tax. The increase in provision was charged to the statement of profit and loss. In March 2013, the Capital Market, Insurance and Savings Division in the Finance Ministry published a final circular on the subject. No further update is required to the amount of the liability for pension as revised in June 2012.

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.

Directives and interpretations regarding the strengthening of internal control on financial reporting of employee rights

On 27 March 2011, the directives of the Supervisor of Banks regarding the strengthening of internal control over financial reporting of employee rights were published. The directives provide a number of interpretations relating to the assessment of a liability in respect of employee rights and directives regarding internal control over the financial reporting process regarding employee rights, with a demand to recruit a qualified actuary, the identification and classification of liabilities in respect of employee rights, the existence of internal control for reliance on the actuary's assessment and validation and certain disclosure requirements.

The directive provides, *inter alia,* that a banking corporation that anticipates paying its employees benefits in excess of the contractual conditions when they leave, should take into account the number of employees who are expected to leave and the benefits the Bank expects to pay in excess of contractual conditions, in case of an early retirement of employees. As a result of the aforesaid directive, the expected number of employees who will take an early retirement was restated in the actuarial models on which the liabilities for pension payments and jubilee grants which the Bank's calculations are based upon, and the benefits in excess if the contractual conditions were taken into account.

The Bank implemented the aforesaid directive for the first time in the financial statements for 2011.

For more details see Note 1R in the financial statements below.

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 in the Bank's Allowance Committee, headed by the President and CEO, and in a committee of the Board of Directors for reviewing the financial statements (from 1 January 2013 in the Audit Committee of the Board of Directors) 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 were 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 field, the legal doctrine relating to which, even on important matters of principle, is still being formed and not yet entirely 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 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 accumulated 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 impairment of assets offered for sale.

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 International Accounting Standard No. 38 – "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).

Tax on income

The Group has implemented the International Standard IAS 12, as provided in the Public Reporting Directive "Taxes on Income" with effect from 1 January 2012. Following implementation of the amendment, the item, "retained earnings" included in capital as of 1 January 2012, was restated at NIS 43 million.

Current taxes and deferred taxes are charged to the statement of profit and loss, or carried directly to capital, if they derive from items that are recorded directly in capital.

The current tax is the amount of tax expected to be paid (or received) on taxable income for the tax year, calculated at the tax rates applicable according to the laws enacted up to the reporting date.

Deferred taxes

The recognition of deferred taxes receivable/payable is with regard to temporary differences between the book value of assets and liabilities for financial reporting purposes and their value for tax purposes.

Deferred taxes are measured\ at the tax rates expected to be applicable to the temporary differences at the date they are realized, based on the laws enacted until the balance sheet date.

A deferred tax asset in respect of carryforward losses, tax benefits and temporary differences allowable is recognized in the books when it is more likely than not that, in the future, there will be taxable income against which it will be possible to utilize them.

The Group does not record deferred taxes in respect of profits from investments in investee companies which the Bank intends to hold and not realize, and also in respect of dividends that are not expected to be distributed by the investee companies.

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, as follows:

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 – the Supervisor of Banks has yet to make a final decision. The final decision will be made, taking into account the timetable laid down in the United States, and progress made in the convergence process between the International and American Standard Boards.

The standards adopted by the Supervisor of Banks and their incidence with effect from 1 January 2011 are as follows:

Reporting standard	Topic	Exposure level
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors – The objective of the standard is to determine the criteria for selecting and changing accounting policy and the related treatment and disclosure.	No significant effect
IAS 21	The Effects of Changes in Foreign Exchange Rates – The objective of the standard is to prescribe how companies must include foreign currency transactions and foreign operations in the financial statements and how to translate financial statements into a presentation currency.	No significant effect
IAS 33	Earnings Per Share - The objective of the standard is to prescribe principles for determining and presenting earnings per share amounts to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity.	No significant effect
IFRS 2	Share-based Payment – The objective of the standard is to determine the financial reporting that companies entering into share-based payment must follow, particularly in transactions in which employees are granted options.	No significant effect
IAS 29	Financial Reporting in Hyperinflationary Economies – The objective of the standard is to establish specific standards for entities reporting in the currency of a hyperinflationary economy.	No significant effect
IAS 34	Interim Financial Reporting – The objective of this standard is to prescribe who has the duty of publishing of an interim financial report.	No significant effect
IFRS 3	Business Combinations – The objective of the standard is to improve the reliable relevance and comparability of the information that reporting companies provide in the financial statements with regard to a business combination and its impacts.	No significant effect
IAS 27	Consolidated and Separate Financial Statements – The standard determines the conditions for the preparation of consolidated statements and the way they are presented.	No significant effect
IAS 28	Investments in companies included on an equity basis– This standard prescribes the accounting treatment of investments in companies included on an equity basis and set out the conditions for implementing the procedures of the equity method.	No significant effect
IAS 36	Impairment of Assets – the objective is to establish procedures that a company must apply in order to ensure that its assets are not stated at an amount that exceeds their recoverable amount, and directives regarding recognition of a loss from the aforesaid impairment.	No significant effect
IAS 17	Leases – The objective of this standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.	No significant effect
IAS 16	Property, Plant and Equipment – The objective of this standard is to prescribe the accounting treatment for property, plant and equipment, so that users can obtain information regarding the fixed assets in the company.	No significant effect
IAS 40	Investment Property – The objective of this standard is to prescribe the accounting treatment of investment property and the related disclosure requirements.	No significant effect

Reporting standard	Topic	Exposure level
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations – The objective of this standard is to prescribe the accounting treatment of assets held for sale and the presentation and disclosure of discontinued operations. The aforesaid assets should be presented according to the lower of the book value and the fair value net of selling costs.	No significant effect
IAS 10	Events After the Reporting Period – The objective of this standard is to determine when a company must make an adjustment in its financial statements in respect of events after the balance sheet date and the required disclosures. If the "going concern" assumption is not appropriate, the company should not prepare its financial statements on a "going concern" basis.	No significant effect
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance – This standard implements the accounting treatment of government grants and assistance and the related disclosure.	No significant effect
IAS 31	Interests in Joint Ventures – prescribes the accounting treatment of interests in joint ventures and the reporting of assets, liabilities, income and expenses of a joint venture in the financial statements.	No significant effect
IAS 38	Intangible Assets – The objective of the standard is to prescribe the accounting treatment for intangible assets that are dealt with specifically in another standard. The standard requires an entity to recognize an intangible asset, if and only if, curtained defined criteria are met.	No significant effect

For additional details on accounting policies and implementation of the standards, see Note 1 to the Financial Statements.

Procedure for Approval of the Financial Statements

The Bank's Board of Directors is the entity ultimately responsible for supervision within the Bank and for the approval of the Bank's financial statements. Most of the members currently serving on the Board of Directors possess accounting and financial expertise. (14 out 15 directors - see below in the chapter, "Members of the Board of Directors").

The Financial Statements Review Committee of the Board of Directors ceased its function at the end of 2012. With effect from 2013, discussions on the financial statements (recommendation to the Board of Directors with regard to their approval) are conducted in the Audit Committee of the Board of Directors, pursuant to the provisions of Regulation 301 of the Supervisor of Banks.

Before the financial statements are submitted to the Audit Committee for discussion, the Bank's financial statements are discussed by the Disclosure Committee. The Disclosure Committee is a management committee comprised of all the members of the Bank's Management, the Chief Internal Auditor and additional senior managers of the Bank. The Disclosure Committee checks, *inter alia*, that the information in the financial statements is accurate, complete and presented fairly. (The Disclosure Committee was set up as part of the implementation of the Bank Supervision Department directive, which is based on Section 302 of the Sarbanes-Oxley (SOX) Law. See the chapter, "Controls and Procedures with regard to Disclosure in the Financial Statements" below.

Prior to the discussion of the financial statements by the full Board of Directors, discussions are held by the Audit Committee, with the participation of the President and Chief Executive Officer, the Chief Accounting Officer, the Chief Internal Auditor and others.

The background material sent to the members of the Audit Committee for discussion includes the minutes of discussions in the Disclosure Committee and its decisions, the draft Board of Directors' Report, the draft of the Management Review, the draft of the Financial Statements, information regarding the Bank's exposure to legal claims and a description of the new legal claims, the draft corporate governance questionnaire and background material for discussion on the appropriateness of the classification of problem customers and the provisions. The members of the committee also receive details of new disclosure requirements (if any) applicable to the Bank.

As part of the deliberations of the financial statements, the Audit Committee discusses the appropriateness of the provisions and the classifications of the Bank's problem debts, after the Chief Executive Officer has presented to the committee the extent of the provisions and the classification for problem debts and the changes and the trends in this area, and after the senior managers have presented the extent of the provisions and classifications for which they are responsible and have detailed the main factors of change in these areas. 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 Chief Accountant 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. If necessary, the subject of impairment of securities is presented by the senior manager from the Capital Market Division. If necessary, the subject of decline in value of the securities is presented by a senior manager from the Capital Market Division.

The Audit Committee submits its recommendations regarding the financial statements to the Board of Directors. The committee's recommendations relate, *inter alia*, (in accordance with the provisions of the Companies Regulations (Directives and Conditions Regarding the Process for Approving the Financial Statements), 2010) ("**the Companies Regulations**") to assessments and estimates made in connection with the statements; internal controls related to financial reporting, completeness and fairness of disclosure in the statements; the accounting policy adopted and the accounting treatment applied on the Bank's material interests; valuations, including assumptions and estimates on which they are based, which support the data in the financial statements.

Following the discussions on the financial statements in the Audit Committee, there is discussion on the final draft of the financial statements in the full Board of Directors, attended by the President and Chief Executive Officer, the Chief Accounting Officer, the Chief Internal Auditor, and when the discussion concerns the approval of the annual financial statements, all the other members of the forum of the Bank's Management. 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 Leumi Group's operations and the Chief Accountant 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 and accordingly approves the financial statements.

All the discussions of the Board of Directors, the Audit Committee and the Disclosure Committee regarding the financial statements are attended by 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 their presentation to the joint auditors to the Audit Committee of the Board of Directors in their discussions of the financial statements, any material weaknesses that may have arisen during the audit processes that they carried out, and after the Board is presented with the representations of the President and Chief Executive Officer and of the Chief Accountant regarding evaluation of the Bank's disclosure controls and procedures for the financial statements.

The composition of the Audit Committee is as stipulated by the Companies Law Regulations. The committee includes seven directors, including, pursuant to the Companies Law, three external directors, including a chairman of the committee. A further two committee members are external directors as stipulated by the Banking Supervision Department, and all the aforesaid external directors (pursuant to both Companies Law and the Banking Supervision Department Regulations) are independent directors. In addition, all committee members have financial and accounting expertise.

Disclosure Policy

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

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

The disclosure policy is based on the Directives for Reporting to the Public of the Supervisor of Banks and the provisional directives of the Israel Securities Authority, which have been adopted by the Supervisor of Banks.

In accordance with the said disclosure policy, Leumi aims to provide all material information necessary to understand its statements, which will be reported clearly and in detail.

Information given in the Directors' Report is prepared in accordance with directives for Reporting to the Public, particularly with regard 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 effect on the Bank, the control structure of the Bank and its organizational structure, legal proceedings, material agreements, and detailed information on other matters.

With regard to information which can be quantified monetarily, quantitative data is given, and with regard to 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 capital. In addition, disclosure is made of matters of public interest or of special sensitivity, such as matters connected with the structure of the Bank, its management, legislation affecting the bank and so on.

For the 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 all dubious cases, whether to make the necessary disclosure. In addition, the Disclosure Committee discusses the findings of the review of the examinations of the financial reporting control. Minutes of the Disclosure Committee are sent for perusal by the members of the Audit Committee of the Board of Directors.

See also the chapter, "Controls and Procedures regarding Disclosure in the Financial Statements" below.

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

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

In accordance with the Public Reporting Directives of the Supervisor of Banks in the Bank of Israel, the names of the sections and the classification of the statement of profit and loss items were changed with effect from 1 January 2012. The main changes are as follows:

- Net interest income includes interest income and expenses, including linkage differences to the index on the principal and does not include exchange rate differences on principal in foreign currency and linked to foreign currency.
- Noninterest income, including:
  - Noninterest financial income, income (expenses) from activity in derivative instruments, profit (loss) from investment in available-for-sale debentures (excluding interest), exchange rate differences, net, profit (loss) from investments in shares (including the sale of shares of investee companies), profit (loss) from the sale of loans and profit (loss) from tradable debentures (excluding interest).
  - Fees
  - Other income, including profit (loss) from the sale of buildings and equipment.

Comparative figures have been reclassified.

The net profit attributable to the shareholders of the banking corporation (hereinafter "net profit") of Leumi Group in 2012 amounted to NIS 931 million, compared with NIS 1,891 million in 2011 – a decrease of 50.8%.

The decrease in net profit in 2012, compared with 2011 is explained as follows:

	For the year ended 31 December *			
	2012	2011	Change	
	NIS millions		NIS millions	%
Net interest income	**7,408**	7,107	301	4.2
Expenses in respect of credit losses	**(1,236)**	(734)	(502)	68.4
Noninterest income	**4,774**	4,175	599	14.3
Operating and other expenses	**(9,100)**	(8,341)	(759)	9.1
Profit before taxes	**1,846**	2,207	(361)	(16.4)
Provision for tax	**(811)**	(418)	(393)	94.0
The Bank's share in the profits of companies included on equity basis	**(67)**	148	(215)	-
Net profit attributable to holders of non-controlling interests	**(37)**	(46)	9	(19.6)
Net profit attributable to shareholders of the banking corporation	**931**	1,891	(960)	(50.8)

* The symbols are according to their effect on net profit.

(1) The financial statements are prepared in reported values. The known consumer price index rose by 1.4% in 2012. The shekel appreciated in nominal terms by 2.3% against the U.S. dollar, and against the euro by 0.3%. The representative rate of exchange of the U.S. dollar on 31 December 2012 was NIS 3.733.

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

The loss of the Leumi Group in the fourth quarter of 2012 amounted to NIS 259 million, compared with a profit of NIS 618 million in the corresponding period last year.

	For the three months ended 31 December *			
	2012	2011	Change	Change
	NIS millions		NIS millions	%
Net interest income	1,784	1,679	105	6.3
Expenses in respect of credit losses	(386)	(385)	(1)	0.3
Noninterest income	1,394	1,203	192	15.9
Operating and other expenses	(2,611)	(2,121)	(490)	23.1
Profit before taxes	181	376	(195)	(51.9)
Provision for tax (tax benefit)	(233)	246	(496)	-
The Bank's share in the profits of companies included on equity basis	(199)	3	(202)	-
Net profit (loss) attributable to holders of non-controlling interests	(8)	(7)	(1)	14.3
Net profit (loss) attributable to shareholders of the banking corporation	(259)	618	(877)	-

* The marks are according to their effect on net profit.
For details on changes, see below
'

The following is the condensed statement of profit and loss for the eight last quarters:

	2012				2011			
	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Net interest income	**1,784**	1,872	1,924	1,828	1,679	1,841	1,776	1,811
Income (expenses) in respect of credit losses	**(386)**	(292)	(333)	(225)	(385)	(378)	(73)	102
Non-interest income	**1,395**	1,208	995	1,177	1,203	675	1,146	1,151
Operating and other expenses	**(2,611)**	(2,294)	(2,200)	(1,995)	(2,121)	(2,055)	(2,079)	(2,086)
Profit before taxes	**181**	494	386	785	376	83	770	978
Provision for taxes (tax benefit)	**233**	113	159	306	(246)	32	260	372
Profit after taxes	**(52)**	381	227	479	622	51	510	606
Group’s share in operating profits (losses) of companies included on equity basis after the effect of taxes	**(199)**	108	63	(39)	3	115	72	(42)
Net profit (loss) attributable to holders of non-controlling interests	**(8)**	(10)	(10)	(9)	(7)	(11)	(18)	(10)
Net profit (loss) attributable to shareholders of the banking corporation	**(259)**	479	280	431	618	155	564	554

Interest income in the Group in all of the four quarters of 2012 was stable and the slight changes from quarter to quarter arose from changes in the balances of loans and changes in Bank of Israel interest.

Net interest income of Leumi Group in 2012 amounted to NIS 7,408 million, compared with NIS 7,107 million in 2011, an increase of NIS 301 million, or 4.2%.

Net interest income in the Bank in 2012 amounted to NIS 5,338 million compared with NIS 5,351 million in 2011.

In the fourth quarter of 2012, net interest income amounted to NIS 1,784 million compared to NIS 1,679 million in the corresponding period in 2011, an increase of 6.3%.

The ratio of net interest income to the average balance of income-bearing monetary balance sheet assets is 2.04% (in annual terms) compared to 2.05% in the corresponding period in 2011.

The following shows the breakdown of net income according to main activity segment:

Segment	For the year ended 31 December		
	2012	2011	Change
	NIS millions		%
Households	**2,799**	2,601	7.6
Small businesses	**924**	908	1.8
Corporate banking	**1,548**	1,451	6.7
Commercial banking	**1,391**	1,350	3.0
Private banking	**350**	412	(15.0)
Financial management – capital markets	**382**	371	3.0
Other	**14**	14	-
Total	**7,408**	7,107	4.2

Total Interest Margin (excluding transactions in financial derivative instruments) in 2012 was 2.25%, compared with 1.36% in 2011. The interest margin including transactions in financial derivatives was 1.29% in 2012, compared with 1.00% in 2011. Pursuant to a directive of the Bank of Israel, the computation of the interest margin is carried out in accordance with rules that were in force until December 2011, i.e., the interest includes exchange rate differences. The interest margin excluding linkage differences and excluding financial instruments was 2.07%, compared with 2.05% in 2011.

The interest margin in the index-linked segment, including derivatives, is 0.57%, compared with 0.52% in 2011, as a result of the decrease in the balances of debentures which are relatively expensive sources.

The interest margin in the unlinked shekel sector, including derivatives, during the reporting period was 1.77%, compared to 1.81% in the corresponding period last year. The interest margin in the foreign currency segment increased from 0.59% in 2011 to 0.77% in 2012.

For further information, see Management Review, Exhibit C and Note 20 to the financial statements.
For further details on the changes in the net interest income before expenses in respect of credit losses by sector, see Note 27(A) to the financial statements.

The following table presents the breakdown of activities by linkage sector, and their contribution to net interest income:

	2012			2011			Changes in net interest income	
	Scope of activity in %	Contribution to income		Scope of activity in %	Contribution to income		NIS millions	
		%	NIS millions		%	NIS millions	Quantitative effect	Price effect
Israeli Currency:								
Unlinked	**46**	**70**	**5,144**	45	72	5,118	(471)	497
CPI-linked	**12**	**10**	**758**	12	10	677	92	(11)
Foreign currency, including foreign currency linked	**42**	**20**	**1,506**	43	18	1,312	155	39
	100		**7,408**	100		7,107	(224)	525

Expenses in respect of credit losses in the Leumi Group for 2012 amounted to some NIS 1,236 million, compared with NIS 734 million in the corresponding period in 2011, an increase of 68.4%. In the Bank, expenses in respect of credit losses amounted to some NIS 1,069 million in 2012, compared with NIS 600 million in the corresponding period in 2011, an increase of 78.2%.

In the fourth quarter, expenses in respect of credit losses amounted to NIS 386 million, compared with NIS 385 million in the corresponding period in 2011.

The overall rate of the expense in respect of credit losses for 2012 was 0.51% of total credit to the public (in annual terms), compared with a rate of 0.30% in 2011. The overall rate of the expense in respect of credit losses in relation to overall credit risk (balance sheet and off-balance sheet) was 0.26% and 0.20%, respectively.

In 2012, individual expenses in respect of credit losses amounted to NIS 923 million, compared with NIS 382 million in 2011. The increase in the individual allowance stems from a deterioration in the financial position of a number of customers.

The individual rate of expense in respect of credit losses in 2012 was 0.38% of the total credit to the public (in annual terms), compared with a rate of 0.15% for 2011. The individual rate of expense in respect of credit losses in relation to overall credit risk (balance sheet and off-balance sheet) was 0.19% and 0.11%, respectively.

In 2012, credit loss expenses on a collective basis amounted to NIS 313 million, compared with NIS 353 million in 2011. Credit loss expenses on a collective basis reflect the Bank's assessment of changes in the business environment.

The percentage of credit loss expenses on a collective basis in 2012 was 0.13% of total credit to the public (in annual terms), compared with a rate of 0.15% in 2011. The percentage of expenses in respect of credit losses on a collective basis in relation to overall credit risk (balance sheet and off-balance sheet) was 0.07% and 0.10%, respectively.

The balance of the allowance for credit losses on a collective basis as at 31 December 2012 amounted to NIS 2,631 million, compared with NIS 2,570 million as at 31 December 2011. The rate of the allowance for credit losses on a collective basis was 1.09% of total net credit to the public, and 0.56% of the total overall credit risk (balance sheet and off-balance sheet), compared with 1.06% and 0.72%, respectively, as at 31 December 2011.

The following table shows the breakdown of expenses (income) in respect of credit losses according to principal operating segments:

	For the year ended 31 December 2012		For the year ended 31 December 2011	
	NIS millions	Percentages*	NIS millions	Percentages*
Households	**71**	**0.1**	69	0.1
Private banking	**1**	**-**	(31)	(0.3)
Small businesses	**84**	**0.4**	89	0.4
Corporate banking	**933**	**1.3**	312	0.4
Commercial banking	**176**	**0.4**	218	0.4
Financial management and other	**(29)**	**(4.1)**	77	7.3
Total	**1,236**	**0.5**	734	0.3

* Percentage of total credit at year end.

The following table shows the breakdown of expenses (income) in respect of credit losses by principal sectors of the economy:

	For the year ended 31 December	
	2012	2011
	NIS millions	
Agriculture	**(10)**	(39)
Industry	**297**	64
Construction and real-estate	**105**	436
Trade	**193**	100
Hotels, accommodation and food	**(59)**	(80)
Transport and storage	**52**	20
Communications and computer services	**(48)**	(19)
Financial services	**568**	250
Other business services	**16**	(11)
Public and communal services	**42**	12
Private individuals – housing loans	**(13)**	(9)
Private individuals – other	**93**	10
Total - public	**1,236**	734
Total - banks	**-**	-
Total	**1,236**	734

The following is a summary of the expenses (income) in respect of credit losses:

	For the year ended 31 December	
	2012	**2011**
	NIS millions	
Individual allowance during the period	**1,217**	801
Reduction in individual allowance	**(294)**	(419)
Net increase carried to the profit and loss statement	**923**	382
Increase in respect of collective allowance carried to profit and loss statement	**313**	352
Total increase in expense in respect of credit losses	**1,236**	734

	For the three months ended 31 December	
	2012	**2011**
	NIS millions	
Individual allowance during the period	**482**	416
Reduction in individual allowance	**(91)**	(238)
Net increase carried to the profit and loss statement	**391**	178
Increase (decrease) in respect of collective allowance carried to profit and loss statement	**(5)**	207
Total increase in expense in respect of credit losses	**386**	385

The following table shows the breakdown of expenses (income) in respect of credit losses in the Group (the Bank and consolidated companies) that were recorded in the statement of profit and loss:

	For the year ended 31 December		
	2012	2011	Change
	NIS millions		%
The Bank	**1,069**	600	78.2
Arab Israel Bank	**15**	6	150.0
Leumi Mortgage Bank *	**(10)**	(16)	(37.5)
Leumi Card	**19**	15	26.7
Bank Leumi USA	**26**	49	(46.9)
Bank Leumi UK	**108**	36	200.0
Leumi Private Bank Switzerland	**6**	-	+
Leumi Romania	**1**	41	-
Leumi Leasing and Investments	**2**	3	(33.3)
Total expenses	**1,236**	734	68.4

* Activity merged with the Bank on 31 December 2012.

The following table presents the quarterly development of expenses (income) in respect of credit losses:

	2012				2011			
	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Individual allowance	391	211	160	161	178	241	24	(61)
Collective allowance	(5)	81	173	64	207	137	49	(41)
Total	386	292	333	225	385	378	73	(102)
Allowance as percentage of total credit to the public (on an annual basis)	0.64	0.48	0.56	0.38	0.64	0.64	0.13	(0.18)

Collective allowance expenses for credit losses increased in the second quarter of 2012 due to a change in the Bank's assessment of changes in the business environment. On the other hand, in the third and fourth quarter of 2012, there was an increase in individual allowances due to deterioration among a number of customers.

The following table shows the expenses in respect of credit losses as a percentage of the balance of credit to the public at the Bank's responsibility:

	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002
	%										
The banking system in Israel	(*)	0.38	0.40	0.73	0.71	0.21	0.52	0.69	0.88	1.13	1.36
Leumi Group	**0.51**	0.30	0.26	0.74	1.01	0.20	0.51	0.79	0.87	1.09	1.09

(*) Banking system data are not known on the date of publication of this Report.

Non-performing assets (*), impaired debts accruing interest income, problem commercial credit risk and unimpaired debts in arrears of 90 days or more:

(*) Impaired debts that do not accrue interest income.

On a consolidated basis	**31 December 2012**		
	Balance sheet	Off- balance sheet	Total
	NIS millions		
1. Problem credit risk: (1)			
Impaired credit risk	**7,486**	**515**	**8,001**
Subordinate credit risk	**2,022**	**109**	**2,131**
Credit risk under special supervision (2)	**2,779**	**664**	**3,443**
Total problem credit	**12,287**	**1,288**	**13,575**
Of which: Unimpaired debts, in arrears of 90 days or more (2)	**1,293**	**-**	**-**
2. Noninterest-performing assets:			
Impaired debts	**7,199**	**-**	**-**
Assets received in respect of credit cleared	**65**	**-**	**-**
Total noninterest-performing assets	**7,264**	**-**	**-**

On a consolidated basis	31 December 2011		
	Balance sheet	Off- balance sheet	Total
	NIS millions		
1. Problem credit risk: (1)			
Impaired credit risk	6,855	501	7,356
Subordinate credit risk	1,544	87	1,631
Credit risk under special supervision (2)	3,797	497	4,294
Total problem credit	12,196	1,085	13,281
Of which: Unimpaired debts, in arrears of 90 days or more (2)	1,556	-	-
2. Noninterest-performing assets:			
Impaired debts	6,792	-	-
Assets received in respect of credit cleared	75	-	-
Total noninterest-performing assets	6,867	-	-

Note: Balance sheet and off-balance sheet credit risk is presented before the effect of the allowances for credit losses and before the effect of deductible collateral for the purpose of a borrower and a group of borrowers.

(1) Credit risk impaired risk, subordinate or under special supervision
(2) Including in respect of housing loans in respect of there is an allowance according to the extent arrears and in respect of housing loans in respect of which there is no allowance according to the extent of arrears which are in arrears of 90 days or more.

Below is a summary of credit risk indices pursuant to the new directives:

	31 December 2012	31 December 2011
	%	
Balance of impaired credit to the public not accruing income as a percentage of the balance of credit to the public	**2.9**	2.7
Balance of credit to the public which is not impaired in arrears of 90 days or more as a percentage of the balance of credit to the public	**0.5**	0.6
Balance of the allowance for credit losses in respect of credit to the public as a percentage of the balance of credit to the public	**1.6**	1.6
Balance of the allowance for credit losses in respect of credit to the public as a percentage of the balance of impaired credit to the public not accruing interest income	**55.4**	59.7
Balance of allowance for credit losses to the public as a percentage of the total commercial balance sheet credit in respect of the public	**37.5**	38.0
Problem commercial credit risk in respect of the public as a percentage of total credit risk in respect of the public	**3.4**	3.3

	31 December 2012	30 September 2012	31 December 2011
	%		
Expenses in respect of credit losses as a percentage of the average balance of credit to the public (in annual terms)	**0.5**	0.5	0.3
Net write-offs in respect of credit to the public as a percentage of the average balance of credit to the public (in annual terms)	**0.5**	0.5	0.9
Net write-offs in respect of credit to the public as a percentage of the balance of the allowance for credit losses in respect of credit to the public (in annual terms)	**27.8**	31.9	52.2

Non-interest income of Leumi Group in 2012 amounted to NIS 4,774 million, compared with NIS 4,175 million in the corresponding period last year, an increase of NIS 599 million, or 14.3%.

Non-interest income of the Bank in 2012 amounted to NIS 3,265 million, compared with NIS 2,604 million in the corresponding period last year, an increase of 25.4%.

In the fourth quarter of the year, non-interest income amounted to NIS 1,394 million, compared with NIS 1,203 million in the corresponding period last year, an increase of 15.9%.

The changes in non-interest income in the Group derive from:

	For the three months ended			For the year ended		
	31 December 2012	31 December 2011		**31 December 2012**	31 December 2011	
	NIS millions		% Change	NIS millions		% Change
Non-interest financial income	**205**	177	15.8	**444**	11	+
Commissions	**1,107**	1,007	9.9	**4,199**	4,116	2.0
Other income	**82**	19	+	**131**	48	172.9
Total	**1,394**	1,203	15.9	**4,774**	4,175	14.3

The following shows the quarterly development of noninterest income:

	2012				2011			
	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Non-interest financial income	**205**	119	(25)	145	177	(336)	116	54
Commissions	**1,107**	1,050	1,022	1,020	1,007	1,005	1,018	1,086
Other income	**82**	39	(2)	12	19	6	12	11
Total	**1,394**	1,208	995	1,177	1,203	675	1,146	1,151

Details of non-interest financial income are as follows:

	For the year ended		
	31 December 2012	31 December 2011	Change
	NIS millions		%
Net expenses in respect of derivative instruments and net exchange rate differences	**(76)**	(418)	+
Profits from sale of available-for-sale debentures, net	**291**	265	9.8
Losses from investments in shares including dividends *	**(10)**	(149)	+
Realized and unrealized gains from adjustments of tradable debentures and shares to fair value, net	**239**	313	(23.6)
Total	**444**	11	+

* Including the record of an impairment of a nature other than temporary in respect of the investment in the shares of Partner Communication Ltd. amounting to NIS 160 million, net, and NIS 239 million, net, in the third quarter of 2011.

	For the three months ended		
	31 December 2012	31 December 2011	Change
	NIS millions		%
Net expenses in respect of derivative instruments and net exchange rate differences	**76**	74	2.7
Profits from sale of available-for-sale debentures, net	**28**	68	(58.8)
Gains (losses) from investments in shares including dividends	**13**	(9)	+
Realized and unrealized gains (losses) from adjustments of tradable debentures and shares to fair value, net	**88**	44	100.0
Total	**205**	177	15.8

The following table shows the development of the main items in noninterest financial income:

	2012				2011			
	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Income (expenses), net, in respect of derivative instruments and net exchange rate differences	**76**	(98)	(157)	103	74	(503)	11	-
Profits from the sale of available-for-sale of debentures, net	**28**	137	68	58	68	55	65	77
Profits (losses) from investments in shares, including dividends *	**13**	25	(34)	(14)	(9)	(207)	39	28
Realized and unrealized gains (losses) from adjustments of tradable debentures and shares to fair value, net	**88**	55	98	(2)	44	319	1	(51)
Total	**205**	119	(25)	145	177	(336)	116	54

* Including the record of an impairment of a nature other than temporary amounting to NIS 59 million in respect of the investment in the shares of Partner in the first quarter of 2012, NIS 101 million, net, in the second quarter of 2012 and NIS 239 million in the third quarter of 2011.

Noninterest income was affected as follows:

In the second quarter of 2012, an expense in respect of derivative instruments was recorded. Furthermore an expense in respect of a decline in the value of shares in Partner was recorded. These decreases were partly offset by an increase in the fair value of tradable debentures.

In the third quarter of 2012, the increase in noninterest income was mainly due to an increase in profits from the available-for-sale debentures.

In the fourth quarter of 2012, the increase in noninterest income was due to an increase in net income in respect of exchange rate differences and an increase in profits from tradable debentures, which were partly offset by a decrease in profits from the sale of available-for-sale debentures.

The main changes in the item, commissions, are as follows:

a. An increase in account management income amounting to NIS 31 million (3.7%).
b. An increase in income from conversion differences amounting to NIS 11 million (3.8%).
c. An increase in credit card income amounting to NIS 8 million (0.9%).
d. An increase in income from activity in securities amounting to NIS 42 million (5.3%).
e. An increase in commissions from financing transactions amounting to NIS 11 million (2.7%).
f. A decrease in income from credit handling and the preparation of contracts amounting to NIS 10 million (2.7%).
g. A decrease in distribution commissions of financial products amounting to NIS 11 million (4.6%).

Part of the increase in accounts management and activity in securities derives from the merger with Banque Safdié.

In connection with legal claims and discussions with the Antitrust Commissioner on subjects related to credit cards, see Note 18(H) to the financial statements.
In connection with the notice of the Antitrust Commissioner regarding the adjustment of fees, see Note 18(J).

There were no changes in the first three quarters of 2012. On the other hand, in the fourth quarter, there was an improvement in income from commissions, mainly income from credit handling and income from activity in securities, which was partly offset by a decrease in credit card income.

Income from commissions accounts for 46.1% of the operating and other expenses, compared with 49.3% in 2011.

Details of other income are as follows:

	For the year ended		
	31 December 2012	31 December 2011	Change
	NIS millions		%
Income from severance pay fund	**95**	-	-
Other income	**36**	48	(25.0)
Total	**131**	48	172.9

There was an improvement in other income in the third and fourth quarter of 2012 as a result of income from employee severance pay funds.

The development of non-interest income by main activity segment is as follows:

Segment	For the year ended		
	31 December 2012	31 December 2011	Change
	NIS millions		%
Households	**1,852**	1,937	(4.4)
Small businesses	**507**	496	2.2
Corporate banking	**637**	646	(1.4)
Commercial banking	**562**	585	(3.9)
Private banking	**662**	495	33.7
Financial management	**589**	49	+
Other	**(35)**	(33)	-
Total	**4,774**	4,175	14.3

The proportion of non-interest income from total income (i.e., net interest income and non-interest income) was 39.2%, compared with 37.0% in 2011.

Total operating and other expenses of Leumi Group in 2012 amounted to NIS 9,100 million, compared with NIS 8,341 million in 2011, an increase of 9.1%. Total operating and other expenses of the Bank in 2012 amounted to NIS 6,774 million, compared with NIS 6,198 in 2011, an increase of 9.3%.

Operating and other expenses in the fourth quarter of 2012 amounted to NIS 2,611 million, compared with NIS 2,121 million in the corresponding period in 2011, an increase of 23.1%.

a. Salary expenses in 2012 amounted to NIS 5,290 million, compared with NIS 5,061 million in 2011, an increase of 4.5%

The increase in salary expenses is primarily attributable to the expense of NIS 323 million in respect of bringing forward the retirement of employees as part of the program of reducing personnel in the Bank, as a result of a plan for a structural change in the Bank. This plan is spread over the year 2012 to 2014. Excluding the abovementioned expense, the change in salary expenses is a reduction of NIS 94 million, a decrease of 1.9%. The decrease in salary derives from a decrease in pension expenses as a result of profits recorded in the severance pay funds and provident funds, which are also used as a fund to cover employees' pension liability, compared with losses in 2011, On the other hand, an increase in salary expenses as a result of an increase in expenses from the merger of Banque Safdié in Switzerland and an increase in salary tax to 17% partly offset the abovementioned decrease.

The following table shows the quarterly development of salary expenses:

	2012					2011				
	Annual total	**4th quarter**	3rd quarter	2nd quarter	1st quarter	Annual total	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions									
Salary expenses, excluding special salary expenses	**4,703**	1,163	1,198	1,169	1,173	4,575	1,256	1,018	1,126	1,175
Actuarial changes and salary tax	**200**	17	144	25	14	-	-	-	-	-
Supplement to provisions for severance pay and pension after offsetting fund profits	**64**	11	(58)	112	(1)	473	(60)	226	131	176
Early retirement	**323**	123	150	50	-	-	-	-		-
Benefit in respect of sale of shares to employees	**-**	-	-	-	-	13	-	(3)	16	-
Total salary expenses	**5,290**	1,314	1,434	1,356	1,186	5,061	1,196	1,241	1,273	1,351

The changes in salary expenses were affected as follows:

In the first quarter of 2012, the total effect of an increase in employees' salaries was recorded with effect from 1 January. On the other hand, income from the severance pay funds and the remuneration fund was recorded throughout the year.

In the second quarter of 2012, expenses in respect of the advancement of employee retirement and an increase in pension provisions as a result of a decline in the profitability of the Bank employees' provident funds.

In the third quarter of 2012, a further increase was recorded in respect of the advancement of employee retirement in accordance with the decision of management and the Board of Directors of the Bank, which was partly offset by an increase in the profitability of the provident and severance pay funds which reduced the provisions for pension and severance pay.

In the fourth quarter of 2012, there was a decrease in salary expenses, due to a further improvement in the profitability of the provident and severance pay funds, which was partly offset by an increase in respect of the plan for the advancement of employee retirement.

Additional details on the components of salary expenses are as follows:

1. The Bank's actuarial obligation for pension and long-service grants in the financial statements are calculated using a capitalization rate of 4% determined by the Supervisor of Banks, and on the assumption of a real increase in salary based on past experience, and varying according to the age of the employee. The rates of increase vary between 0.8% and 7.2%.

2. In July 2012, the Capital Market, Insurance and Savings Department in the Ministry of Finance published a draft position paper concerning the update of demographic assumptions in pension funds and life insurance, including a possible update of mortality tables.
In accordance with the aforesaid, in the financial statements at 30 June 2012, the Bank updated its evaluation of demographic variables, based on the updated estimates of life expectancy included in the draft position paper. As a consequence, the Bank increased the liability for pension by some NIS 25 million before tax. In March 2013, the Capital Market, Insurance and Savings Division in the Finance Ministry published a circular on the subject, No further update was required to the amount of the pension liability.

3. As a result of an increase in salary tax to 17%, with effect 1 September 2012, instead of the plan to reduce salary tax to 15.5% from 1 January 2013, the Bank increased the pension liability by NIS 63 million.

For further details – see Note 15 to the financial statements.

Salary and related expenses (excluding early retirement expenses) account for some 54.6% of total operating expenses, compared with 60.7% in 2011.

b. Operating and other expenses, excluding salary, amounted to NIS 3,810 million in 2012, compared with NIS 3,280 million in 2011, an increase of 16.2%.

Additional significant changes were as follows:

1. An increase in other expenses amounting to NIS 394 million, of which NIS 400 million is in respect of expenses that were or were likely to be incurred by the Group as a result the investigations being carried out by the U.S. authorities regarding American customers.

2. An increase in building and equipment maintenance expenses amounting to NIS 51 million (5.1%).

3. An increase in depreciation expenses amounting to NIS 64 million (9.0%) mainly as a result of recording an interim impairment amounting to NIS 47 million.

4. A decrease in expenses in respect of professional services amounting to NIS 56 million (14.9%)

5. A decrease in marketing and advertising expenses amounting to NIS 16 million (5.7%).

Computer expenses in the Group, presented in Note 25 to the statements, do not include the computer expenses in the Bank, which are included among all the other expenses, due to the fact that the Computer Unit Center is within the Bank. These computer expenses mainly include the expenses of subsidiaries that purchase computer services and/or out-sourcing costs.

For further information, see Notes 24 and 25 of the financial statements

The following table shows the quarterly development of operating and other expenses and maintenance of buildings and equipment *:

	2012					2011				
	Annual total	**4th quarter**	3rd quarter	2nd quarter	1st quarter	Annual total	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions									
Depreciation	**775**	**226**	184	188	177	711	180	173	191	167
Amortization of intangible assets	**23**	**8**	4	5	6	2	2	-	-	-
Maintenance of buildings and equipment	**1,044**	**268**	268	258	250	993	262	249	241	241
Other expenses	**1,968**	**795**	404	393	376	1,574	481	392	374	327
Total operating and other expenses	**3,810**	**1,297**	860	844	809	3,280	925	814	806	735

* Excluding salary

The changes in operating and other expenses (excluding salary) in the first three quarters of the year were not material and were attributable to the fact that some of the expenses are not linear. On the other hand, in the fourth quarter, a provision was made for expenses that are likely to be incurred by the Group as a result of investigations being conducted by the U.S. authorities.

Operating expenses constitute 74.7% of total income, compared with 73.9% in 2011 and excluding the provision for early retirement and provisions in respect of the U.S. customers, 68.8%.

Total operating and other expenses (in annual terms) constitute 2.42% of the total balance sheet, compared with 2.28% for 2011.

Profit before taxes of Leumi Group for 2012 amounted to NIS 1,846 million, compared with NIS 2,207 in 2011, a decrease of 16.4%. The Bank's profit before tax amounted to NIS 760 million in 2012, compared to NIS 1,157 million in 2011, a decrease of 34.3%. In the fourth quarter of 2012, pre-tax profit amounted to NIS 181 million, compared with NIS 376 million in the corresponding period last year, a decrease of NIS 195 million.

Provision for taxes on profit of Leumi Group for 2012 amounted to NIS 811 million, compared with NIS 418 in 2011. The rate of the provision in 2012 was some 43.9% of the pre-tax profit, compared with 18.9% in 2011, an increase of some 25 percentage points. The increase in the rate of the tax provision stems mainly from an increase in deferred taxes in 2011as a result of change in the tax rate reduction plan amounting to NIS 326 million and an increase in expenses for which no deferred taxes were recorded. These changes were partly offset by an increase in deferred taxes, as a result of a change in income tax and profit tax rates, as detailed Note 26 to the financial statements.

Provision for tax

In the first quarter of the year, the tax rate was 39.0%, compared to 38.0% in the corresponding quarter in 2011, mainly due to an increase in disallowed expenses in respect of a provision for impairment in an investment in a subsidiary.

In the second quarter of the year, the tax rate was 41.2%, compared to 33.8% in the corresponding period in 2011, mainly as a result of negative exchange rate differences in respect of investments in foreign subsidiaries, compared to positive exchange rate differences in the corresponding period in 2011.

In the third quarter, the tax rate was 22.9%, compared to 38.6% in the corresponding period in 2011, mainly as a result of the change in deferred taxes in respect of an increase in profit tax to 17%.

In the fourth quarter, the tax rate reached 128.7%, mainly due to a provision for which no deferred taxes were recorded.

Profit after taxes for 2012 amounted to NIS 1,035 million, compared with NIS 1,789 million in 2011, a decrease of 42.1%. The loss after taxes for the fourth quarter of 2012 amounted to NIS 52 million, compared with a profit of NIS 622 million in 2011.

The Group share in the loss after taxes of companies included on equity basis amounted to a loss of NIS 67 million in 2012, compared with a profit of NIS 148 million in 2011. For details, see the section below, "Financial Management – Capital Markets" in the chapter, "Activity Sectors in the Group".

Most of the loss in this item derives from the contribution of the following companies:

1. The Israel Corporation Ltd. – A loss of NIS 110 million in 2012, compared to a profit of NIS 97 million in 2011.

2. Companies included on equity basis of Leumi Partners – a profit of NIS 34 million in 2012, compared with a profit of NIS 60 million in 2011.

Net profit before attribution to holders of non-controlling interests amounted to NIS 968 million in 2012, compared with a profit of NIS 1,937 million in 2011, a decrease of 50.0%. In the fourth quarter of 2012, there was a loss before attribution to holders of non-controlling interests amounting to NIS 251 million, compared with a profit of NIS 625 million in the corresponding period in 2011.

Net profit attributable to holders of non-controlling interests in 2012 amounted to NIS 37 million, compared to a profit of NIS 46 million in 2011.

Net profit attributable to the shareholders of the banking corporation for 2012 amounted to NIS 931 million, compared with a profit of NIS 1,891 million in the corresponding period in 2011, a decrease of 50.8%. In the fourth quarter of 2012, there was a loss attributable to the shareholders of the banking corporation amounting to NIS 259 million, compared with a profit of NIS 618 million in the corresponding period in 2011.

Return on Equity – Average for the Period to Shareholders of the Banking Corporation in Annual Terms:

	For the year	
	2012	2011
	%	
Net profit attributable to the shareholders of the banking corporation	**3.8**	8.3

	2012				2011			
	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
	%							
Net profit (loss) attributable to the shareholders of the banking corporation	**(4.0)**	8.0	4.7	7.5	11.2	2.7	10.3	10.1

Basic net profit per share attributable to the shareholders of the banking corporation was NIS 0.68 for 2012, compared with NIS 1.28 for 2011.

Structure and Development of Assets and Liabilities

Total Assets of the Leumi Group on 31 December 2012 amounted to NIS 376.2 billion, compared with NIS 365.9 billion at the end of 2011, an increase of 2.8%. The Bank's total assets on 31 December 2012 amounted to NIS 340.3 billion, compared with NIS 327.7 billion at the end of 2011, an increase of 5.5%.

Out of the Group's total assets, the value of assets denominated in or linked to foreign currency was some NIS 90.2 billion, some 24% of total assets. In 2012, the shekel appreciated against the US dollar by 2.3% and against the euro by 0.3%.

The change in the exchange rate of the shekel in relation to foreign currencies in general contributed to a decrease of some 0.4% in the total assets of the Group.

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 deposit management services are provided – amounted to NIS 989 billion, compared with some NIS 898 billion at the end of 2011 (about US$ 265 billion and US$ 241 billion respectively). With regard to the increase in total assets under management, see below.

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

	Consolidated			The Bank		
	31 December			31 December		
	2012	2011	Change	**2012**	2011	Change
	NIS millions		%	NIS millions		%
Total assets	**376,160**	365,854	2.8	**340,309**	322,720	5.5
Cash and deposits with banks	**54,621**	53,044	3.0	**49,438**	93,879	(47.3)
Securities	**56,408**	47,936	17.7	**49,475**	41,253	19.9
Credit to the public, net	**241,264**	241,320	0.0	**207,922**	151,608	37.1
Buildings and equipment	**3,705**	3,653	1.4	**3,248**	3,154	3.0
Deposits of the public	**289,538**	279,404	3.6	**274,482**	257,530	6.6
Deposits from banks	**4,073**	5,056	(19.4)	**7,066**	9,589	(26.3)
Debentures, notes and subordinated notes	**27,525**	29,999	(8.2)	**6,882**	7,719	(11.6)

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

	Consolidated			The Bank		
	31 December			31 December		
	2012	2011	Change	**2012**	2011	Change
	NIS millions		%	NIS millions		%
Documentary credits	**1,818**	2,055	(11.5)	**1,160**	1,376	(15.7)
Credit guarantees	**5,717**	7,280	(21.4)	**4,777**	6,199	(22.9)
Guarantees to purchasers of apartments	**13,520**	11,437	18.2	**13,520**	11,398	18.6
Other guarantees and liabilities	**16,242**	15,479	4.9	**15,813**	14,916	6.0
Derivative instruments*	**455,424**	416,117	9.4	**443,800**	403,205	31.3
Options of all kinds	**111,390**	130,733	(14.8)	**109,393**	129,339	(21.8)

* Including forward transactions, financial swap contracts, swaps, futures and credit derivative transactions. For further details, see Note 18a and 18**f** to the financial statements.

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

	Consolidated		
	2012	2011	Change
	NIS millions		%
Securities portfolios of customers	**527,582**	462,318	14.1
Of which: in the management of mutual funds (2) (3)	**60,482**	52,648	14.9
Provident funds (2) (3)	**53,372**	45,902	16.3
Supplementary training funds (2) (3)	**32,747**	24,385	32.2
Total	**613,201**	532,605	15.1

(1) Including a change 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 custodial services are provided.
(2) The Group in Israel does not manage mutual funds, provident funds or supplementary training funds.
(3) Assets of customers in relation to which the Group provides operational management services, including balances of the funds of customers who receive counseling at Leumi.

The increase in the value of the assets results from an increase in market values in Israel and abroad, which was partly offset by an increase in the level of activity.

Deposits of the Public

Deposits of the public with the Group amounted to NIS 289.5 billion at the end of 2012, compared with NIS 279.4 billion at the end of 2011, an increase of 3.6%.

The appreciation of the shekel against most foreign currencies contributed to a 0.6% decrease in total deposits of the public.

Debentures, notes and subordinated notes, the balance of which was some NIS 27.5 billion as at the end of 2012, compared with NIS 30.0 billion at the end of 2011. Deposits of the public, debentures and subordinated capital notes increased in 2012 by 2.5%, and together constitute 84.3% of total assets.

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

	31 December 2012				
	On demand	Short-term	Savings schemes	Earmarked deposits	Total
	%	%	%	%	NIS millions
Israeli currency:					
Unlinked	**45**	**56**	**-**	**30**	**151,962**
CPI-linked	**-**	**12**	**100**	**70**	**28,467**
Foreign currency:					
Including linked to foreign currency	**55**	**32**	**-**	**-**	**108,771**
Non-monetary	**-**	**-**	**-**	**-**	**338**
Total, as a percentage	**100**	**100**	**100**	**100**	
Total in NIS millions	**75,355**	**211,500**	**2,677**	**6**	**289,538**

	31 December 2011				
	On demand	Short-term	Savings schemes	Earmarked deposits	Total
	%	%	%	%	NIS millions
Israeli currency:					
Unlinked	46	55	1	40	145,719
CPI-linked	-	11	96	60	25,915
Foreign currency:					
Including linked to foreign currency	54	34	3	-	107,594
Non-monetary	-	-	-	-	176
Total, as a percentage	100	100	100	100	
Total in NIS millions	63,134	212,680	3,582	8	279,404

Developments in the various types of deposits were as follows:

- Unlinked shekel deposits of the public increased by NIS 6.2 billion (4.3%) compared with 31 December 2011, primarily as a result of the public's preferring to minimize exposure and risks.

- Deposits of the public denominated in or linked to foreign currency increased by NIS 1.2 billion (1.1%), compared with 31 December 2011, and after offsetting the effect of the changes in the exchange rate of the shekel, these deposits increased by 2.7%. Deposits of the public with the foreign subsidiaries in 2012 decreased by some 0.4%, or about NIS 0.1 billion, a result of an appreciation of the shekel against the foreign currencies in which the subsidiaries operate.

- CPI-linked shekel deposits increased by NIS 2.6 million (9.8%) compared with 31 December 2011, mainly in demand deposits.

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

	31 December	31 December	% change
	2012	2011	
Segment	NIS millions		
Households	**131,998**	130,276	1.3
Small businesses	**19,735**	18,109	9.0
Corporate banking	**26,291**	28,079	(6.4)
Commercial banking	**50,164**	46,527	7.8
Private banking	**38,338**	39,999	(4.0)
Financial management, capital markets and other*	**23,012**	16,314	46.1
Total	**289,538**	279,404	3.6

The following table sets out the quarterly development of deposits of the public by main activity segment:

	2012				2011			
	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Households	**131,998**	133,435	131,402	129,856	130,276	126,558	120,984	118,228
Small businesses	**19,735**	18,950	18,466	17,833	18,109	18,971	16,877	16,588
Corporate banking	**26,291**	23,692	23,038	23,896	28,079	28,377	26,340	26,865
Commercial banking	**50,164**	48,973	48,780	46,805	46,527	43,363	40,749	37,764
Private banking	**38,338**	39,126	37,864	38,025	39,999	35,815	34,072	36,116
Financial management – capital markets and other *	**23,012**	21,053	20,884	21,227	16,414	14,165	13,682	12,697
Total	**289,538**	285,229	280,434	277,642	279,404	267,249	252,704	248,258

* Includes mainly deposits of institutional bodies.

Deposits from Governments amounted to some NIS 451 million at the end of 2012. These deposits include deposits from government sources that were made available to the banks in former years mainly for restructuring debts of the kibbutzim, and also deposits for granting housing loans to eligible members of the public.

In 2012, there was a decline of some NIS 68 million in deposits from governments.

This item also includes deposits of foreign governments in overseas subsidiaries, which amounted to some NIS 191 million at the end of 2012, compared with NIS 123 million at the end of 2011.

Deposits with banks and deposits from banks

A. Deposits with banks (central and commercial):

	31 December 2012		31 December 2011	
	With central banks	With commercial banks	With central banks	With commercial banks
	NIS millions			
Israeli currency:				
Unlinked	**36,418**	**1,156**	36,131	791
CPI-linked	**-**	**277**	-	326
Foreign currency including linked to foreign currency	**4,691**	**9,940**	4,708	8,947
Total deposits with banks	**41,109**	**11,373**	40,839	10,064

Total deposits with banks increased by 3.1%.

B. Deposits from banks (commercial):

	31 December 2012	31 December 2011
	NIS millions	
Israeli currency:		
Unlinked	**1,694**	1,425
CPI-linked	**166**	213
Foreign currency including linked to foreign currency	**2,213**	3,418
Total deposits from banks	**4,073**	5,056

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 2012, deposits of the Group with the Bank of Israel amounted to NIS 36.9 billion, against which there were no loans from the Bank of Israel.

For further details, see page 114.

As may be seen from these tables, the liquidity position of the Group is extremely high, and the Group has net deposits with banks amounting to NIS 48.3 billion.

Credit to the public, net

Credit to the public in the Leumi Group at the end of 2012 amounted to NIS 241.3 billion, similar to the balance at the end of 2011 (in the Bank, NIS 207.9 billion similar to the balance at the end of 2011, including Leumi Mortgage Bank). Credit to the public constitutes 64.1% of total assets, compared with 66.0% at the end of 2011.

The appreciation of the shekel against most foreign currencies contributed to a decrease of 0.3% in total credit to the public. After canceling the effect of the appreciation, there was an increase of 0.3% in total credit to the public.

As well as granting credit to the public, the Group invests in the securities of companies, including securities of holding companies of banks, amounting to NIS 11,171 million at the end of 2012, compared with NIS 8,034 million at the end of 2011. These investments also involve credit risk.

The following table sets out the quarterly development of credit to the public by linkage segment:

	2012				
	31 March	30 June	30 September	31 December	Total for year
Unlinked in NIS millions*	**133,225**	**131,943**	**133,116**	**137,794**	**137,794**
% increase (decrease)	**0.1%**	**(1.0%)**	**0.9%**	**3.5%**	**3.6%**
CPI-linked in NIS millions	**53,048**	**55,189**	**55,991**	**54,847**	**54,847**
% increase (decrease)	**1.2%**	**4.0%**	**1.5%**	**(2.0%)**	**4.6%**
Foreign currency including foreign currency-linked in NIS millions	**54,227**	**54,295**	**52,357**	**48,623**	**48,623**
% increase (decrease)	**(2.9%)**	**0.1%**	**(3.6%)**	**(7.1%)**	**(13.0%)**
Total in NIS millions	**240,500**	**241,427**	**241,464**	**241,264**	**241,264**
% increase	**(0.3%)**	**0.4%**	**-**	**(0.1%)**	**-**

* Including non-monetary items.

Total credit to the public by the Group in Israel amounted to some NIS 215 billion at the end of 2012, similar to 2011.

The following table sets out the mix of credit to the public by linkage segment:

	31 December 2012		31 December 2011		Change
	NIS millions	% of mix	NIS millions	% of mix	%
Unlinked*	**137,794**	**57**	133,031	55	3.6
CPI-linked	**54,847**	**23**	52,423	22	4.6
Foreign currency and linked to foreign currency	**48,623**	**20**	55,866	23	(13.0)
Total	**241,264**	**100**	241,320	100	-

* Including non-monetary items.

Credit to the public in unlinked shekels increased by NIS 4,763 million, or 3.6%, and index-linked credit to the public increased by NIS 2,424 million, or 4.5%. The decrease in foreign currency and foreign currency-linked credit to the public amounted to NIS 7,243 million, or 13.0%, and after neutralizing the effect of the changes in the exchange rate of the shekel, credit to the public in foreign currency and linked to foreign currency increased by 11.6%.

Total credit to the public that was offset deriving from deposits according to the extent of their collection amounted to NIS 6.1 billion in the Group. Some 79.4% of such credit is granted from government deposits according to the extent of their collection for financing the purchase of an apartment (housing loans).

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

	31 December 2012	31 December 2011
	NIS millions	
US dollar	**32,924**	38,825
Euro	**6,622**	6,778
Other currencies	**9,077**	10,263
Total	**48,623**	55,866

The following table sets out the development of indebtedness to the construction and real estate segment:

	31 December 2012	31 December 2011	Change
	NIS millions		%
Balance sheet credit risk	**51,007**	49,557	2.9
Guarantees to apartment purchasers*	**5,905**	4,966	18.9
Other off-balance sheet risk	**22,895**	25,216	(9.2)
Total	**79,808**	79,739	0.1

* Weighted according to balance sheet value.

Total credit risk of the construction and real estate sector in Israel (according to the report by sector of the economy in Exhibit E to the Management Review) increased by 2.2% in 2012. The credit risk of the construction and real estate sector in Israel constitutes some 22.3% 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, total indebtedness in the sector at the Bank amounts to some 19.7% of total indebtedness in Israel. There was no sectoral excess of credit, compared with an excess of 4.5% at the end of 2011.

The following table sets out the development of credit to the public by principal operating segment:

Segment	**31 December 2012** NIS millions	31 December 2011	Change %
Households	**90,492**	83,045	9.0
Of which: Housing loans	**61,998**	56,104	10.5
Small businesses	**21,733**	20,039	8.5
Corporate banking	**70,252**	77,571	(9.4)
Commercial banking	**49,908**	50,536	(1.2)
Private banking	**8,170**	9,074	(10.0)
Financial management, capital markets and others	**709**	1,055	(32.8)
Total at end of period	**241,264**	241,320	0.0

Total business credit (commercial and corporate) decreased by 6.2% to NIS 120.2 billion in 2012. Total private credit (households, small businesses and private banking) increased by 7.3% to NIS 120.4 billion in 2012.

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

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

	2012				2011			
End of period balances	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Households	**90,492**	89,084	86,128	84,039	83,045	81,579	79,720	77,826
Of which: Housing loans	**61,998**	60,888	58,699	56,811	56,104	55,246	54,093	52,755
Small businesses	**21,733**	21,014	20,819	20,207	20,039	19,604	19,371	19,153
Corporate banking	**70,252**	70,895	74,815	77,660	77,571	76,507	74,001	73,404
Commercial banking	**49,908**	51,088	49,834	49,257	50,536	50,108	46,376	46,116
Private banking	**8,170**	8,508	8,658	8,451	9,074	8,171	7,587	7,666
Financial management, capital markets and others	**709**	875	1,173	886	1,055	1,346	1,293	906
Total at end of period	**241,264**	241,464	241,427	240,500	241,320	237,315	228,348	225,071

Lien 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 lien in favor of the Bank of Israel on its rights to receive amounts and monetary shekel payments that are or will be payable to the Bank from time to time, from its customers who are corporations (established according to the laws of the State of Israel), that are not in arrears with their repayments to the Bank of loans received from the Bank, of which the average duration of the credit does not exceed three years, and were granted or will be granted to these customers by the Bank. The amount of the lien is equal to the total of the amounts to be secured by the debenture, from time to time, up to an aggregate of NIS 1.1 billion.

This lien secures funds that are required for the Bank's operations for purpose of its activities with the CLS (Continuous Link Settlement) Clearinghouse.

For further details, see page 114 of the Report.

Credit risk by economic sector

The following table sets out the development of overall credit risk to the public [(1)] by principal sector of the economy:

Sector of the economy	**31 December 2012** Overall credit risk to the public	Percentage of total	31 December 2011 Overall credit risk to the public	Percentage of total
	NIS millions	%	NIS millions	%
Agriculture	**2,086**	**0.6**	2,217	0.6
Industry	**43,430**	**12.0**	49,483	13.8
Construction and real estate [(2)]	**79,807**	**22.0**	79,739	22.2
Electricity and water	**3,679**	**1.0**	1,750	0.5
Trade	**32,124**	**8.8**	31,117	8.7
Hotels, accommodation and food services	**5,283**	**1.4**	5,001	1.4
Transportation and storage	**6,371**	**1.7**	6,732	1.9
Communications and computer services	**6,359**	**1.7**	8,486	2.4
Financial services	**39,500**	**10.9**	37,226	10.4
Other business services	**11,099**	**3.1**	12,540	3.5
Public and community services	**9,034**	**2.5**	8,233	2.3
Private individuals - housing loans	**65,439**	**18.0**	59,270	16.5
Private individuals – other	**59,101**	**16.3**	56,837	15.8
Total	**363,312**	**100.0**	358,631	100.0

(1) Including off-balance sheet credit risk and investments of the public in debentures, and other assets in respect of derivative instruments.

(2) Including housing loans which have been extended to purchasing groups in the process of building amounting to NIS 1,067 million and off-balance sheet risk amounting to NIS 2,164 million, compared to NIS 932 million and NIS 2,032 million, respectively, as of 31 December 2011.

Below is a distribution of credit risk in the real estate and construction sector by principal operating area:

	31 December 2012 Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk	31 December 2011 Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk
	NIS millions					
Construction for trade and services	**5,027**	**2,911**	**7,938**	4,154	3,437	7,591
Construction for industry	**850**	**394**	**1,244**	851	356	1,207
Construction for housing	**6,457**	**16,788**	**23,245**	7,357	15,257	22,614
Income generating assets	**23,280**	**2,649**	**25,929**	23,894	2,889	26,783
Other	**12,754**	**8,697**	**21,451**	13,301	8,243	21,544
Total construction and real estate sector	**48,368**	**31,439**	**79,807**	49,557	30,182	79,739

See Exhibit E to the Management Review for further details as to the distribution of credit to the public by sector of the economy.

Part of the information set out 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 section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" on page 54 above.

Industry Sector:

The following discussion is by industry sub-sector:

Industry Sectors:

Among companies operating in the industry sector, 2012 was characterized mainly by uncertainty, both in terms of sales turnover and in terms of production costs.

The central event to which exporters were exposed in 2012 was the continuation of the economic crisis in countries in Europe and its implications for the Israeli market.

Raw material prices also had a significant effect on the companies' profitability, and there is a difficulty in partly or wholly "rolling over" prices to end-customers. Raw material prices in 2012 were characterized by high volatility, a fact which caused companies to reduce inventory.

The companies' profitability was affected during the year by fluctuations in exchange rates.

a. Metal

In Israel, the metals sector incorporates companies operating in a wide range of areas, such as: processing and marketing flat tin and steel products, profiles and pipes, trade in special formats, anti-corrosion protection, the manufacture and marketing of greenhouses, the production and marketing of construction iron, communication cabinets, electric pylons, etc. The metal market is affected by the prices of raw materials and the profits of most of the companies in the sector are derived from timing differences between the date of purchasing inventory and the date it is sold. Raw material prices in 2012 were characterized by an ongoing and continuous decline compared to last year's price levels.

In general, the sector maintained stability in the level of sales during 2012. However, because of a fall in raw material prices, there was an erosion in the profitability of companies in the sector, compared with 2011. The slowdown in global activity had a low impact on the metal sector, because the sector is not export-biased. The slowdown in the domestic market, in sectors using metal products in large volumes, such as the construction industry (and as is generally known, there is fear of a credit squeeze in this area), is likely to lead to a slowdown in sector activity.

b. Hi-tech Companies

Macro-economic data for 2012 published so far indicate a continuation of the slowdown that began in the industry as a result of the global economic crisis.

The main growth engine in the hi-tech industry is exports, and, as such, the sector is greatly influenced by developments abroad: uncertainty, the financial crisis in Europe and its repercussions, the investment policy in infrastructures of various countries and growth in developing countries all affect sector growth. Furthermore, the sector is exposed to the appreciation of the shekel against the dollar and against other currencies. (In 2012, the sector benefited from the strengthening of the dollar against the shekel, while the recent period was characterized by much erosion in the exchange rate against the dollar.)

Against the backdrop of the above, there was a trend in previous years to divert sector exports from western countries (the Eurozone and the United States) to countries in Asia, Africa and Latin America and turn them into a significant export destination for the hi-tech industry. The increase in demand in the developing countries reduces the dependency of Israeli exports to the US as a principal target.

Diamond sector

The global diamond sector has undergone a degree of turbulence in recent years. After a significant increase in trading volumes and prices throughout the two-year-period (from the second quarter of 2009 to the second quarter of 2011) which was primarily attributable to the expansion of the retail set-up in China and India. From the second half of 2011, and until today, there has been a continuing trend of falling volumes in trade and prices, as a consequence of the change in trend in China and India and the state of the global economy. The retail market for polished diamonds in the United States has retained its stability in recent years.

The Israeli diamond sector is characterized by the following activities: trade, marketing and preparation of diamonds for polishing, and, in smaller volumes, diamond-polishing. In 2012, it was characterized by a significant fall in trading volumes, both in the export of polished diamonds (a decrease of 22.8% from 2011) and in the export of uncut diamonds (a decrease of 20.1% compared with 2011). This state of slowed activity continues to characterize the sector in Israel at the beginning of 2013.

Residential real estate

The residential construction sector in Israel in 2012 was characterized by a certain awakening and a decrease in the level of risk, even though the level of uncertainty remained relatively high. At the same time, governmental/regulatory intervention continued, against a backdrop of housing prices which continued to increase (albeit at a rate which was moderate compared to previous periods).

Below are a number of characteristics that affected the sector in 2012:

1. In 2012, demand for the purchase of apartments began to recover. However, demand was lower than its level in the peak period, *inter alia*, against a backdrop of moderation in the activity of investors in the housing market. One way in which moderation in demand is expressed is an increase in "shelf life" (the time required for a sale) of a new apartment from the date of starting to build.

2. The level of housing construction starts has been on a downward trend since the second half of 2011, with the present level of building starts falling to a record low of recent years, lower than the average annual increase in the number of households in Israel. This trend has yet to be reflected in the data for the number of apartments under active construction, whose level remains relatively high. However, it is expected to have a gradual impact on active construction data throughout 2013.

3. An examination of the new apartment market indicates that the past year was characterized by equilibrium of demand and supply. This balance was largely achieved thanks to an increase in the number of building starts, particularly during 2010-2011, while at the same time, there was, as stated above, demand fell slightly. As a result of this combination, the number of months of supply in the past year stabilized at around 12 months. This level supports continued moderation against the pressures for an increase in housing prices (which, in the first ten months of 2012, rose by a nominal rate of 3.9%, compared to an increase of 5.4% in 2011 and an increase at two-digit rates between 2008 and 2010).

4. In examining housing prices by region, it appeared that in most regions, in 2012, housing prices returned to the point they were during 2011. This excludes the Haifa and the North where prices continued to rise significantly, even after the level returned to the point at which they were at the beginning of 2011. In these regions, the shortfall in the supply of apartments was particularly noticeable which ostensibly explains the price increases therein.

5. Regulatory intervention, as aforesaid, continued, mainly on the side of demand (the mortgage market).

Income-generating Property

Non-residential construction in Israel includes income-generating property, mainly office buildings, shopping, commercial and business centers, and other buildings used for industry and trade. The income-generating real estate market for offices, which serves the business segment, closely correlates with the business product growth and the commercial real estate market is greatly affected by developments in household private consumption.

In the area of commerce, a stabilizing trend was noted in 2012, as evidenced in relatively high occupancy rates, the relative stability of rents collected, and rates of return on assets.

In the area of office construction, in recent years, following the financial crisis, there has been an increase in the supply of new building for offices, which occurred, *inter alia*, against a backdrop of entrepreneurs diverting their activity from the area of real estate housing to income-generating property.

On the other hand, a trend of increase in initiation and construction of office buildings was noticed, mainly in the Tel Aviv and Dan Region, which exceeds the growth rate of demand for this type of building.

Infrastructure

National projects - In recent years, including 2012, the moderate increase in the execution of large-volume national infrastructure projects continued, primarily in PPP (Public Private Partnership) formats (which are based on collaboration between the private and public sectors). The projects are financed in a Project Finance format against tenders issued by the State/authorities or against the allocation of licenses. Large infrastructure projects have been established mainly in the areas of transport, communication, water, energy and electricity (including private power stations based on gas and/or solar energy). It is expected that this trend will also continue into 2013, particularly in the area of energy and its various derivatives.

Contractors and infrastructure – Government investment, public investment and the investment of the business sector in infrastructure increased during 2012. The volume of housing construction, the volume of non-housing construction (office and commerce buildings) and public construction, as mentioned, led to a stabilization of the activity of performance contractors, and even to a certain shortfall in manpower in the sector. These trends have yet to be reflected in a significant improvement in the profitability of performance of infrastructure contractors, and volatility is still high.

Trade and Services

a. Trade

The retail sector experienced a recovery in 2012, which was felt by most of the companies, with a slight increase in sales, on the one hand, and erosion in profit rates, on the other hand. In contrast, wholesale trade prices remained relatively stable, and there was, in fact, a slowdown which began with the social protest in the summer of 2011. In some of the sub-sectors, the effects of the streamlining procedures were considered to have been somewhat successful in halting the erosion in profits.

In addition, it was apparent that there was an expansion in products intended for current consumption, while the trend for durable goods was in the opposite direction.

b. Food chains

The sector comprises the two largest public chains (and their sub-chains) whose sales account for more than 50% of the sales of the sector, and also comprises the smaller chains, whose share is consolidated to create a "fourth chain"(established in 2005 by owners of then-large supermarkets, who amalgamated as a joint purchasing force to buy from suppliers and established a joint a joint private brand).

The sector underwent significant changes in 2012. The profitability rates of companies in the industry, and more steeply, those of the large chains, were eroded as a result of increased competition, the social protest, the economic slowdown and the chains' exposure to price hikes initiated by the suppliers, following increases in raw material prices, with the chains not being able to roll over the full amount of the price increases to the end-consumer.

Competition in the sector increased substantially in 2012 and the chains opened new branches at a faster rate than the market growth rate. The medium-sized and small chains act consistently to increase their share of the market at the expense of the large chains. Mergers of the small chains which took place in 2012, and the entry of new players into the sector intensified the competition. Competition in the food retail sector results in erosion in rates of profitability and requires the companies to make adjustments in the expense structure.

c. Hotels:

In 2012, the growth trend in tourism in Israel continued, reflected in an increase in the number of tourist entries and the number of overnight stays in hotels, notwithstanding the geographical-political instability in our region (including the unrest in neighboring Arab countries) and the economic situation in Europe.

In 2012, there was a slight rise in the number of incoming visitors to Israel, compared with 2011. This year, the number of incoming tourists to Israel (including single-day visitors) stood at 3.5 million.

The number of overnight stays in the first ten months of 2012 was 18.7 million, a 3%-increase over the corresponding period of the previous year. The average room occupancy on a national basis reached 66.6% during the period, a slightly higher (1%) than the occupancy rate in the corresponding period in 2011.

d. Communications Services:

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

The key issues worthy of note in this sector in 2012 were:

- The communications industry was substantially impacted last year by the regulatory body, whose various directives led to an increase in competition and the erosion of profitability in the various companies. This impact shows up in the various segments of the industry. In the cellular field, barriers to entry were removed through a lowering of connectivity fees and the cancelation of exit penalties. Two new competitors entered the market resulting in a string of "unlimited" packages, as well as a number of mobile virtual network operators (MVNO) commencing operations. In the multi-channel television segment, it was decided to expand the "Idan+" broadcasting set-up, and the companies were forced to market relatively low-priced "narrow" packages. The fixed line communication segment continued to examine of ways of maintaining a wholesale market in communication infrastructure. It appears that the market trend for convergence in the large communication groups is continuing, allowing them to offer a wide range of communication services under one roof.

Details regarding the main sub-sectors are as follows:

1. **Fixed line communications** – The trend of market convergence for large communication groups is also becoming apparent in the fixed-line communication segment and it is evident that the companies operating in this area have begun to combine in offering their customers additional communication products.

2. **Cellular communications** – The cellular segment represents a dominant component of the total activity in the communication sector. The opening up of cellular communication to competition and the significant reforms led by the regulator have contributed to substantially intensify competition in this field. In 2012, the veteran cellular companies reported a decrease in profitability and cash-generating ability, compared with previous years, mainly as a result of the actions of the regulator and the entry of new players who implanted the "unlimited" package into this segment. As outlined above, the Communications Ministry is acting to increase competition in this sector. The impairment in the profit of these companies is partly offset by comprehensive streamlining measures.

3. **Multi-channel television** – There are two companies operating in this sector, and they are engaged in lively competition. The companies continue to invest in broadcast content, in order to penetrate and preserve various sections of the market. No significant impact from "Idan+" broadcasts has yet been felt by the companies operating in the sector. During the year, the companies were obliged to market "narrow" packages including a number of basic channels at low prices and it is too early to determine the effect of the "narrow" packages on the companies. The opening up of the wholesale market to fixed-line communication companies is expected to give cellular companies an opportunity to provide Internet television (IPTV) services that will result in an increase is competition in the field.

4. **Internet access –** The provision of broadband Internet access services may be divided into two parts: the provision of an infrastructure through traditional fixed line communications and the provision of access services through the service providers (almost all of which also currently provide international communications services). Three large companies currently operate in the sector, sharing the market relatively equally among them. The penetration rate in the sector is relatively high (more than 75% of Israeli households), and therefore, growth rates in the sector are not high. Two of the largest companies operating in the field were purchased by the cellular companies.

Households and Private Consumption

Private consumption expenses rose in real terms in 2012 by 2.7%, and in terms of private consumption per capita, there was an increase of 0.8%. These figures indicate a slowdown from 2011, in which real consumer expenditure rose by 3.8%, due to the decrease in the consumption of durable products. The slowdown in private consumption expenditure in 2012 commenced in the second quarter of the year, against a background of a slowdown in economic activity in the economy as a whole.

Credit cards

Data from the Central Bureau of Statistics indicate an increase in the growth rate of the volume of purchases by credit card. The growth rate was 6.7% at fixed prices in 2012 compared with 3.7% in 2011. The improvement in the growth rate in the credit card sector is reinforced against the background of a fall in the growth rate in the economy between the two periods.

Mortgages - housing loans

The mortgage sector ended 2012 with an increase of 3% in the provision of mortgages over the corresponding period in the previous year. On the supply side, there was a 13% fall in the number of building starts. The number of months of supply of apartments in December 2012 stood at 11.6, with the average number since the beginning of the year being around 12.1 months of apartments. This number reflects the number of months which will satisfy the inventory of apartments remaining for sale given the rate of monthly sales in the final month.

During 2012, the Supervisor of Banks issued a number of directives related to the housing loans market, as follows:

1. **Housing loans at variable interest**

On 3 May 2011, the Supervisor of Banks published a directive, pursuant to which a banking corporation may approve and extend a housing loan, if the ratio between the part of the housing loan at variable interest (i.e., loans, the interest on which is liable to vary over a period shorter than five years from the date of its approval) and total housing loan does not exceed 33.3%.

This directive will apply to loans for which approval was given in principle from 5 May 2011 and thereafter, and to loans the refinancing of which was approved by the bank since 5 May 2011 (except for refinancing where there was a reduction in the weighting of the variable interest component of the loan and its amount).

It was further provided that the banking corporation is entitled not to apply the restriction to certain types of housing loans as set forth below, if the ratio between the total of variable interest housing loans to the total of housing loans for which approval in principle was given since 5 May 2011, extended each quarter, does not exceed 33.3%. The loans in question are as follows:

a. Housing loans in foreign currency to a foreign resident;

b. Bridging loans whose original repayment period is up to three years;

c. Loans for any purpose up to NIS 100,000

2. Collective allowance – Housing loans

On 1 May 2011, the Banking Supervision Department published a letter requiring the calculation of the collective allowance for credit losses in housing loans as defined in Proper Conduct of Banking Business Regulation 451 of the Bank of Israel. This was in light of the content of their letter according to which the rapid increase in housing loans, which had occurred in recent years, had not been reflected in allowances by extent of arrears.

In a letter of the Bank of Israel of 9 May 2011, it was determined that the initial effect of the calculation of the collective allowance as of 1 January 2011 will be included within the framework of the effect of the initial application of the new directives for the measurement and disclosure of impaired debts, credit risk and allowance for credit losses.

3. Allocation of capital – housing loans

On 19 February 2013, the Supervisor of Banks published a draft update of directives regarding real estate for housing. For details of the main points of the directives included in the new draft, see page 53 above.

Below is additional data on total credit:

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

Credit ceiling in NIS thousands		**31 December 2012**			31 December 2011		
		Percentage of total number of borrowers	Percentage of total balance sheet credit	Percentage of total off-balance sheet credit	Percentage of total number of borrowers	Percentage of total balance sheet credit	Percentage of total off-balance sheet credit
From	To	%					
0	80	**83.4**	**6.3**	**20.1**	83.3	6.0	18.4
80	600	**13.8**	**18.5**	**11.2**	14.1	17.6	11.1
600	1,200	**1.7**	**10.7**	**3.0**	1.6	9.3	2.7
1,200	2,000	**0.5**	**5.1**	**2.1**	0.4	4.5	1.9
2,000	8,000	**0.4**	**8.9**	**5.5**	0.4	8.8	5.4
8,000	20,000	**0.1**	**7.2**	**5.2**	0.1	7.2	5.7
20,000	40,000	**0.05**	**7.1**	**6.4**	0.05	7.2	6.6
40,000	200,000	**0.04**	**15.8**	**17.8**	0.04	17.0	19.4
200,000	800,000	*** 0.01**	**13.0**	**21.5**	* 0.01	13.9	17.9
Above 800,000		**** 0.00**	**7.4**	**7.2**	** 0.00	8.5	10.9
Total		**100.0**	**100.0**	**100.0**	100.0	100.0	100.0

* - In 2012, 154 borrowers and in 2011, 143 borrowers
** In 2012, 17 borrowers and in 2011, 25 borrowers.

See Note 4F to the financial statements for further details about the distribution of credit by size.

The following table sets out details of balances of credit to the public and off-balance sheet credit risk exceeding NIS 800 million per single borrower, based on a more detailed cross-section of credit size by economic sector as of 31 December 2012:

1. Credit risk by size of credit to the borrower as of 31 December 2012:

Credit ceiling in NIS millions		Number of borrowers		Balance sheet credit		Off-balance sheet credit	
		Total	Of which, related parties	Total	Of which, related parties	Total	Of which, related parties
From	To				In NIS millions		
800	1,200	**9**	**-**	**5,054**	**-**	**3,908**	**-**
1,200	1,600	**3**	**-**	**3,950**	**-**	**235**	**-**
2,000	2,400	**3**	**1**	**4,312**	**2,016**	**2,119**	**-**
2,800	3,200	**1**	**-**	**2,878**	**-**	**62**	**-**
3,200	3,301	**1**	**-**	**2,175**	**-**	**1,126**	**-**
Total		**17**	**1**	**18,369**	**2,016**	**7,450**	**-**

Credit risk by size of credit to the borrower as of 31 December 2011:

Credit ceiling in NIS millions		Number of borrowers		Balance sheet credit		Off-balance sheet credit	
		Total	Of which, related parties	Total	Of which, related parties	Total	Of which, related parties
From	To				In NIS millions		
800	1,200	14	1	7,592	708	5,529	147
1,200	1,600	5	-	4,527	-	2,011	-
1,600	2,000	3	-	2,535	-	2,559	-
2,000	2,400	1	-	1,640	-	566	-
2,400	2,710	2	-	5,009	-	293	-
Total		25	1	21,303	708	10,958	147

2. Credit risk according to economic sectors as of 31 December 2012:

	Number of borrowers	Balance sheet credit	Off-balance sheet credit
	Total	Total	Total
		In NIS millions	
Industry	**4**	**2,298**	**4,187**
Construction and real estate	**5**	**3,699**	**1,470**
Public and community services	**1**	**778**	**235**
Communications and computer services	**1**	**2,878**	**62**
Financial services	**4**	**5,332**	**146**
Electricity and water	**1**	**2,175**	**1,126**
Trade	**1**	**1,209**	**224**
Total	**17**	**18,369**	**7,450**

Credit risk according to economic sectors as of 31 December 2011:

	Number of borrowers	Balance sheet credit	Off-balance sheet credit
	Total	Total	Total
		In NIS millions	
Industry	9	6,948	5,961
Construction and real estate	8	5,759	2,293
Public and community services	1	853	19
Communications and computer services	2	2,917	846
Financial services	3	3,686	356
Electricity and water	1	977	790
Trade	1	163	693
Total	25	21,303	10,958

All the related parties in the above tables are corporations in which the Bank holds less than 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 credit loss expenses have been recorded.

(1) On 29 October 2012, credit of NIS 2 billion was extended to an interested party, following compliance with preconditions. For further information, see Immediate Report dated 29 October 2012, (ref no. 2012-01-266487).

3. Credit to groups of borrowers whose indebtedness exceeds 15% of the Bank's capital (for capital adequacy purposes) is as follows:

31 December 2012					
Group of borrowers	Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk	Of which: derivative instruments	% of capital
	In NIS millions				
1	**6,183**	**1,421**	**7,604**	**117**	**18.0**

For further information on the subject of groups of borrowers, see page 213.

4. The total amount of debts of large borrowers, banking groups of borrowers whose debt is in excess of 10% of the Bank's capital, constituted 18.0% of the Bank's capital at 31 December 2012, compared with the Bank of Israel limit of 120% of capital for capital adequacy purposes**.**

Problem debts

The risk of problem credit after individual and collective allowances is as follows:

	31 December 2012			31 December 2011		
	Balance sheet	Off-balance sheet	Total	Balance sheet	Off-balance sheet	Total
	In NIS millions					
Impaired debts	**5,648**	**393**	**6,041**	5,118	369	5,487
Substandard debts	**2,183**	**102**	**2,285**	1,118	78	1,196
Special mention debts	**1,979**	**626**	**2,605**	3,570	473	4,043
Total	**9,810**	**1,121**	**10,931**	9,806	920	10,726

Problem credit risk:

	31 December 2012	31 December 2011
	Problem credit risk	Problem credit risk
	In NIS millions	
Commercial problem credit risk	**12,264**	11,841
Retail problem credit risk	**1,311**	1,440
Total	**13,575**	13,281
Allowance for credit losses	**2,644**	2,555
Problem credit after allowance for credit losses	**10,931**	10,726

For additional information on problem credit - See Note 4 to the Financial Statements and Exhibit E in the Management Review.

Credit to governments as at 31 December 2012 amounted to NIS 442 million, a decrease of NIS 6 million, 1.3%, compared with 31 December 2011.

Securities

The Group's investments in securities as at 31 December 2012 amounted to NIS 56.4 billion, compared with NIS 47.9 billion in 2011, an increase of 17.7%.

Securities in the Group are classified into two categories: securities for trading and available-for-sale securities.

Securities for trading are presented in the balance sheet at fair value, and the difference between fair value and adjusted cost is charged to the statement of profit and loss.

Available-for-sale securities are presented in the balance sheet at fair value, with the difference between fair value and adjusted cost 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. Whenever the impairment is of a non-temporary nature, the difference is charged to the statement of profit and loss.

Method of calculating fair value

The fair value of Israeli securities is based mainly on prices quoted on the Tel-Aviv Stock Exchange and the fair value of foreign securities on prices received from external sources.

The CLO portfolio, which constitutes some 2.43% of the securities portfolio, is valued independently based on a model, used by leading banks worldwide.

Debentures in Israel which are denominated in NIS and are not tradable have been revalued using a model, as there is no active market for these debentures.

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

	31 December 2012	31 December 2011
Securities traded on an active market	**40,458**	34,219
Securities based on prices determined by external models	**13,102**	11,600
Securities based on quotation from counterparty or cost	**2,848**	2,117
Total	**56,408**	47,936

For further details of the accounting policy and the method of valuing the securities portfolio and the distinctions between a temporary impairment and that of a non-temporary nature, see the Section "Accounting Policy on Critical Subjects" and Note 3 to the financial statements.

The following table sets out the classification of the securities item in the consolidated balance sheet in accordance with the above rules:

	31 December 2012				
	Adjusted cost	Unrealized gains from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value	Balance sheet value
	NIS millions				
Debentures					
Available-for-sale	**42,260**	**576**	**(109)**	**42,727**	**42,727**
For trading	**11,092**	*** 236**	*** (13)**	**11,315**	**11,315**
	53,352	**812**	**(122)**	**54,042**	**54,042**
Shares and funds					
Available-for-sale	**1,726**	**453**	**(12)**	**2,167**	**2,167**
For trading	**189**	*** 11**	*** (1)**	**199**	**199**
	1,915	**464**	**(13)**	**2,366**	**2,366**
Total securities	**55,267**	**1,276**	**(135)**	**56,408**	**56,408**

* Carried to profit and loss.

	31 December 2011				
	Adjusted cost	Unrealized gains from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value	Balance sheet value
	NIS millions				
Debentures					
Available-for-sale	36,524	227	(748)	36,003	36,003
For trading	9,369	* 78	* (66)	9,381	9,381
	45,893	305	(814)	45,384	45,384
Shares and funds					
Available-for-sale	1,876	341	(26)	2,191	2,191
For trading	363	* 4	* (6)	361	361
	2,239	345	(32)	2,552	2,552
Total securities	48,132	650	(846)	47,936	47,936

* Carried to profit and loss.

As at 31 December 2012, some 79.6% of the Group's *nostro* portfolio was classified as available-for-sale securities and some 20.4% as the trading portfolio. This classification allows for flexibility in the management of the securities portfolio. Some 4.2% of the value of the securities represents investments in shares of companies that are not presented on equity basis, but according to cost or to the market value of the shares traded on the stock exchange.

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

	2012	2011
	NIS millions	
Debentures redeemed and/or sold (available-for-sale)	**44,392**	35,051
Purchases of debentures available-for-sale	**50,300**	26,477
Net profit from investments in debentures:		
Interest income on accrual basis	**1,253**	1,207
Profit from sale and from decrease in value of available-for-sale debentures	**291**	265
Profit realized and/or unrealized from adjustments to fair value of debentures for trading	**229**	176

The following table sets out details of the composition of investments in debentures by linkage types:

	31 December 2012			31 December 2011		
	Government of Israel	Foreign governments	Other companies	Government of Israel	Foreign governments	Other companies
	NIS millions					
Israeli currency:						
Unlinked	**26,319**	**-**	**860**	19,227	-	619
CPI-linked	**3,441**	**-**	**1,320**	7,124	-	861
Foreign currency including foreign currency-linked	**2,218**	**6,765**	**13,119**	1,577	3,858	12,118
Total debentures	**31,978**	**6,765**	*** 15,299**	27,928	3,858	* 13,598

* Of which NIS 1,272 million is subordinated debentures as at 31 December 2012 (NIS 1,605 million as at 31 December 2011).

In 2012, there was an increase of some NIS 1.7 billion, about 12.5% in Group investments in corporate debentures, including banks and financial institutions, mainly in foreign currency debentures abroad.
Some 70% of debentures is 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 2012		31 December 2011	
	Issued in Israel	Issued abroad	Issued in Israel	Issued abroad
Economy sector	NIS millions			
Agriculture	**-**	**15**	-	-
Industry	**179**	**801**	71	313
Construction and real estate	**53**	**244**	41	92
Electricity and water	**867**	**206**	216	181
Trade	**312**	**50**	331	-
Transportation and storage	**24**	**11**	26	-
Communications and computer services	**53**	**205**	79	149
Financial services *	**474**	**7,343**	610	5,776
Business and other services	**95**	**101**	16	34
Public and community services	**24**	**114**	24	75
Total	**2,081**	**9,090**	1,414	6,620

* Including asset-backed securities.

The Available-for-Sale Portfolio

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

	2012		2011		Change	
	NIS millions					
	Abroad	In Israel	Abroad	In Israel	Abroad	In Israel
Debentures	**20,400**	**22,327**	16,641	19,362	3,759	2,965
Shares and funds	**594**	**1,573**	724	1,467	(130)	106
Total	**20,994**	**23,900**	17,365	20,829	3,629	3,071

a. In 2012, in respect of the available-for-sale portfolio, NIS 1,066 million (before tax) was recorded to shareholders' equity due to an increase in value of Government of Israel debentures and an increase in value in respect of debentures of banks abroad, compared with a fall in value of NIS 1,021 million (before tax) in 2011

b. In addition, NIS 291 million was recorded to profit and loss, in respect of net profits from the sale of available-for-sale debentures, compared with profits of NIS 265 million in 2011**.**

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

	For the year ended	
	31 December 2012	31 December 2011
	NIS millions	
Profits in respect of available-for-sale securities which were recorded to profit and loss	**1,167**	1,006
Adjustments to capital reserve of available-for sale securities in shareholders' equity	**1,066**	(1,021)

d. The following table shows net balances in shareholders' equity:

	31 December 2012	30 September 2012	31 December 2011	Movement 4th Quarter	Year 2012
	NIS millions				
Shares	**441**	292	315	149	126
Israel government debentures	**276**	169	151	107	125
Foreign government debentures	**12**	11	(2)	1	14
Other debentures	*** 179**	53	(670)	126	849
Other credit instruments, mainly hedged securities** and loans	**(166)**	(187)	(118)	21	(48)
Total before tax	**742**	338	(324)	404	1,066
Related tax	**(247)**	(108)	106	(139)	(353)
Net total	**495**	230	(218)	265	713

* Of which the cumulative balance of impairment in respect of subordinated notes issued by foreign banks, some NIS 274 million
** Recorded to profit and loss in the same way as the hedged debentures, see Note 3.

The accumulated net balance of adjustments to fair value of securities held in the available-for-sale portfolio, as at 31 December 2012, amounted to a positive amount of NIS 495 million (after the effect of tax) compared with a negative amount of NIS 218 million at the end of 2011. These amounts represent net losses/profits which had not been realized at the dates of the Financial Statements.

Bank management estimates that there is impairment in securities in the available-for-sale portfolio, mostly of a temporary nature. The Banks intends and is able to continue holding the investments until the expected recovery of the full cost of the assets or until their redemption. Accordingly, this impairment is recorded in capital. This is on the basis of the criteria set forth in the Significant Accounting Policies in Note 1 of the 2012 Annual Report.

e. Below is the impairment in available-for-sale securities charged to shareholders' equity as at 31 December 2012:

		Duration of impairment 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	**3**	**1**	**-**	**13**	**17**
	Other debentures	**5**	**1**	**-**	**52**	**58**
	Total	**8**	**2**	**-**	**65**	**75**
10%- 20%	Shares	**9**	**-**	**-**	**-**	**9**
	Asset-backed debentures	**-**	**-**	**-**	**3**	**3**
	Other debentures	**-**	**-**	**-**	**25**	**25**
	Total	**9**	**-**	**-**	**28**	**37**
20%-30%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**-**	**-**
	Other debentures	**-**	**-**	**-**	**6**	**6**
	Total	**-**	**-**	**-**	**6**	**6**
30%-35%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**-**	**-**
	Other debentures	**-**	**-**	**-**	**-**	**-**
	Total	**-**	**-**	**-**	**-**	**-**
35%-40%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**-**	**-**
	Other debentures	**-**	**-**	**-**	**-**	**-**
	Total	**-**	**-**	**-**	**-**	**-**
Above 40%	Shares	**3**	**-**	**-**	**-**	**3**
	Asset-backed debentures	**-**	**-**	**-**	**-**	**-**
	Other debentures	**-**	**-**	**-**	**-**	**-**
	Total	**3**	**-**	**-**	**-**	**3**
Total amount	Shares	**12**	**-**	**-**	**-**	**12**
	Asset-backed debentures	**3**	**1**	**-**	**16**	**20**
	Other debentures	**5**	**1**	**-**	**83**	**89**
Overall total		**20**	**2**	**-**	**99**	**121**

For the treatment of the evaluation of securities and distinctions between an impairment of a temporary nature and that of a non-temporary nature, see page 64 above.

* The duration of the impairment from the commencement of the impairment means from the beginning of any impairment whatsoever of the security from the price of the adjusted cost.

Trading Portfolio

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

	2012		2011		Change	
	NIS millions					
	Abroad	In Israel	Abroad	In Israel	Abroad	In Israel
Debentures	**1,635**	**9,680**	793	8,588	842	1,092
Shares and funds	**27**	**172**	-	361	27	(189)
Total	**1,662**	**9,852**	793	8,949	869	903

In respect of trading debentures, realized and unrealized profits amounting to NIS 229 million were recorded in the statement of profit and loss, compared with profits amounting to NIS 176 million in 2011, and in respect of shares and funds, realized and unrealized profits were recorded amounting to NIS 10 million, compared with profits of NIS 137 million in 2011.

Investments in Securities Issued Abroad

The Group's securities portfolio includes some NIS 22.6 billion (some US$ 6.0 billion) of securities issued abroad, all of which (except for some 1%) are investment grade securities, of which some 88% are rated 'A-' and above. The portfolio includes subordinated debentures of banks abroad with a fair value of NIS 1,272 million. Of the said portfolio, some NIS 21 billion (some US$ 5.6 billion) is classified in the available-for-sale securities portfolio, and the balance is classified in the trading portfolio.

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

	2012		2011	
	Available-for-sale portfolio	Trading portfolio	Available-for-sale portfolio	Trading portfolio
Balance sheet value	NIS millions			
Government debentures*	**8,487**	**447**	5,089	251
Debentures of banks and financial institutions	**5,281**	**88**	7,854	366
Asset-backed debentures	**5,049**	**358**	2,444	120
Other debentures	**1,583**	**742**	1,254	56
Shares and funds	**594**	**27**	724	-
Total	**20,994**	**1,662**	17,365	793

* Of which Government of Israel debentures issued abroad at 31 December 2012, NIS 2,033 million in the available portfolio and NIS 136 million in the trading portfolio, and at 31 December 2011, NIS 1,414 million in the available portfolio and NIS 68 million in the trading portfolio.

The net increase in value (the offset between of costs and impairments) carried to capital in respect of securities issued abroad as at 31 December 2012 amounts to NIS 331 million (NIS 212 million after tax).

The following table shows the breakdown of the debentures of banks and financial institutions abroad (excluding asset-backed securities) by credit rating and by country as at 31 December 2012:

	AAA to AA-	A+	A	A-	BBB+ to BBB-	BB+ to B-	Not rated	Total
	NIS millions							
U.S.A. – by bank level (2)								
Citigroup Inc NY	**-**	**-**	**-**	**-**	**211**	**-**	**-**	**211**
Bank of America	**-**	**-**	**-**	**15**	**236**	**-**	**-**	**251**
Goldman, Sachs and Co.	**-**	**-**	**55**	**296**	**-**	**-**	**-**	**351**
Morgan Stanley	**-**	**-**	**-**	**-**	**215**	**-**	**-**	**215**
Merrill Lynch	**-**	**-**	**-**	**-**	**205**	**-**	**-**	**205**
United States – other (2)(3)	**15**	**-**	**22**	**55**	**35**	**-**	**124**	**251**
United Kingdom	**61**	**-**	**674**	**39**	**15**	**310**	**181**	**1,280**
Belgium (1)	**-**	**-**	**-**	**-**	**5**	**-**	**-**	**5**
Austria (1)	**-**	**-**	**-**	**-**	**-**	**-**	**20**	**20**
Italy (1) (5)	**-**	**-**	**-**	**-**	**252**	**-**	**-**	**252**
Germany (1)	**475**	**-**	**25**	**-**	**262**	**-**	**-**	**762**
The Netherlands (1)	**-**	**-**	**146**	**166**	**282**	**77**	**32**	**703**
Luxembourg (1)	**-**	**-**	**-**	**-**	**14**	**-**	**-**	**14**
Spain (1) (5)	**-**	**-**	**-**	**23**	**65**	**-**	**37**	**125**
France (1)	**-**	**-**	**286**	**-**	**-**	**-**	**-**	**286**
Switzerland	**-**	**-**	**18**	**-**	**-**	**-**	**-**	**18**
Australia	**32**	**-**	**-**	**-**	**-**	**-**	**39**	**71**
Sweden	**62**	**-**	**16**	**-**	**-**	**-**	**-**	**78**
New Zealand	**79**	**-**	**-**	**-**	**-**	**-**	**-**	**79**
Norway	**-**	**30**	**-**	**-**	**-**	**-**	**-**	**30**
Denmark	**-**	**-**	**-**	**-**	**84**	**-**	**-**	**84**
Other	**38**	**-**	**-**	**-**	**-**	**-**	**40**	**78**
Total (4)	**762**	**30**	**1,242**	**594**	**1,881**	**387**	**473**	**5,369**

(1) Eurozone countries amounting to NIS 2,166 million.
(2) North American countries (United States) amounting to NIS 1,483 million.
(3) This amount includes investments in 7 banks in the United States.
(4) Including subordinated debentures with a fair value as at 31 December 2012 of NIS 1,272 million (including available portfolio and trading portfolio).
(5) For further details in connection with credit exposure for countries abroad, see page 218.

The following table shows the breakdown of the debentures of banks and financial institutions abroad (excluding asset-backed securities) by credit rating and by country as at 31 December 2011:

	AAA to AA-	A+	A	A-	BBB+ to BBB-	BB+ to B-	Not rated	Total
	NIS millions							
U.S.A. – by bank level (2)								
Citigroup Inc NY	-	76	-	538	-	-	-	614
Chase Manhattan Bank, N.A.	122	119	-	-	-	-	-	241
Bank of America (including Merrill Lynch)	4	-	51	-	472	-	-	527
Goldman, Sachs and Co.	67	293	-	-	-	-	-	360
Morgan Stanley	-	41	239	-	-	-	-	280
Wells Fargo Bank N.A.	-	-	283	-	-	-	-	283
United States – other (2) (3)	39	-	62	-	163	-	187	451
United Kingdom	312	412	303	223	465	-	-	1,715
Austria (1)	-	-	20	-	-	-	-	20
Italy (1) (5)	-	-	359	-	-	-	-	359
Germany (1)	48	-	-	236	-	-	35	319
Denmark	-	-	88	-	-	-	-	88
Holland (1)	214	458	131	-	18	-	-	821
Luxembourg (1)	-	-	-	-	-	-	14	14
Spain (1) (5)	297	-	12	31	-	-	30	370
France (1)	354	131	79	-	-	-	20	584
Switzerland	8	-	-	-	-	-	85	93
Australia	567	-	-	-	-	-	-	567
Sweden	21	-	67	-	12	-	56	156
New Zealand	253	-	-	-	-	-	-	253
Norway	29	-	-	-	-	-	-	29
Canada (2)	19	-	-	-	-	-	-	19
South Korea	-	38	-	-	-	-	19	57
Total (4)	2,354	1,568	1,694	1,028	1,130	-	446	8,220

(1) Eurozone countries amounting to NIS 2,487 million.
(2) North American countries (United States and Canada) amounting to NIS 2,756 million.
(3) This amount includes investments in six banks in the United States.
(4) Including subordinated debentures with a fair value as at 31 December 2011 of NIS 1,605 million (including available portfolio and trading portfolio).
(5) For further details in connection with credit exposure for countries abroad, see page 218.

1. Investments in asset-backed securities issued abroad

The Group's asset-backed securities portfolio (both mortgage-backed and non-mortgage-backed), all of which is rated investment grade at 31 December 2012, amounted to NIS 5.4 billion (some US$ 1.4 billion), compared with NIS 2.6 billion at 31 December 2011. Of the said portfolio, some NIS 5.0 billion (some US$ 1.3 billion) is classified in the available-for-sale portfolio.

The available-for-sale portfolio of investments in asset-backed securities abroad as at 31 December 2012 includes an investment in mortgage-backed debentures amounting to NIS 3.6 billion. 92% of the total mortgage-backed debentures in the available-for-sale portfolio were issued by federal agencies in the United States (GNMA, FHLMC and FNMA).

The following table shows a summary of investments in asset-backed debentures in the available-for-sale portfolio:

	31 December 2012			
	Adjusted cost	Unrealized profits	Unrealized losses	Balance sheet value (fair value)
	NIS millions			
MBS - mortgage-backed securities	**3,611**	**22**	**(2)**	**3,631**
ABS asset-backed securities (other than mortgage-backed)	**1,382**	**54**	**(18)**	**1,418**
Of which: CLO	**1,334**	**54**	**(17)**	**1,371**
Other	**48**	**-**	**(1)**	**47**
Total	**4,993**	**76**	**(20)**	**5,049**

	31 December 2011			
	Adjusted cost	Unrealized profits	Unrealized losses	Balance sheet value (fair value)
	NIS millions			
MBS - mortgage-backed securities	1,722	23	(12)	1,733
ABS asset-backed securities (other than mortgage-backed)	770	3	(62)	711
Of which: CLO	720	1	(60)	661
Other	50	2	(2)	50
Total	2,492	26	(74)	2,444

For the definition of asset-backed securities see Note 3 to the financial statements.

Securitization Exposures

Investment in asset-backed securities by exposure type (Table 9(f) – Basel II)

	31 December 2012	31 December 2011
	Accrued amount of exposure	
	NIS millions	
Mortgage-backed securities (MBS):		
Pass-through securities:		
Securities guaranteed by US Government GNMA	**257**	114
Securities issued by FNMA and FHLMC	**511**	259
Other securities	**5**	5
Other mortgage-backed securities		
Securities issued by FHLMC, FNMA, or GNMA, or guaranteed by these entities	**2,581**	1,017
Other mortgage-backed securities	**322**	448
Total mortgage-backed securities (MBS)	**3,676**	1,843
Asset-backed securities (ABS):		
Credit card debtors	**75**	40
Lines of credit for any purpose secured by dwelling	**5**	5
Credit for purchase of vehicle	**166**	-
Other credit to private persons	**20**	5
Credit not to private persons	**1**	4
CLO debentures	**1,371**	661
SCDO debentures	**-**	-
Others	**93**	6
Total asset-backed (ABS)	**1,731**	721
Total asset-backed securities	**5,407**	2,564

Investment in asset-backed securities by risk weighting* (Table 9(g) – Basel II)

	31 December 2012	31 December 2011	**31 December 2012**	31 December 2011
	Accrued amount of exposure		Capital requirement for securitization exposure	
	NIS millions			
20%	**727**	1,001	**13**	18
40%	**390**	-	**14**	-
50%	**169**	100	**8**	5
100%	**370**	21	**33**	2
225%	**42**	-	**8**	-
350%	**-**	-	**-**	-
650%	**2**	-	**1**	-
Deducted from equity	**21**	29	**-**	-
Total	**1,721**	1,151	**77**	25

* From 31 December 2012, the Bank applies the Bank of Israel directives regarding re-securitization.
Not including, FNMA, FHLMC securities, which are presented as a U.S. Government obligation and the weight of their saving is 20%. Not including GNMA securities for which there is U.S. State guarantee and the weight of their saving is 0%

As at 31 December 2012, the accumulated net increase in value charged to shareholders' equity resulting from the mortgage-backed securities portfolio was some NIS 20 million.
The projected term to maturity for all the mortgage-backed securities portfolio is an average of 3.8 years.
The total of the asset-backed debentures, which are not in the U.S. State guarantee and are not covered by U.S. federal institutions in the available-for-sale portfolio and the trading portfolio, amounts to some NIS 322 million.
In addition to mortgage-backed securities, the Group's available-for-sale portfolio also includes other securities backed by assets other than mortgages (car financing credit and other types of credit), amounting to some NIS 1.4 billion. Of these, CLO-type debentures amount to NIS 1.37 billion. The projected term to maturity of the portfolio of securities backed by assets other than mortgages is an average of 3.3 years.

The charge to profit and loss in respect of these two portfolios was made on the basis of the policy detailed in the section on Significant Accounting Policies in Note 1 to the Financial Statements and on page 98 of the Directors' Report above.

In the framework of the trading portfolio, there are investments in asset-backed securities amounting to NIS 40 million (in 2011 – NIS 10 million).

For the definition of asset-backed securities see Note 3 to the financial statements.

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

The Group's securities portfolio as at 31 December 2012 includes some NIS 17.2 billion (US$ 4.6 billion) of non-asset-backed securities. Of these securities, NIS 15.9 billion (US$ 4.3 billion) are classified in the available-for-sale portfolio, with the balance in the trading portfolio. Of the total securities, 81% are rated A- or higher, including mainly securities issued by the U.S. government, banks and financial institutions, securities, and the balance, mainly securities issued by the Israeli government.

For further details regarding exposure to overseas financial institutions, see chapter "Exposure to Risk and Methods of Risk Management", "Credit Risk".

As at 31 December 2012, aggregate increase in value in shareholders' equity in respect of non-asset-backed securities issued abroad in the available-for-sale portfolio amounted to NIS 275 million (NIS 176 million after tax).

The portfolio of bank debentures also includes some NIS 1,272 million in subordinated debentures. Debentures of this type 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 generally has the option of early repayment of the debenture (call). In the event that 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 rate increases (step-up mechanism).

	Fair value		Balance of reserve as at
	31 December 2012	31 December 2011	31 December 2012
	NIS millions		
Total subordinated debentures and shares for sale of banks issued abroad	**1,257**	1,534	274

As stated above, in addition to the available-for-sale portfolio, the securities portfolio also includes non-asset backed securities in the trading portfolio. This includes mainly securities of states, banks and financial institutions, and securities funds. All the securities in the trading portfolio are of investment grade.

The value of the non-asset backed trading portfolio as of 31 December 2012 amounted to NIS 1.3 billion (US$ 0.3 billion). The difference between fair value and adjusted cost, if there is such a difference, is recorded in the profit and loss account.

3. Investments in corporate debentures issued in Israel

Investments in debentures issued in Israel amounted to NIS 33.8 billion on 31 December 2012, of which NIS 29.8 billion was in debentures issued by the Government of Israel in NIS, with the balance in debentures of the Government of Israel in foreign currency and debentures issued by companies. Some 62.0% of the investments in corporate debentures amounting to some NIS 1.4 billion were included in the available-for-sale portfolio, and the balance was in the trading portfolio.

Corporate debentures in the available-for-sale portfolio amounting to NIS 1.4 billion includes a positive capital reserve amounting to NIS 47 million and a negative capital reserve amounting to NIS 7 million.

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. The revaluation of the traded corporate debentures is based on market prices on the stock exchange, and the revaluation of the non-listed corporate debentures is carried out as described above.

4. Investments in shares and funds

Total investments in shares and funds amounted to some NIS 2,366 million on 31 December 2012, of which NIS 1,172 million was in listed shares and NIS 1,194 million was in non-listed shares. Of the total investment, NIS 2,167 million is classified in the available-for-sale portfolio and NIS 199 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 the Group's investment policy to include setting limits for the volume of overall investment and in a single company, the 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.
- Maximizing 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.
- Moderating 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) which the Bank plans to hold for the long term
- Medium-term investments
- Investments in growth companies (start-up companies)

Accounting treatment of investments:

- Investments are recorded as investments in the available-for-sale securities portfolio. When the investment is in a company included on equity basis, it is recorded in "investments included on equity basis".
- With regard to the accounting method, see the Chapter on Accounting Policy and Note 1(H-I).

The following table sets out the principal investments in shares and funds recorded in the securities item (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 2012	31 December 2011	**31 December 2012**	31 December 2011	**31 December 2012**	31 December 2011	
	%		NIS millions				
Migdal Insurance and Financial Holdings Ltd. (2)	**9.79**	9.79	**594**	534	**53**	48	listed
Africa Israel Properties Ltd. (3)	**2.2**	2.2	**22**	16	**2**	1	listed
Otzar Hityashvuth Hayehudim B.M.	**8.62**	8.62	**50**	44	**5**	4	listed
Partner Communications Ltd.	**4.99**	4.99	**174**	261	**16**	23	listed
Electra Consumer Products (1970) Ltd.	**8.98**	8.98	**57**	66	**5**	6	listed
T.S.I. Roads Limited Partnership	**17.82**	17.82	**108**	101	**10**	9	not listed
Tower Semiconductor capital notes	**-**	-	**49**	49	**4**	4	not listed
CLS Bank	**-**	-	**21**	21	**2**	2	not listed
Funds	**-**	-	**825**	1,140	**74**	103	623 not listed
Apax	**-**	-	**72**	69	**6**	6	not listed
Others	**-**	-	**394**	251	**36**	24	314 not listed
Total			**2,366**	2,552	**213**	230	

* The value of the investment in the consolidated balance sheet equals the balance of fair value of the investment.
(1) See page 168 for details of non-banking investments reported on equity basis.
(2) At 8 January 2013, the shareholding percentage was 4.71%.
(3) Sold on 7 March 2013.

Partner Communication Ltd.

Leumi Partners Ltd. (hereinafter, "Leumi Partners") has decided to write down the investment in the shares of Partner Communication Ltd. (hereinafter, "Partner") and transfer the balance of the negative reserve accumulated to 30 June 2012 from capital reserves to profit and loss. The write-down is derived from the market price at 30 June 2012 and amounted to NIS 239 million in 2011, and NIS 160 million in 2012. The said write-down was made in accordance with Leumi Group's accounting policy, which requires such amortization in a situation in which there is a significant and continuing impairment. As of 31 December 2012, there is a positive capital reserve of NIS 53 million.

From the date of the investment in Partner which was made in October 2009, Leumi Partners received payments in connection with the transaction, including dividends and commissions, amounting to NIS 195.4 million, gross before tax.

In January 2013, Leumi Partners sold 3.2 million shares in Partner for consideration of NIS 83.5 million. The company is expected to record a gain on sale amounting to NIS 33.6 million in the first quarter of 2013.

TSI Roads Limited Partnership

On 31 December 2010 Leumi Partners invested (as a limited partner) in the limited partnership, TSI Roads Limited Partnership ("the Partnership"), which purchased 50% in Derech Eretz Highways (1997) Ltd. ("Derech Eretz").

In August 2011, Leumi Partners signed an agreement for a further investment in the partnership ("additional investment") which was intended to enable the partnership to invest in Derech Eretz for the purpose of exercising the right of first refusal *vis-à-vis* the State, for the purpose of purchasing certificates and debt that the State was entitled to allocate. The State has not approved the notice of the exercise of the right of refusal by Derech Eretz and this matter has been forwarded for discussion in arbitration between Derech Eretz, the State of Israel and the body that the State announced as the winning party. On 10 October 2011, the decision was given by the arbitrator approving the State's notice on the rejection of the exercise of the right of first refusal. As a result of the arbitrator's decision, the participation certificates of the State were sold to the winning party ("the winning party"). On 13 September 2011, the partnership signed an agreement with Housing and Construction Ltd. to purchase the holdings of Housing and Construction in Derech Eretz. The agreement is contingent on preconditions, including the approval of the State and the approval of the senior lenders to Derech Eretz. These holdings include capital and shareholder loans representing 25.5% of Derech Ertez. Prior to the transaction, TSI held 25.5% of the share capital of Derech Eretz and thereafter, held 51%, and it will be a controlling shareholder in the road. In December 2012, Leumi Partners signed an addendum to the TSI partnership agreement, whereby it undertook to invest in TSI, alongside the additional limited partners, the amount to be used in financing the purchase. The amount of Leumi Partners' investment will be some NIS 139 million, with the addition of linkage to the consumer price index and interest at 8% per annum to the date of closing. Furthermore, the company will undertake to make a further investment against a guarantee to be given by TSI to Derech Eretz amounting to NIS 80 million, linked to the consumer price index. Not all of the preconditions for fulfilling the transaction have yet been met.

Migdal

At the beginning of 2013, Leumi distributed some 5.08% of the shares of the company to a number of institutional entities at a price of NIS 5.72 per share (some 2.2% discount on the market price) and for aggregate consideration of NIS 306 million. As a result of the sale, the Bank is expected to record a one-time net profit of NIS 120 million in the financial statements for the first quarter of 2013.

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

	Balance sheet amount	
	2012	2011
Quoted shares	**1,172**	1,367
Funds according to quote by counterparty	**696**	822
Unquoted shares	**498**	363
Total	**2,366**	2,552

Securities Lien

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 to 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 2012, the Bank had pledged debentures with a value of NIS 1.4 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 2012 was NIS 74 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 2012 there were no balances outstanding.

As at 31 December 2012, the Bank had not been granted any loans from the Bank of Israel while the balance of the Bank's deposits with the Bank of Israel amounted to NIS 36.3 billion.

The Bank is executing short-term lending of securities in foreign currency from the available portfolio, via the Euroclear clearinghouse, for other customers of the clearinghouse, without knowing the identity of the borrowers. The lending is carried out under a full guarantee of the Euroclear clearinghouse which is an AA+ rated financial institution. The value of the balance of the securities lent to the Euroclear clearinghouse as of 31 December 2012 stood at some NIS 117 million. In order to guarantee clearance of securities for customers, the Bank received from the Euroclear Clearinghouse a credit line amounting to US$ 150 million, against which there is a floating lien of securities in the *nostro* portfolio.

Other assets and debit balances in respect of derivative instruments

At the end of 2012, other assets amounted to NIS 4.5 billion, compared with NIS 4.2 billion at the end of 2011, an increase of some 7.2%, or some NIS 0.3 billion. The increase in this item resulted from an increase in the balance of deferred tax receivable.

The balance of the fair value of derivative instruments made with and for customers fell from NIS 11.6 billion at 31 December 2011 to NIS 11.4 billion at 31 December 2012.

Other liabilities and credit balances in respect of derivative instruments

Other liabilities amounted to NIS 15.6 billion at 31 December 2012, compared with NIS 14.7 billion at 31 December 2011, an increase of 5.7%.

Credit balances in respect of derivative instruments amounted to NIS 12.8 million at 31 December 2012, compared with NIS 12.1 million at 31 December 2011.

Fixed assets and plant

Buildings and equipment - the amortized cost of buildings and equipment as at 31 December 2012 amounted to NIS 3.7 billion, similar to 31 December 2011.

Investments in buildings and equipment as at 31 December 2012 are as follows:

	Cost	Accumulated depreciation	Net book value	
			31 December 2012	31 December 2011
	NIS millions			
Buildings and land	**3,395**	**1,836**	**1,559**	1,622
Equipment, furniture and vehicles	**3,243**	**2,530**	**713**	628
Software	**4,600**	**3,167**	**1,433**	1,403
Total	**11,238**	**7,533**	**3,705**	3,653

The above buildings 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 2012 amounted to NIS 28 million.

The majority of the premises 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 held by the Bank, Binyanei Bank Ltd. and Lyn City Center Ltd. (wholly-owned subsidiaries of the Bank). The Group owns 173 properties, of which 124 are branches and archives and 25 are Head Office buildings. The total area under ownership is some 261,000 sq. mtrs., divided into branches - some 80,000 sq. mtrs., Head Office buildings (excluding the Bank Leumi Service Center complex in North Lod) – some 41,000 sq. mtrs., and the balance, divided amongst offices in use by subsidiaries, a logistical center, plots, vacant properties etc. Properties designated for sale constituted 7,598 sq. mtrs. as of 31 December 2012, and are presented at the lower of amortized cost or realization value.

Investment in buildings in 2012 amounted to NIS 1,559 million (including property purchases amounting to NIS 70 million) compared with NIS 1,622 million in 2011 (including property purchases of NIS 83 million). In addition to areas owned by the Bank, the Bank holds leased property covering 83,000 sq. mtrs.

"Keshev" – "The Yitzhak Rabin Bank Leumi Service Center", which includes "Hatam" – the Operations and Computerized Operating Services Division of the Bank and the Bank's training center, is located in Lod, within a facility comprising a total area of 78.8 dunams.

Leumi has established an underground facility for the computer complex. The facility is protected against rocket attack, biological and chemical warfare and earthquakes. The facility is constructed with advanced technology enabling high-level day-to-day operation and independent functioning in times of emergency. The transfer of the computer system to the facility was completed at the end of 2010. The infrastructure in the new computer center has an optimal survival and redundancy level and the structure is built in accordance with international standards.

Leumi has 2 mainframe computers produced by IBM, part of the Z Series range. For use by the production systems: a primary computer with an operating power of some 9,778 mips, with a current operating capacity of 8,943 mips (number of instructions in millions per second) and a secondary computer with an operating power of some 471 mips. The secondary production computer is expandable to a capacity of some 9,894 mips for internal back-up purposes in the Keshev facility.

One computer, with an operating power of some 2,147 mips, operates at the Tel Aviv facility, and serves as the development and testing environment. This computer is expandable to a capacity of some 13,662 mips in emergency situations in which the Keshev facility ceases to operate.

The Bank has an online and historical database stored on discs and cassettes in the main computer facility at Keshev and in the back-up facility in Tel-Aviv. A third up-to-date copy of data is stored in an installation in the Jerusalem area. The data go through designated communication infrastructure between Leumi's Computer Centers.

Leumi's branches are computerized and connected on-line to the Bank's computer center at Keshev. In the past year, the branches' servers were transferred to the Computer Center in Keshev and Tel Aviv. In total, 350 servers and 6,845 work-stations, most of which are PC-based, have been installed in the branches. There are 357 innovative automatic teller machines, of which 150 include an option for depositing cash for use by customers and some 565 self-service "Leumi Digital" stations. 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 have a separate external Internet connection.

During the years 2008-2012, the Bank upgraded the network of "Leumi Digital" customer stations and the process of replacing all of the customer stations with new and advanced equipment was completed.

As of the end of 2012, there were 226 Leumi Digital external customer stations and 339 internal customer stations.

Information security at Leumi is based on the principle of banking secrecy and various laws and directives, such as 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 drafting of procedures.

In an era in which threat from external factors are increasing, Leumi is prepared for computer attacks and is taking steps to hedge the risks arising from various cyber attacks.

The operations and computer function of 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 uniform computerized banking systems.

Hatam operates an array of computerized systems for the Arab Israel Bank (a subsidiary) and for the Union Bank. There is an agreement with them relating to computer services provided by Hatam, which includes operating services, computer systems development, consultancy services, organization and method services, back-ups, training and other services.

The main computer center of the Mortgage Division is located in Keshev, and it receives services from IBM, and the back-up site was set up in Tel Aviv.

The overseas subsidiaries are connected to each other and to the Bank in Israel via a private communication network. This system is used for voice communication as well as for transmitting encrypted data in a secured manner. The Bank invests in maintaining and developing Internet sites for the Bank's overseas subsidiaries based on the Bank's infrastructure. In addition, the technological infrastructure was upgraded to improve the availability of the systems.

Bank Leumi USA has outsourcing agreements with a number of U.S. companies regarding the information systems used for the management of its banking business.

In 2012, the Group invested in equipment including software some NIS 765 million, compared with some NIS 647 million in 2011. The budget was adapted to support the strategic goals as defined by the Bank Management, as well as the operating requirements for future banking. Projects carried out in 2012 were designed for the benefit of the customers, to increase their satisfaction, to reinforce their loyalty and to prevent their leaving. The major investment in 2012 (as in previous years) focused on the following spheres: the distribution network (with the aim of increasing the shift to direct channels), improving the "customer experience" through Leumi Digital, Leumi Cellular, trading on the capital market via the Internet, initiation of campaigns, developments in BI CRM (CRM BI-Business Intelligence Management - Customer Relationship) (a tool for generating business information enabling the recipient to obtain a picture of the state of activity in the various channels) and data services for sub-custodial customers on the Internet. In addition, as in every year, emphasis was placed on compliance with regulatory directives. This year, some of the investments were directed to the leverage of the implementation of the Basel regulations in favor of educated risk management and transaction services and the realization of an optimal business technological solution, which contributes directly to the maintenance of Leumi's risk level under changing market conditions.

In order to supply the needs of capital market customers, to strengthen the business connection with its customers and to withstand the competition in the market, some of the investments were directed, *inter alia,* to the development and expansion of data channels from the Bank to the systems of the customers in their offices. Development work was completed on the following projects: upgrade and improvement of the content management system, BLM Underlying Assets Project (Customer Control of Futures Instruments. In addition, in the second half of 2012, was combined for the production of innovative development as part of the Customer Review of Future Instruments (BLM) Underlying Assets Project. The system enables an improvement of service to Leumi customers and a reinforcement of their activity in the capital market, precisely estimating the risk in the calculation of the request for collateral.

In addition, in 2012, a electronic foreign currency trading system was developed for selected customers of the foreign currency dealing room and *nostro*.

As part of the foreign trading update project, during 2012, innovative services were initiated contributing to savings in personnel in the branches and in the International Trade Centre (Sahbal), to the improvement of customer service, to a shortening of the time required to carry out customers' instructions and to the avoidance of operating errors.

In 2012, additional new services for Leumi Trade customers were developed – an Express Debenture model, Investor Tool Center, Express ETFs, contingent instructions for professionals in the capital market, a new Ma'of model, Leumi Trade Global, etc.

In addition, during 2012, a new system -"Mabat" - went to air, in conjunction with the Investment Consulting Division, giving the consultant in the branch advanced and Internet user's experience. The system assists in complying with the regulatory requirements (the Israeli Securities Authority) with regard to the consultant's commitment to be exposed to all existing information related to the consulting areas in which he is engaged. The system provided an overall, up-to-date and broad picture from a rich variety of external and internal sources of information.

The Mabat system includes unique models for the consultant: shares, debentures, mutual funds, ETFs, daily bulletin, reviews, stock exchange notices, etc.

In the cellular field, an "iLeumi" application has been developed, for information and for executing transactions from an account to an iPhone. In addition, a Leumi Wallet application has been developed, for information and for executing transactions from an account to 3G devices. In 2011, the iLeumi Trade application was developed, enabling the receipt of information and trading in securities by cellular phone. Further to the abovementioned developments in the cellular field, in 2012, two applications were developed for handsets with an Android operation system: a Leumi application for information and for executing transactions from the account and a Leumi Trade application for information and for trading on the capital market. In addition, a Leumi HD application was developed for information and executing transactions on iPod devices. Services were added for budget management and the payment of electricity and Bezeq accounts by scanning to iPhone devices. In addition, a mortgage calculator by iPhone was developed for the Mortgage Division, as well as applications for account management for the Arab-Israel Bank and the Union Bank.

The Bank's investments and expenses in respect of information technologies in 2012:

Expenses recorded in the statement of profit and loss amounted to NIS 1,556 million, of which NIS 450 million were recorded in salary and related, NIS 604 million in depreciation expenses and NIS 502 million in other expenses.

Costs in respect of the information technology setup which were not recorded in the statement of profit and loss, but recorded as assets in the financial statements, amounted to NIS 738 million.

The balance of the assets in respect of the information technology setup as at 31 December 2012 amounted to NIS 2,167 million.

Against the background of various requirements by the authorities (Bank of Israel, Ministry of Finance etc.) for the execution of various directives, in 2012, the Bank invested in computer–related expenses estimated at some NIS 44 million (some NIS 48 million in 2011).

The principal issues in which the Bank invested in 2012 were Basel II, pension counseling and impaired debts.

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.

The Operations and Computer Division has been certified for quality standards in the following areas: software quality, data security, quality management systems, information technology services management, business continuity, safety and occupational hygiene, and fire safety.

This year, Leumi has contended for the first time with the category of large organizations and was awarded second place in the Yitzhak Rabin National Prize for Quality and Excellence. This competition is considered most prestigious in the area of quality and excellence in the State of Israel and its purpose is to raise the threshold of quality in Israel, to approve, streamline procedures and encourage various organizations and entities to be in a constant process of improvement.

The Israel Standards Institute has awarded Leumi, for the first time, the prestigious Diamond Medal for 2012 which is given to companies with seven or more medals for quality.

The Procurement, Building and Logistics Department has certification for 4 standards and Hatam has certification for 4 standards.

In addition, with effect from 2011, the system is certified for the Conservation of Energy Standard.

See Note 7 to the financial statements for further details.

Intangible Assets

1. The Bank is the sole proprietor of the "Leumi" trademark, and its 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 databases in which information is stored, *inter alia*, regarding customers, suppliers and employees of Leumi, with advanced technological means that are designed to protect customer activity and the Bank's business activity, while reducing the risks arising from the use of information systems.

4. The Group holds various intellectual property rights and user rights in various computer programs and information systems for the purpose of managing its business, including 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 on page 23.

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

Segments	Credit to the public			Deposits of the public			Total assets		
	2012	2011	Change	**2012**	2011	Change	**2012**	2011	Change
	NIS millions		%	NIS millions		%	NIS millions		**%**
Households[(1)]	**90,492**	83,045	9.0	**131,998**	130,276	1.3	**91,216**	83,831	8.8
Small businesses	**21,733**	20,039	8.5	**19,735**	18,109	9.0	**21,757**	20,068	8.4
Corporate banking	**70,252**	77,571	(9.4)	**26,291**	28,079	(6.4)	**71,905**	80,896	(11.1)
Commercial banking	**49,908**	50,536	(1.2)	**50,164**	46,527	7.8	**50,758**	51,431	(1.3)
Private banking	**8,170**	9,074	(10.0)	**38,338**	39,999	(4.2)	**13,167**	13,989	(5.9)
Financial management capital markets and others	**709**	1,055	(32.8)	**23,012**	16,414	40.2	**127,357**	115,639	10.1
Total	**241,264**	241,320	-	**289,538**	279,404	3.6	**376,160**	365,854	2.8

(1) Credit to households also including housing loans (mortgages) increased by 9% and, after canceling mortgages, increased by 5.8%. Housing loans amounted to NIS 62.0 billion at the end of 2012, having increased by 10.5%. The rate of increase on credit (banking and finance) in 2011 was 6.32%.

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

Segments	Guarantees and documentary credit			Securities portfolios, including mutual funds		
	2012	2011	Change	**2012**	2011	Change
	NIS millions		%	NIS millions		%
Households	**443**	499	(11.2)	**94,329**	88,849	6.2
Small businesses	**1,564**	1,331	17.5	**6,764**	6,485	4.3
Corporate banking	**27,652**	26,297	5.2	**59,996**	72,639	(17.4)
Commercial banking	**6,470**	6,772	(4.5)	**48,660**	44,225	10.0
Private banking	**387**	469	(17.5)	**85,065**	80,115	6.2
Financial management – capital markets and others	**821**	883	(7.0)	**232,768**	170,005	36.9
Total	**37,337**	36,251	3.0	**527,582**	462,318	14.1

Return on equity by operating segments

The equity for the purpose of calculating the capital to risk assets ratio (Tier 1 and Tier 2 capital) was allocated to the segments according to the relative share of each segment in the total of all the weighted risk assets of the Group, and according to the allocation of Pillar 2 equity for each segment according to its characteristics and constituents.

The profit of the operating segments has been adjusted for risk capital in each segment. The risk-adjusted yield has been calculated as the ratio of the adjusted profit to shareholders' equity allocated to the segment, constituting the share of the allocated risk capital (Tiers 1 and 2).

The following table shows the breakdown of net profit by operating segment:

Segment	**2012**	2011	Change
	NIS millions		%
Households	**447**	364	22.8
Small businesses	**319**	316	0.9
Corporate banking	**392**	760	(48.4)
Commercial banking	**444**	440	0.9
Private banking	**81**	173	(53.2)
Financial management	**(627)**	(414)	-
Other	**(125)**	252	-
Total	**931**	1,891	(50.8)

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 according to the allocation of all of the Bank's capital between the segments (according to actual capital adequacy pursuant to Basel II).

Segment	**As at 31 December 2012**		**As at 31 December 2011**	
	Allocation of all the capital		Allocation of all the capital	
	RORAC	EVA	RORAC	EVA
	%	NIS millions	%	NIS millions
Households	**9.6**	**(20)**	8.7	(54)
Small businesses	**21.1**	**168**	22.7	177
Corporate banking	**4.3**	**(522)**	9.3	(60)
Commercial banking	**10.3**	**13**	11.4	54
Private banking	**8.4**	**(16)**	22.0	94
Financial management – capital market	**(18.3)**	**(970)**	(10.1)	(823)
Other	**(29.9)**	**(167)**	70.1	216
Total to net profit	**3.8**	**(1,515)**	8.3	(395)

For the criteria for classifying customers according to operating segments, see page 24.
For further details regarding activities of the principal investee companies, see page 169 below.
A breakdown of the results of the operating segments is presented in Note 27 to the Financial Statements.

1. 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 54.

The strategic objectives for banking in the household segment are to broaden the customer base and expand the activities of existing customers, while placing emphasis on the provision of efficient service that is adapted to their needs, and consequently, an expansion of activity and an increase in profitability of the household segment. Household credit is an important growth driver for retail activity, in light of the high level of dispersion and good risk management capabilities.

Project "Advancing Together"

The information below is "forward-looking information". For an explanation of this phrase, see page 54.

In 2011, the Bank commenced the "Advancing Together" project which is aimed at upgrading the customer experience, while improving operating efficiency. As part of this project, several activities and procedures that are not involved with contact with customers are being taken from the branches and are being transferred to the remit of national centers of expertise. At the same time, in the branch and various channels, new initiatives are being launched to improve customer experience and service and adapt them to customer's needs. The project is being implemented gradually in all of the Bank's branches and full deployment is expected by the end of 2013.

In addition, two credit centers dealing with requests for credit from the branches were set up.

The important points of emphasis 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 various customers' 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 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.
- **service** - improving the level of service in order to increase customer satisfaction and loyalty by creating advantages for groups of customers through the provision of differential value proposals**;**
- **cooperation with companies in the Group,** in order to utilize the Group's abilities in providing comprehensive banking solutions to customers.

In September 2012, the merger of Leumi Mortgage Bank into Bank Leumi was approved. The merger came into effect on 31 December 2012 and Leumi Mortgage Bank began to operate in the format of a department, as a part of the Banking Division. The merger is expected to strengthen the Mortgage Department (hereinafter "Leumi Mortgage Department") with the Group's activity, and improve the quality and accessibility of customer service.

In connection with the draft directives regarding real estate for housing dated 19 February 2013, see the chapter "Legislation relating to the Banking System".

Structure of the Segment

Household banking segments its customers according to their characteristics, needs, preferences and scope of activity, and develops services, products and distribution channels for them according to this segmentation.
Service to these customers is in a range of channels and is provided both through a wide spread of 244 branches (including 16 counters and branches of the Arab Israel Bank Ltd.) located throughout the country and organized into eight districts on a geographical basis, and through the Leumi Call center, the Internet, Leumi information terminals, cellular, and through advanced Internet solutions adapted to meet customers' needs.

Service to customers in branches is provided by banking teams divided into customer segments. All aspects of customer service are coordinated by these teams, who specialize in providing service according to the customer's characteristics and needs.

Legislative Restrictions, Regulations and Special Constraints that apply to Banking in the Household Segment

The Bank, and the household segment, in particular, operates 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 Commissioner.

For information regarding the team examining Increasing Competitiveness in the Banking Sector, see page 47.

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

The household segment was 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. Private consumer expenditure increased in real terms in 2012 by 2.7%, and in terms of private consumption per capita, by 0.8%. This is a lower rate than the average of the previous five years. This involved a slower expansion in comparison to 2011, in which expenditure for private consumption in real terms increased by some 3.8%, mainly due to a decline in consumption of durable products. The slowdown in expenditure for private consumption in 2012 began in the second quarter of the year, against the backdrop of a slowdown in economic activity in the entire economy.

The segment is taking steps, *inter alia*, to expand the number of its customers receiving telephone service provided by the Leumi Call center, to which hundreds of thousands of customers are currently connected, and who perform most of their day-to-day transactions in their accounts via the center.

Each day, thousands of operations are performed via the Internet. In 2012, the Bank continued making technological improvements and adaptations of Leumi's websites to the various customer segments. In addition, developments in technology enable the Bank to develop products and services according to customer requirements.

Critical success factors in the segment

- 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;
- Broadening the exposure and availability of direct technological channels (Internet and telephone) to customers and broadening the geographical distribution (ATMs).
- Quality: abiding by the rules of consistent and methodical documentation, while strictly adhering to rules of compliance with consumer laws and regulations;
- 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;
- Provision of investment counseling and pension counseling services by making available suitable manpower and technological support.

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 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 light of increasingly strict and frequently changing regulations.

Alternatives to banking products and services in the segment

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, as follows:

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 fundamental principles of success are: the segmentation and understanding the requirements of customers and the provision of value proposals for contending with the competition, the availability and correct usage of distribution channels, while improving efficiency.

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 the supervision of the Bank of Israel, or not supervised at all, and do not operate under the restrictions that apply to the banks.

Directives issued by the Supervisor of Banks, which make it easier for customers to move from bank to bank, affect 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, the Bank invests considerable resources in development and the creation of a high level of availability of a range of channels: telephone, the internet and branches, in order to provide customers with an interface with the Bank for executing transactions and receiving information.

In the private credit field, the Bank offers customers, various credit products which are appropriate to their needs and the various stages in their lives, *inter alia*, it is possible to receive pre-approved loan, limited in amount, via all of the self-service channels, including ATMs, according to the characteristics and needs of each customer.

In the investments field, the Bank 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.

Pension Counseling

The balances of the pension assets held by customers receiving consultation in the Leumi Group known at the end of December 2012, including advance training funds in respect of which consultancy is provided in the framework of pension consulting and/or investment consulting amounts to some NIS 15.46 billion.

Customers

The Bank is able to offer its services with adaptations to the following various population groups in the segment: households with medium to low levels of wealth and current account requirements, customers with growth, for example,: young people, discharged soldiers, students and new immigrants, pensioners, salary-earners, mortgage customers and wealthy private customers.

For further details, see page 24.

Marketing and Distribution

The following information is "forward-looking information." For the meaning of this term, see page 54.

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. The Bank sees strategic importance in a broad distribution network. In 2012, eight new branches (including Total Digital, a virtual branch providing banking services remotely via various communication systems) were opened and one branch was closed. During the course of 2013, three new branches are planned to be opened to serve customers of this segment and two branches are expected to be closed. 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 channel of the household segment is the branch channel, while some of 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 and an exclusive page on Facebook. Through these channels, the Bank provides a service to customers, and general and marketing information for the use of the Internet users.

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 tailored to their needs.

Human Capital

In 2012, the average number of positions assigned to the household segment totaled 7,174, of which 1,471 were management staff, compared with 7,211 positions in 2011, of which 1,382 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 are employed in basic positions, having received appropriate training.

Credit Cards

See page 162 below.

Housing Loans – Mortgages -– These loans are provided by the Bank through the Leumi Mortgage Department in 97 representative offices operating in branches of Leumi and nine independent representative offices.

The majority of Leumi Mortgage Department'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 "Leumi Mortgage Running for You" and "Time Out from the Mortgage".

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

In addition, the Bank also provides loans for purchasing groups; see Exhibit E – Economic Sectors.

For additional details relating to the Bank of Israel's instructions on mortgages, see page 95.

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

	2012	2011	
	Annual total	Annual total	Change
	NIS millions		%
From bank funds	**13,665**	11,930	14.5
From Ministry of Finance funds:			
Directed loans	**34**	15	126.7
Bullet loans	**15**	4	275.0
Total new loans	**13,714**	11,949	14.8
Refinanced loans	**1,597**	1,182	35.1
Total performance	**15,311**	13,131	16.6

Details relating to Leumi Mortgage Department

Development of credit balance for housing, net:

	Balance of credit portfolio	Rate of growth
	NIS millions	%
December 2009	42,734	
December 2010	* 49,319	15.4
December 2011	54,386	10.3
December 2012	**60,294**	**10.9**

* Data in the tables below as of 31 December 2010 below are presented after implementing the directive of the Supervisor of Banks regarding measurement and disclosure of impaired debts.

Development of credit balance, net by linkage basis:

	Unlinked	Percentage of credit portfolio	Index-linked	Percentage of credit portfolio	Foreign currency	Percentage of credit portfolio	Total portfolio
	NIS millions	%	NIS millions	%	NIS millions	%	NIS millions
December 2009	15,585	36.5	26,114	61.1	1,035	2.4	42,734
December 2010 *	21,552	43.7	26,619	54.0	1,148	2.3	49,319
December 2011	22,973	42.2	29,802	54.8	1,611	3.0	54,386
December 2012	**26,234**	**43.5**	**32,522**	**53.9**	**1,538**	**2.6**	**60,294**

In recent years, there has been an increase in the level of housing credit, arising from, *inter alia*, an increase in demand for housing units and a rise in the prices of housing units. Most of this credit represents credit for the purpose of purchasing housing.

* Data in the tables below as of 31 December 2010 below are presented after implementing the directive of the Supervisor of Banks regarding measurement and disclosure of impaired debts.

Development of balance of housing credit portfolio, at variable and fixed interest:

	Fixed		Variable			Total credit portfolio
	Unlinked	Index-linked	Unlinked	Index-linked	Foreign currency	
	NIS millions					
December 2010 *	766	11,309	20,786	15,310	1,148	49,319
December 2011	1,142	11,125	21,831	18,677	1,611	54,386
December 2012	**2,144**	**10,698**	**24,090**	**21,824**	**1,538**	**60,294**

* Data for 31 December 2010 in the table below are presented after implementation of the directives of the Supervisor of Banks with regard to measurement and disclosure of impaired debts.

Development of new housing credit balance by interest path:

The development of new credit according to variable and fixed interest paths (a variable interest loan is a loan where the interest that it bears is likely to change over the life of the loan) is as follows:

	2012				**2011**	2010	2009
	Fourth quarter	Third quarter	Second quarter	First quarter	Annual average	Annual average	Annual average
	Percentage of loans granted %						
Fixed – linked	**9.9**	13.9	14.8	14.9	10.0	6.7	6.5
Variable – linked to index – every 5 years and over	**34.2**	38.8	44.8	45.1	26.7	11.6	4.5
Variable – linked up to 5 years	**3.7**	4.2	4.6	5.7	13.1	20.5	15.0
Fixed – unlinked	**11.6**	8.4	6.8	6.1	3.8	4.3	1.2
Variable – unlinked– 5 years and over	**11.3**	5.4	-	-	-	-	-
Variable – unlinked up to 5 years	**28.2**	27.5	27.6	27.0	42.0	53.8	70.5
Variable – foreign currency	**1.1**	1.8	1.4	1.2	4.4	3.1	2.3

The increase in the proportion of the index-linked variable interest loans including loans with variable interest every five years and more was on account of a decrease in the proportional share of variable interest loans on an index-linked basis, in light of the directive of the Supervisor of Banks relating to extending loans at variable interest, as stated above.

The percentage of new credit extended by the Bank in variable interest housing loans during 2012 stood at 79%, compared with 86% in 2011. The figures relate to all of the various interest paths and linkage segments, including loans in which the interest varies each period of five years and more. After canceling the effect of index-linked variable interest which varies each period of five years and more, which the directive of the Banking Supervision Department, as stated above, departs from the definition of variable interest loans, 33% were extended in 2012 on a variable interest basis, compared with 60% in 2011.

The balance of the past due portfolio in housing loans more than 90 days in arrears is as follows:

	Balance of recorded debt	Amount in arrears	Percentage of amount in arrears
	NIS millions		%
December 2008	40,024	1,587	4.0
December 2009	43,317	1,306	3.0
December 2010	49,911	1,046	2.1
December 2011	54,888	918	1.7
December 2012	**60,738**	**829**	**1.4**

The allowance for credit losses as at 31 December 2012, including the collective allowance on housing loans (hereinafter: "the overall allowance") as required in a letter of the Bank of Israel dated 1 May 2011, is NIS 444 million, representing 0.73% of the housing credit balance, compared to the balance of the allowance as at 31 December 2011, amounting to NIS 502 million, representing 0.92% of the housing credit balance. The decrease in the allowance for credit losses derives from a decrease in the balance of arrears in the Bank's credit portfolio.

Data relating to new housing credit:

In 2012, the Bank extended new housing loans amounting to NIS 12.7 billion of the Bank's funds.

Development of the rate of financing, in new credit, above 60%:

The development of new credit extended by Leumi Mortgage Bank at a rate of financing higher than 60% is as follows: (The rate of financing is the ratio between the rate of credit approved for a borrower (even if all or part thereof has not yet been actually extended) and the value of the asset mortgaged, at the time of extending the credit facility.)

	2012					2011	2010
	Annual average	Fourth quarter	Third quarter	Second quarter	First quarter	Annual average	Annual average
Rate of financing	%						
Between 60% and 70%	**22.6**	20.6	22.6	23.2	24.5	23.0	25.3
Between 70% and 80%	**12.9**	13.2	13.6	12.0	12.8	12.5	19.7
Above 80%	**3.5**	3,.8	4.0	3.5	2.5	3.2	3.1

Development of the rate of financing*, balance of credit portfolio:

The average rate of financing of the credit portfolio balance at 31 December 2012 was 50.6%.

Development of new credit, in which the repayment ratio* is lower than 2:

The percentage of new credit of loans in 2012 in which the repayment ratio is lower that 2 to income-earners of NIS 10,000 and below, at the date of approval of the credit, stood at 1% of the total extensions of new credit compared with an average of 2% for 2010 - 2011 (the repayment ratio is calculated by dividing the fixed monthly income of the borrower by the total monthly repayments in respect of the existing mortgage loans and in respect of the new loan).

This calculation complies with the Bank of Israel directives reporting to the Banking Supervision Department pursuant to Regulation 876.

* The definition mentioned in the disclosure above (for example: repayment ratio, rate of financing, etc.) is in accordance with the Bank's reporting to the Bank of Israel.

Development of new credit, in which the repayment dates are longer than 25 years:

The percentage of the new credit of housing loans in 2012, in which repayment dates according to loan contracts longer than 25 years, stood on average at 31% of the total of new credit extended, compared with an average rate of some 39% for 2011 and some 37% for 2010.

In general, the Bank does not extend new loans whose terms enable the borrower to make a payment which is lower than the interest accrued on the loan, except in extraordinary cases.

The Bank does not extend loans secured by a secondary mortgage, except in extraordinary cases.

According to the Bank's credit policy, the Bank extends new loans in which the information the Bank has on the borrower or on the collateral, at the time of granting the loan, is complete, updated and verified.

Developments in credit risks

In recent years, against a background of rising demand for housing units, both for residential purposes and for investment, there has been a significant increase in housing prices, resulting in a substantial increase in the level of housing credit. Against the backdrop of this price increase, the risk inherent in the provision of loans at high financing rates has increased, attributable to the high debt burden on the borrower and a higher exposure when there is an impairment in the security.

In addition, the low interest rates which prevailed in the economy in recent years, particularly unlinked Prime interest, led to a sharp increase in the proportion of unlinked variable interest loans, out of the total credit to the public in the mortgage market. Accordingly, in an environment of an increase in interest rates, the borrowers are exposed to an increase in the level of mortgage payments.

As a result of the economic developments that have occurred in recent years, as presented above, the Bank adopted a number of measures in order to contend with the increase in the abovementioned credit risks.

- As part of the risk management, it was decided to tighten the administrative limits for the following features: high financing rates, current monthly repayment ability, credit rating according to the Bank's internal statistical model, loan products/paths, interest types and extent of loan.

- As part of credit risk management, the Bank periodically performs stress scenarios that have examined the effect of a possible fall in the value of securities, a possible increase in interest rates and the effect of other macroeconomic variables on the Bank's results.

As a part of its capital planning and its goals, the Bank has maintained further "capital buffers" to deal with higher risk features, such as: a capital buffer in respect of loans at high financing rates, a capital buffer in respect of the gap between the current rate of allowance for credit losses and the average rate over an economic cycle and a capital buffer in respect of the possibility of a fall in real estate prices.

The average loan extended by the Bank in 2012 was NIS 530 thousand, compared with NIS 540 thousand in 2011, NIS 665 thousand in 2010 and NIS 596 thousand in 2009.

It appears that, to date, the quality of the Bank's credit portfolio is good, this, relying on the data for extent of debts in arrears, the credit loss allowances and the problem debts as a percentage of the Bank's total credit portfolio, as well as the low rate of losses on the liquidation of assets.

Below is a summary of the results of operations of the Household Segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Overseas activity: Banking and finance	Overseas activity: Mortgages	Total
	2012						
	NIS millions						
Net interest income:							
From external sources	**(605)**	**251**	**8**	**2,230**	**(11)**	**11**	**1,884**
Intersegmental	**2,576**	**(50)**	**(5)**	**(1,623)**	**18**	**(1)**	**915**
Non-interest income:	**-**	**-**	**-**	**-**	**-**	**-**	**-**
From external sources	**582**	**496**	**456**	**82**	**6**	**-**	**1,622**
Intersegmental	**5**	**177**	**-**	**48**	**-**	**-**	**230**
Total income	**2,558**	**874**	**459**	**737**	**13**	**10**	**4,651**
Expenses in respect of credit losses	**62**	**18**	**-**	**(11)**	**2**	**-**	**71**
Operating and other expenses:	**-**	**-**	**-**	**-**	**-**	**-**	**-**
To external sources	**2,629**	**636**	**314**	**256**	**14**	**6**	**3,855**
Intersegmental	**-**	**(5)**	**-**	**22**	**-**	**-**	**17**
Profit before taxes	**(133)**	**225**	**145**	**470**	**(3)**	**4**	**708**
Provision for (benefit from) taxes on profit	**(50)**	**69**	**52**	**165**	**-**	**-**	**236**
Profit (loss) after taxes	**(83)**	**156**	**93**	**305**	**(3)**	**4**	**472**
Net profit attributable to non-controlling interests	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Net profit (loss)	**(83)**	**131**	**93**	**305**	**(3)**	**4**	**447**
% Return on equity							**9.6%**
Average balance of assets	**19,798**	**8,216**	**130**	**58,915**	**67**	**191**	**87,317**
of which: investments in companies included on equity basis	**-**	**2**	**-**	**-**	**-**	**-**	**2**
Average balance of liabilities	**126,514**	**1,020**	**-**	**6,428**	**879**	**9**	**134,850**
Average balance of risk assets	**21,503**	**8,036**	**128**	**32,147**	**224**	**67**	**62,105**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**53,968**	**-**	**-**	**-**	**53,968**
Average balance of securities	**-**	**-**	**48,990**	**-**	**175**	**-**	**49,165**
Average balance of other assets under management	**204**	**-**	**-**	**4,930**	**-**	**-**	**5,134**
Margin from credit-granting activities*	**912**	**200**	**3**	**559**	**(7)**	**10**	**1,677**
Margin from deposit-taking activities*	**1,059**	**1**	**-**	**48**	**14**	**-**	**1,122**
Other	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total net interest income	**1,971**	**201**	**3**	**607**	**7**	**10**	**2,799**
Balance of credit to the public	**19,907**	**8,387**	**138**	**61,794**	**62**	**204**	**90,492**
Balance of deposits of the public	**127,229**	**32**	**-**	**3,804**	**924**	**9**	**131,998**

* 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.

Household Segment (cont.):

	Banking and finance	Credit cards	Capital market	Mortgages	Overseas activity: Banking and finance	Overseas activity: Mortgages	Total
	2011						
	NIS millions						
Net interest income:							
From external sources	(794)	236	7	2,163	(9)	11	1,614
Intersegmental	2,726	(49)	(4)	(1,703)	20	(3)	987
Non-interest income:	-	-	-	-	-	-	-
From external sources	601	488	500	216	6	-	1,811
Intersegmental	11	204	-	(89)	-	-	126
Total income	2,544	879	503	587	17	8	4,538
Expenses in respect of credit losses	62	21	-	(21)	1	6	69
Operating and other expenses:							
To external sources	2,670	612	304	275	17	6	3,884
Intersegmental	5	(4)	-	19	-	-	20
Profit (loss) before taxes	(193)	250	199	314	(1)	(4)	565
Provision for (benefit from) taxes on profit	(69)	72	69	100	1	-	173
Profit (loss) after taxes	(124)	178	130	214	(2)	(4)	392
Net profit attributable to non-controlling interests	-	(28)	-	-	-	-	(28)
Net profit (loss)	(124)	150	130	214	(2)	(4)	364
% Return on equity							8.7%
Average balance of assets	18,593	7,506	125	53,932	107	156	80,419
of which: investments in companies included on equity basis	-	5	-	-	-	-	5
Average balance of liabilities	117,188	958	-	9,260	842	8	128,256
Average balance of risk assets	20,818	7,407	123	28,575	290	55	57,268
Average balance of mutual funds and supplementary training funds	-	-	53,540	-	-	-	53,540
Average balance of securities	-	-	50,640	-	166	-	50,806
Average balance of other assets under management	254	-	-	5,643	-	-	5,897
Margin from credit-granting activities*	851	186	3	399	(4)	8	1,443
Margin from deposit-taking activities*	1,081	1	-	61	15	-	1,158
Total net interest income	1,932	187	3	460	11	8	2,601
Balance of credit to the public at 31 December 2011	19,119	7,615	134	55,925	73	179	83,045
Balance of deposits of the public at 31 December 2011	124,787	32	-	4,607	842	8	130,276

Main Changes in the Volume of Activity

Total credit to households at the end of 2012 amounted to NIS 90.5 billion, an increase of 9%. Of this, consumer credit totaled NIS 28.6 billion, an increase of 5.8% and credit for housing totaled NIS 62.0 billion, an increase of 10.5%. Deposits of the public increased from NIS 130.3 billion to NIS 132.0 billion, an increase of 1.3%.

In the securities portfolios of the segment, there was an increase of some NIS 5.5 billion, 6.2%, mainly resulting from an increase in market values.

Main Changes in the Net Profit

Net profit from the household segment totaled NIS 447 million in 2012, compared with NIS 364 million in the corresponding period in 2011, an increase of NIS 83 million (22.8%).

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

- An increase in interest income amounting to NIS 198 million, 7.6%, and a decrease in operating expenses of NIS 32 million.
- On the other hand, a decrease in noninterest income amounting to NIS 85 million, mainly from securities fees, partially offset the aforementioned changes.

Mortgages

The net profit in mortgages amounted in 2012 to NIS 305 million, compared with NIS 214 million in 2011, an increase of NIS 91 million. Net interest income and operating revenues increased by NIS 152 million from NIS 587 million in 2011 to NIS 737 million in 2012, as a result of an increase in activity in the financial margin. In expenses in respect of credit losses, there was a decrease in credit loss allowances amounting to NIS 4 million in 2012. Operating expenses in 2012 amounted to NIS 278 million, compared with NIS 294 million in 2011.

2. 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 23 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 page 54.

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 tailored to their needs.

In connection with the project "Advancing Together", see above on page 122.

The business line emphases in the small business segment 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 tailored to the needs of customers, using data and analytical models to analyze and forecast the customers’ financial activities and needs;
- systematic, information-based **initiative** *vis-à-vis* customers in all products: commercial credit, consumer credit, international trade, 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**;**
- **collaboration with companies in the Group,** 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 and 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, investments and routine business activities, while determining sub-segments by level 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 Commissioner.

For information regarding the team evaluating Increased Competitiveness in the Banking Sector, see page 47.

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:

- High levels of management and interpersonal capabilities of the bodies responsible in the business centers.
- 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 proactive 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

Capital Market – brokers, insurance companies, fund managers

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.

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.

Segment 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 any place and any time.

Customers

The customers associated with 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 25 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, teams are established in most of the branches in the Banking Division for handling customers in the segment, 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.

Human Capital

In 2012, the average number of positions assigned to the small business segment totaled 1,846 of which 482 were management staff, compared with 1,866 positions, of which, 466 were management staff, last year.

The employees engaged in this segment are mainly employees with academic education. In addition, employees receive regular professional training in various fields of banking..

The following table presents a summary of the results of operations of the Small Business Segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Real estate	Overseas activity Banking and finance	Overseas activity Real estate	Total
	2012							
	NIS millions							
Net interest income:								
From external sources	**724**	**24**	**1**	**4**	**298**	**39**	**7**	**1,097**
Intersegmental	**(59)**	**(6)**	**(1)**	**(3)**	**(92)**	**(9)**	**(3)**	**(173)**
Non-interest income:								
From external sources	**339**	**108**	**23**	**-**	**66**	**14**	**1**	**551**
Intersegmental	**3**	**(47)**	**-**	**-**	**-**	**-**	**-**	**(44)**
Total income	**1,007**	**79**	**23**	**1**	**272**	**44**	**5**	**1,431**
Expenses in respect of credit losses	**74**	**-**	**-**	**-**	**7**	**3**	**-**	**84**
Operating and other expenses:								
To external sources	**649**	**52**	**12**	**-**	**109**	**29**	**3**	**854**
Intersegmental	**1**	**3**	**-**	**-**	**-**	**-**	**-**	**4**
Profit before taxes	**283**	**24**	**11**	**1**	**156**	**12**	**2**	**489**
Provision for taxes on profit	**100**	**7**	**4**	**-**	**55**	**1**	**-**	**167**
Profit after taxes	**183**	**17**	**7**	**1**	**101**	**11**	**2**	**322**
Net profit attributable to non-controlling interests	**(1)**	**(2)**	**-**	**-**	**-**	**-**	**-**	**(3)**
Net profit (loss)	**182**	**15**	**7**	**1**	**101**	**11**	**2**	**319**
% Return on equity								**21.1%**
Average balance of assets	**13,112**	**840**	**24**	**98**	**5,872**	**668**	**174**	**20,788**
Average balance of liabilities	**14,930**	**1,430**	**-**	**-**	**3,282**	**528**	**66**	**20,236**
Average balance of risk assets	**11,000**	**665**	**23**	**72**	**5,806**	**669**	**174**	**18,409**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**2,175**	**-**	**-**	**-**	**-**	**2,175**
Average balance of securities	**-**	**-**	**4,748**	**-**	**-**	**5**	**-**	**4,753**
Average balance of other assets under management	**226**	**-**	**-**	**-**	**-**	**-**	**-**	**226**
Margin from credit-granting activities	**519**	**18**	**-**	**1**	**182**	**16**	**3**	**739**
Margin from deposit-taking activities	**146**	**-**	**-**	**-**	**24**	**14**	**1**	**185**
Total net interest income	**665**	**18**	**-**	**1**	**206**	**30**	**4**	**924**
Balance of credit to the public	**13,470**	**874**	**29**	**107**	**6,137**	**883**	**233**	**21,733**
Balance of deposits of the public	**15,574**	**-**	**-**	**-**	**3,482**	**622**	**57**	**19,735**

Small Business Segment (continued):

	Banking and finance	Credit cards	Capital market	Mortgages	Real estate	Overseas activity Banking and finance	Overseas activity Real estate	Total
	2011							
	NIS millions							
Net interest income:								
From external sources	726	25	2	5	303	34	3	1,098
Intersegmental	(70)	(6)	(1)	(3)	(103)	(7)	-	(190)
Non-interest income:								
From external sources	339	107	25	-	64	12	1	548
Intersegmental	-	(52)	-	-	-	-	-	(52)
Total income	995	74	26	2	264	39	4	1,404
Expenses in respect of credit losses	55	(2)	-	-	17	17	2	89
Operating and other expenses:								
To external sources	627	47	12	-	106	30	2	824
Intersegmental	2	3	-	-	-	-	-	5
Profit (loss) before taxes	311	26	14	2	141	(8)	-	486
Provision for taxes on profit	105	7	5	1	49	1	-	168
Profit (loss) after taxes	206	19	9	1	92	(9)	-	318
Net profit attributable to non-controlling interests	-	(2)	-	-	-	-	-	(2)
Net profit (loss)	206	17	9	1	92	(9)	-	316
% Return on equity								22.7%
Average balance of assets	12,383	810	30	104	5,474	549	115	19,465
Average balance of liabilities	14,171	1,395	-	-	2,980	412	72	19,030
Average balance of risk assets	10,725	632	30	80	5,403	666	115	17,651
Average balance of mutual funds and supplementary training funds	-	-	2,199	-	-	-	-	2,199
Average balance of securities	-	-	5,698	-	-	4	-	5,702
Average balance of other assets under management	244	-	-	-	-	-	-	244
Margin from credit-granting activities	504	19	1	2	174	14	2	716
Margin from deposit-taking activities	152	-	-	-	26	13	1	192
Total net interest income	656	19	1	2	200	27	3	908
Balance of credit to the public at 31 December 2011	12,741	814	31	93	5,750	488	122	20,039
Balance of deposits of the public at 31 December 2011	14,747	-	-	-	2,876	416	70	18,109

Main changes in the volume of activity

In the small business segment there was an increase of NIS 1.7 billion, 8.5%, most of which was from domestic activities. The total deposits of the public increased by NIS 1.6 billion, 9.0%, all of which was from domestic activity.

The securities portfolios recorded an increase of some NIS 0.3 billion (4.3%).

Main changes in the net profit

Net profit in the small business segment totaled NIS 319 million in 2012, compared with NIS 316 million in 2011.

The increase in profit derives mainly from an increase in income amounting to NIS 27 million, a decrease in expenses in respect of credit losses amounting to NIS 5 million, representing 0.38% of the credit portfolio at the end of 2012. The above increase was partially offset by an increase in operating expenses of NIS 29 million, 3.5%.

The abovementioned positive effect is attributable to an increase in overseas activity and an improvement in net profit amounting to NIS 13 million, compared with a loss of NIS 9 million in 2011. This change is attributable to an increase of NIS 13 million in Romania and an increase of NIS 7 million in the United Kingdom. On the other hand, the profit from activity in Israel amounted to NIS 306 million, compared with NIS 325 million in 2011, as a result of an increase in expenses in respect of credit losses amounting to NIS 11 million and in operating expenses amounting to NIS 29 million.

3. Corporate Banking Segment

General

The corporate banking segment 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 services, capital market activities, financial instruments designed to hedge against market risks, complex transactions (projects, mergers and acquisitions, syndicate organization), etc. Services outside of Israel are provided to the corporate segment primarily by Bank Leumi USA, Bank Leumi (UK) and Bank Leumi Romania.

Structure of the segment

The corporate banking segment is managed in Israel by the Corporate Division, which also incorporates the Complex Finance and Real Estate Division, the divisions managing the activities of the segment through the Corporate Department and the Construction and Real Estate Department, which together operate seven business sectors, as well as through the Credit Department. Service to customers is provided by customer relations managers, who coordinate the Group's services to the customer and specialize in the market sector 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. Special/complex transactions, for example, international trade activity, finance of foreign debtors/domestic debtors, sale of debts and syndicates, etc., the acquisition of means of control, examination of investment programs and the financing of projects are handled by a designated unit specializing in handling transactions of this kind, due to the complexity and level of risk involved.

The sectors in the Corporate Department are as follows:

a. The technology sector, specializing in providing services to corporate customers, mainly in the area of high-tech, communication and the security industry;

b. The consumption and trade sector, specializing in providing services to corporate customers, mainly in the area of the food and drink industry, hotels, the written media, retail chains, importers of household appliances, importers of agricultural, wood and metal products;

c. The industry, transport and public institutions sector, specializing in providing services for corporate customers, mainly from the area of industry, airline companies, vehicle importers, leasing, aircraft and local authorities;

d. The chemicals sector, energy and holding companies, specializing in providing services for holding companies and corporate customers, mainly from the area of chemicals, pharmaceuticals and fuel companies.

Credit Department

The Credit Department's activities include developing control processes and assimilating work procedures for granting credit at the Bank level, implementing and assimilating the Basel II regulatory directives, as well as the directives regarding measurement and disclosure of impaired debts, credit risks and provisions for credit losses, which became effective from 1 January 2011.

Credit Risk Management Unit (CRMU)

The CRMU operates with the Credit Department. This unit is responsible for the analysis and independent examination of credit facilities and the detection of customers whose situation has deteriorated, indicating the main risks characterizing the credit and making recommendations for the continuation for handling the customers. In addition, it performs systematic credit controls, making recommendations on classifications and allowances and is engaged in the development of methodologies and financing "structures".

Business objectives and strategy

The following information is "forward-looking information." For the meaning of this term, see page 54.

2012 was characterized further to the implementation of the selective policy of activity expansion, distinguishing between the various risk levels and accordingly and expansion of the credit margins and its conditions. This policy was adopted against the background of geopolitical threats and a slowdown in economic growth in Israel and around the world, and is expected to continue in 2013.

In order to disperse risk, *inter alia*, activity continues in the main activity centers of the Bank abroad contributing to the dispersal of risks through exposure to different macro-economic environments and various features of customers.

Restrictions, legislation, regulations and special constraints that apply to the segment

The restrictions that are especially relevant for the corporate banking segment are the restrictions prescribed in Proper Conduct of Banking Management Regulation No. 313 and the restriction in accordance with Proper Conduct of Banking Business Regulation 323 relating to the balance of credit for all transactions for purchase of control in a controlling instrument (for further information see below on page 213).

Since 2007, corporate banking has been taking steps 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 with company-wide 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 of 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

For an expansion on the subject of the world economy, see the chapter, "Economic Review". Regarding the developments in each of the sectors that comprise the segment, see page 90 above.

Technological changes that may have a material impact on the segment

The information systems that serve the corporate banking segment are intended to assist in analyzing customers' needs and in the ongoing work with them, in the analysis and measurement of credit risks and in the monitoring and control of customers' activities. The various technological systems are updated and upgraded on an ongoing basis for the benefit of the segment.

Critical success factors in the segment

Critical success factors in the segment are: staff possessing high levels of management and interpersonal abilities (both *vis-à-vis* the customers and within the organization), familiarity with the customers, including their financial position and the prospects/risks inherent in working with them, improvement of professionalism and ongoing monitoring of the changes occurring in the market in order to identify potential and avoid risk, 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, credit risk management and control.

Alternatives to the products and services of the segment, and the changes that have occurred therein

Since the sources available to the Bank for providing long-term financing are limited in comparison with the sources available in the short to medium-term, the Bank is taking steps to bring in institutional investors to participate in financing through their integration in financing consortia or by means of the sale of portions of the existing medium and long-term bank credit.

Products and services of the segment

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, organization of syndicates, financial instruments to hedge against currency risks, interest risks and fluctuations in commodities prices. 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 mostly characterized by their leading position in the market and dominance in their field of activity. 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 status of the Israeli banks as the sole financers of corporations has continued to dwindle over the years, so that the weighting of credit to the business sector provided by the banking system stands at some 52% at the end of 2012.

The Israeli capital market and the institutional entities make up most of the competition for business credit (particularly for large companies), due to the expected substantial issues of government debt in the coming years. It is anticipated that the volume of available sources in the capital market will dwindle. Also, it is likely that the debt agreements with those companies that raise funds will not improve the fund-raising ability of the business sector in the near future, especially with regard to companies identified by institutional investors and those who determine economic policy will seem less attractive than in the past.

In view of the aforesaid, and in light of the increase in the Government deficit, it appears that most of the burden will fall on the local banking system, and it is doubtful whether it will be able to address that need in full, especially given regulation affecting the concentration of sectors of industry, groups of borrowers and capital adequacy.

Human Capital

In order to bring employees engaged in the field of credit to the required professional level, there is an appropriate training system. On specific topics, there is the support of a specialist or outside unit (for example, appraisal experts, team of accounts, project support unit for financing international trade, unit for financing syndicate participation, etc.).

In 2012, the average number of positions assigned to the segment (including the Complex Finance and Real Estate Division) totaled 1,102 positions, of which, 439 were management positions, compared with 1,108 positions in 2011, 451 of which were management staff. Most of the employees have an academic education. In addition to their educational qualifications, as part of their training at the Bank, the employees undergo regular professional training in various fields of banking, as well as management courses. Within the scope of their work, employees must possess the ability to analyze complex credit applications, to lead complicated transactions, and the ability to provide service of the highest standard.

Complex Finance and Real Estate Division

General

The Division operates in the context of the Corporate Division and as part of the corporate banking segment. The main activity of the Structured Finance and Real Estate Division is carried out through the Construction and Real Estate Department, specializing 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. Project financing is provided in the form of closed construction lending (construction loan), which is subject to tight supervision and control with an emphasis on meticulous scrutiny of each project.

The Credit Risk Management Unit in the Credit Department, which constitutes a part of the Credit Department, examines and approves the transactions or submits them for deliberation by the appropriate credit committee.

The Structured Finance and International Trade Department, which operates as part of the Division, is also responsible for planning special transactions, such as financing projects in Israel and abroad, transactions to finance the means of control, the sale of debts and the organization of syndicates, the examination of investment, trade and international finance programs.

The Syndication and Sale of Debts Sector is responsible for the activity of selling debts, intended, inter alia, to reduce credit concentrations in necessary focal points, and to organize syndicates, whose purpose is, inter alia, a continuation of leading large-volume transactions, dividing up risk with partners in the financing and prudent management of the Bank's capital.

Structure of the Construction and Real Estate Division

Most of the corporate activity in financing the construction and real estate sector, including large infrastructure projects, is carried out through the Construction and Real Estate Division. The division supplies a comprehensive range of banking services to major business enterprises in the economy, middle-market business enterprises engaging in construction and real estate and entrepreneurs whose goal is to set up and operate projects in the field of infrastructure.

The division is divided into three sectors, each operated by two to four senior customer relations managers, with specific expertise in the real estate sector and in the field of infrastructure and performing contractors. The senior customer relations managers coordinate all handling of the banking needs of the customers of the department.

The sectors in the division are:

a. The construction companies sector, which supplies an extensive range of banking services to the major customers in the economy in the field of construction and real estate in Israel and abroad.

b. The real estate promotion sector, which specializes in providing services mainly to middle-market business customers, with the majority of its activity focusing on financing the residential housing branch and which is handled via the closed construction loan method.

c. The infrastructure sector, which is engaged in the financing of national infrastructure projects employing the P.P.P. (Public Private Partnership) method (which is based on cooperation between the public and private sectors) and in the provision of services to corporate customers in the field of infrastructure and performance contracting.

The Bank, through the Construction and Real Estate Division, also 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 the 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 54.

The Real Estate Division is involved in the segment of major and middle-market customers in the real estate field. The main objective is to deepen its relative advantage, provide maximum service to the Department's customers and to continue to improve its contribution to the Group's profits. The division guides activity in this area, carefully and prudently scrutinizing the exposures deriving from customers' activity and the unique risks for this sector. At the same time, the division acts to expand the variety of products and services being offered to customers.

Restrictions, legislation, regulations and special constraints that apply to the segment

For further details, see page 140 above under the corporate banking segment.

Project financing using the closed construction lending format 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 and directives of 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, a supplementary allowance for credit losses is required in respect of the sum of the amount of the excess.

After the merger of Leumi Mortgage Bank Ltd. with Bank Leumi, the rate of concentration of the Real Estate Division for 2012 is within the regulatory limit.

From 1 January 2011, the directive governing the measurement and disclosure of impaired debts came into force, pursuant to which a collective allowance for credit losses is computed. In accordance with the above mentioned directive, if the total collective allowance is higher than the allowance required as a supplementary allowance (pursuant to Proper Conduct of Banking Business Regulation 315), there is no need to make a supplementary allowance.

In connection with the merger of Leumi Mortgage Bank, see page 11

Developments in the markets of the segment or changes in the characteristics of its customers

With regard to developments that have occurred in each of the industries making up the segment, see page 90.

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 the assessment of borrowers and in the monitoring and control of customers' activities. The various technological systems are updated and upgraded on an ongoing basis for the benefit of the segment.

Critical success factors in the segment

Critical success factors in the segment are: recognition of all of the segments in the market and the trends therein, 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.

Alternatives to the products and services of the segment, and the changes that have occurred therein

Most of the real estate segment is financed through the banking system. However, in recent years, the involvement of the capital market has been increasing - either through the issue of debentures (whose proceeds are used for any purpose, including making investment abroad) or by the provision of direct loans by the institutional entities secured by the collateral of income-yielding assets, or the provision of loans and the issue of guarantees for housing projects, in the last period, with increasing involvement particularly, in this activity segment being identified.

Since the sources available to the Bank for providing long-term financing are limited in comparison with the sources available in the short to medium-term, we are operating in the field of long-term projects (mainly infrastructure projects and income-yielding assets) to bring in institutional investors to participate in financing through their integration in financing consortia or by means of the sale of portions of the existing long-term bank credit.

Structure of the Competition in the Segment and the Changes that have occurred therein

There is competition over financing of the real estate sector, both from the four major banking groups in Israel and from small banks in the system. In recent years, there has been involvement by institutional entities, such as insurance companies and pension funds.

Products and services of the segment

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 differentiating between the various segments – residential, income-producing properties designated for commerce and offices, and construction for industry and commerce. Residential projects will be financed, as a rule, using the closed construction lending method, which enables high frequency, tight supervision of the project being overseen.

The Construction and Real Estate Division continues its involvement in the financing of national projects under the various PPP methods. These transactions are analyzed in conjunction with a special unit in the Structured Finance and International Trade 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 establishment and operation contract limitation, technical constraints, etc.

The following table presents a summary of the results of operations of the Corporate Banking segment:

	Banking and finance	Credit cards	Capital market	Real estate	Overseas activity Banking and finance	Overseas activity Real estate	Total
	2012						
	NIS millions						
Net interest income:							
From external sources	**1,560**	**28**	**3**	**1,139**	**8**	**6**	**2,744**
Intersegmental	**(586)**	**(9)**	**(3)**	**(612)**	**14**	**-**	**(1,196)**
Non-interest income:							
From external sources	**102**	**189**	**15**	**297**	**8**	**2**	**613**
Intersegmental	**150**	**(100)**	**-**	**(26)**	**-**	**-**	**24**
Total income	**1,226**	**108**	**15**	**798**	**30**	**8**	**2,185**
Expenses in respect of credit losses	**991**	**1**	**-**	**(59)**	**-**	**-**	**933**
Operating and other expenses:							
To external sources	**375**	**76**	**17**	**160**	**18**	**4**	**650**
Intersegmental	**-**	**1**	**-**	**-**	**-**	**-**	**1**
Profit (loss) before taxes	**(140)**	**30**	**(2)**	**697**	**12**	**4**	**601**
Provision for taxes (tax benefit)	**(52)**	**7**	**(1)**	**246**	**3**	**1**	**204**
Profit (loss) after taxes	**(88)**	**23**	**(1)**	**451**	**9**	**3**	**397**
Net profit attributable to non-controlling interests	**(1)**	**(4)**	**-**	**-**	**-**	**-**	**(5)**
Net profit (loss)	**(89)**	**19**	**(1)**	**451**	**9**	**3**	**392**
% Return on equity							**4.3%**
Average balance of assets	**49,588**	**416**	**165**	**25,793**	**495**	**167**	**76,624**
Average balance of liabilities	**20,981**	**2,676**	**-**	**5,577**	**899**	**170**	**30,303**
Average balance of risk assets	**76,624**	**393**	**164**	**26,195**	**618**	**167**	**104,161**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**2,087**	**-**	**-**	**-**	**2,087**
Average balance of securities	**-**	**-**	**56,814**	**-**	**130**	**-**	**56,944**
Average balance of other assets under management	**226**	**-**	**-**	**-**	**-**	**-**	**226**
Margin from credit-granting activities	**949**	**19**	**-**	**508**	**3**	**5**	**1,484**
Margin from deposit-taking activities	**25**	**-**	**-**	**19**	**19**	**1**	**64**
Total net interest income	**974**	**19**	**-**	**527**	**22**	**6**	**1,548**
Balance of credit to the public	**44,452**	**389**	**166**	**24,649**	**392**	**204**	**70,252**
Balance of deposits of the public	**19,748**	**-**	**-**	**4,999**	**1,373**	**171**	**26,291**

Corporate Banking Segment (continued)

	Banking and finance	Credit cards	Capital market	Real estate	Overseas activity Banking and finance	Overseas activity Real estate	Total
	2011						
	NIS millions						
Net interest income:							
From external sources	1,495	30	7	1,256	16	(2)	2,802
Intersegmental	(599)	(11)	(7)	(737)	(3)	6	(1,351)
Non-interest income:							
From external sources	37	193	20	250	5	1	506
Intersegmental	255	(115)	-	-	-	-	140
Total income	1,188	97	20	769	18	5	2,097
Expenses in respect of credit losses	(1)	(3)	-	316	-	-	312
Operating and other expenses:							
To external sources	400	73	11	133	10	3	630
Intersegmental	-	1	-	-	-	-	1
Profit before taxes	789	26	9	320	8	2	1,154
Provision for taxes	267	7	3	110	2	1	390
Profit after taxes	522	19	6	210	6	1	764
Net profit attributable to non-controlling interests	-	(4)	-	-	-	-	(4)
Net profit	522	15	6	210	6	1	760
% Return on equity							9.3%
Average balance of assets	49,958	417	158	26,462	576	25	77,596
Average balance of liabilities	26,478	2,611	46	5,551	232	262	35,180
Average balance of risk assets	71,421	388	157	26,608	824	25	99,423
Average balance of mutual funds and supplementary training funds	-	-	1,281	-	-	-	1,281
Average balance of securities	-	-	82,557	-	145	-	82,702
Average balance of other assets under management	221	-	-	-	-	-	221
Margin from credit-granting activities	861	19	-	495	10	2	1,387
Margin from deposit-taking activities	36	-	-	23	3	2	64
Total net interest income	897	19	-	519	13	4	1,451
Balance of credit to the public at 31 December 2011	49,899	387	162	26,389	609	125	77,571
Balance of deposits of the public at 31 December 2011	22,898	-	-	4,894	118	169	28,079

Main Changes in the Volumes of Activity

In the corporate banking segment, there was a decrease in credit to the public of some NIS 7.3 billion, 9.4%, primarily from domestic banking and financial activities. There was a decrease in deposits of the public of some NIS 1.9 billion, 6.4%, mainly in activity in Israel. There was a decrease in activity in securities of some NIS 12.7 billion, or 17.4%. In off-balance sheet activity, there was an increase of 5.2% in guarantees and documentary credit.

Main Changes in the Net Profit

Net profit in the corporate banking segment in 2012 totaled NIS 392 million, compared with NIS 760 million in the corresponding period in 2011, a decrease of 48.4%. The decrease in profit derived mainly from an increase in expenses in respect of credit losses of some NIS 621 million, mainly from a decrease in the collection of debts and an increase in the collective allowance and an increase in operating expenses of NIS 20 million. On the other hand, there was an increase in net interest income amounting to NIS 97 million, 6.7%.

4. 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 120 million were approved, with the customer's total obligo in the banking system not exceeding NIS 250 million and up to NIS 80 million when the customer's total obligo in the banking system exceeds NIS 250 million and the customer's total activity turnover does not exceed NIS 400 million. In addition, the interested parties of the business companies, including shareholders and senior office holders are also dealt with in this segment.

Service and marketing to these customers are carried out on an individual basis, including 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, the financing of active customers in the capital market and 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 leverage their relations with the Bank in Israel in order to expand 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 page 173.

Structure of the segment

The segment is managed in Israel by the Commercial Banking Division. This division has an organizational structure that is unique in the Israeli banking system, which enables it to provide its customers with all-inclusive and comprehensive service (a one-stop shop) 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 23 business branches located in industrial zones and in the major cities, which are attributed geographically to four commercial districts. The branches specialize in the management of business activities characteristic of the Division's customers, giving it a competitive advantage.

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.

Goals and business strategy and expectations for developments in the coming year

The following information is "forward-looking information". For the meaning of this term, see page 54.

Commercial banking serves middle-market business customers. 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, placing an emphasis on financing customers characterized by potential for growth and an appropriate level of risk, 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 90 of the Report.

Developments in the markets of the segment, and in its customers' characteristics

The main activities of the segment's customers are in the local market, in the industrial, infrastructure, trade and services and real estate sectors of the economy and markets abroad, either directly or through subsidiaries.

Expectations for 2013 are for continuation of moderate economic growth around the world and in Israel which is expected to have implications for export customers and customers active in the domestic market. Accordingly, the Division is taking steps in careful risk management, regularly reviewing the customer population, and, in particular, sensitive customers, in particular, and reviewing trends of developments and their implications.

For details on the sectors of the economy, see page 90 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 supplies its customers with technological tools, similar to those used by all of the Bank's customers, through, among other things, a business portal, which expands the range of services for the convenience of the corporate customer. The Bank continues striving 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;
- Familiarity with the customer, including his financial position and the prospects/risks inherent in working with him, as a basis for optimal risk management;
- Cultivating human capital and constantly raising its professional level at the required pace, in light of the changes in the capital market and the business environment;
- Maintaining a control system to reduce the credit risks and a strict approach in relation to all matters pertaining to compliance.

Main entry and exit barriers in the segment

- Training professional manpower with diverse skills;
- Maintaining a range of products tailored to the customers' needs;
- Establishing a network of distribution channels whose spread corresponds to the business potential;
- Establishing and developing technological means to serve customers and employees.

Competition

Competing parties in this segment of activity, in both the credit and investments spheres, are all of the banks operating in Israel (domestic and foreign), overseas banks, entities operating in the capital market, and insurance companies. The insurance companies compete for customers in the segment in both the credit sphere and 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.

Human Capital

- The average number of positions assigned to the segment in 2012 totaled 1,898 of which 778 were management positions, compared with 1,981 positions in 2011, 787 of which were management staff positions.
- The branches and the headquarters are staffed mainly by employees and managers who are all university graduates. In addition, the employees and managers have undergone professional training in the management of the business activities related and adapted to the division's customers.

The following table presents a summary of the results of operations of the Commercial Banking Segment:

	Banking and finance	Credit cards	Capital market	Real estate	Overseas activity: Banking and finance	Overseas activity: Capital market	Overseas activity: Real estate	Total
	2012							
	NIS millions							
Net interest income:								
From external sources	**512**	**12**	**12**	**364**	**582**	**-**	**138**	**1,620**
Intersegmental	**91**	**(4)**	**(12)**	**(169)**	**(88)**	**-**	**(47)**	**(229)**
Non-interest income:								
From external sources	**252**	**72**	**43**	**53**	**74**	**17**	**12**	**523**
Intersegmental	**75**	**(36)**	**-**	**-**	**-**	**-**	**-**	**39**
Total income	**930**	**44**	**43**	**248**	**568**	**17**	**103**	**1,953**
Expenses in respect of credit losses	**46**	**-**	**-**	**(4)**	**40**	**-**	**94**	**176**
Operating and other expenses:								
To external sources	**484**	**31**	**96**	**64**	**355**	**6**	**46**	**1,082**
Intersegmental	**(1)**	**1**	**-**	**1**	**-**	**-**	**-**	**1**
Profit (loss) before taxes	**401**	**12**	**(53)**	**187**	**173**	**11**	**(37)**	**694**
Provision for taxes (tax benefit)	**141**	**4**	**(19)**	**66**	**58**	**4**	**(6)**	**248**
Profit (loss) after taxes	**260**	**8**	**(34)**	**121**	**115**	**7**	**(31)**	**446**
Net profit attributable to non-controlling interests	**-**	**(2)**	**-**	**-**	**-**	**-**	**-**	**(2)**
Net profit (loss)	**260**	**6**	**(34)**	**121**	**115**	**7**	**(31)**	**444**
% return on equity								**10.3%**
Average balance of assets	**23,578**	**321**	**237**	**8,311**	**15,467**	**-**	**3,282**	**51,196**
Average balance of liabilities	**35,150**	**957**	**61**	**2,823**	**11,150**	**-**	**364**	**50,505**
Average balance of risk assets	**26,872**	**270**	**265**	**9,285**	**14,633**	**-**	**3,282**	**54,607**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**3,790**	**-**	**-**	**157**	**-**	**3,947**
Average balance of securities	**-**	**-**	**40,809**	**-**	**-**	**2,110**	**-**	**42,919**
Average balance of other assets under management	**685**	**-**	**-**	**-**	**-**	**-**	**-**	**685**
Margin from credit-granting activities	**523**	**8**	**-**	**183**	**270**	**-**	**86**	**1,070**
Margin from deposit-taking activities	**79**	**-**	**-**	**12**	**224**	**-**	**5**	**321**
Total net interest income	**602**	**8**	**-**	**195**	**495**	**-**	**91**	**1,391**
Balance of credit to the public	**22,846**	**297**	**122**	**8,271**	**15,350**	**-**	**3,022**	**49,908**
Balance of deposits of the public	**35,889**	**-**	**-**	**2,807**	**11,162**	**-**	**306**	**50,164**

Commercial Banking Segment (continued)

	Banking and finance	Credit cards	Capital market	Real estate	Overseas activity: Banking and finance	Overseas activity: Capital market	Overseas activity: Real estate	Total
	2011							
	NIS millions							
Net interest income:								
From external sources	541	12	5	415	503	-	119	1,595
Intersegmental	75	(4)	(3)	(221)	(54)	-	(38)	(245)
Non-interest income:								
From external sources	779	67	41	61	64	7	27	1,046
Intersegmental	(423)	(37)	-	(1)	-	-	-	(461)
Total income	972	38	43	254	513	7	108	1,935
Expenses in respect of credit losses	84	(1)	-	43	37	-	55	218
Operating and other expenses:								
To external sources	533	26	33	70	336	5	43	1,046
Intersegmental	(1)	1	-	1	-	-	-	1
Profit before taxes	356	12	10	140	140	2	10	670
Provision for taxes	122	3	3	49	46	1	5	229
Profit after taxes	234	9	7	91	94	1	5	441
Net profit attributable to non-controlling interests	-	(1)	-	-	-	-	-	(1)
Net profit	234	8	7	91	94	1	5	440
% return on equity								11.4%
Average balance of assets	23,906	325	471	8,029	13,857	-	3,306	49,894
Average balance of liabilities	31,173	892	-	2,560	9,045	-	373	44,043
Average balance of risk assets	24,726	263	468	8,705	13,605	-	3,306	51,073
Average balance of mutual funds and supplementary training funds	-	-	4,101	-	-	139	-	4,240
Average balance of securities	-	-	38,932	-	-	1,899	-	40,831
Average balance of other assets under management	702	-	-	-	-	-	-	702
Margin from credit-granting activities	519	8	1	180	255	-	74	1,037
Margin from deposit-taking activities	97	-	1	14	194	-	7	313
Total net interest income	616	8	2	194	449	-	81	1,350
Balance of credit to the public at 31 December 2011	23,086	312	481	8,283	15,113	-	3,261	50,536
Balance of deposits of the public at 31 December 2011	32,684	-	-	2,676	10,770	-	397	46,527

Main Changes in the Volumes of Activity

Credit to the public fell by some NIS 0.6 billion, 1.2%. All of the decrease was from the activity in Israel. Deposits of the public increased by some NIS 3.6 billion, (7.8%), of which NIS 3.3 billion is in domestic activity. Activity in securities increased by NIS 4.4 billion, at the rate of 10%, which derived mainly from an increase in activity and an increase in market value.

Main Changes in the Net Profit

Net profit in the commercial banking segment totaled NIS 444 million in 2012, compared with NIS 440 million in 2011.

The increase in profit derives from an increase in activities in Israel amounting to NIS 13 million, compared to a decrease of NIS 9 million in activity abroad.

The increase in profit in Israel is derived for a fall in credit loss expenses amounting to NIS 42 million, 19.3%, and an increase in income amounting to NIS 18 million. On the other hand, an increase in operating and other expenses amounting to NIS 36 million partially offset the abovementioned costs.

5. 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, Romania, Uruguay and Jersey. In addition, representative offices of the Group operate in Europe, Latin America, Canada, Hong Kong and Australia. Furthermore, representative offices of Leumi Switzerland, Leumi Luxembourg and Leumi USA operate 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 centers 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 within the framework of the subsidiaries and representative offices

Goals 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, the profitability of the customer's asset portfolio, to the level of professionalism and excellence in service, while developing professional and competitive teams with initiative, and the highest standards of service orientation. This strategy also applies to the Bank's overseas units, which also operate to increase business with existing and new 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 in the Bank of Israel, the Commissioner of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority, the Authority for the Prohibition on Money Laundering 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 additional information regarding FATCA, see page 46.
For further information regarding "American customers", see page 245.

Developments in the markets of the activity segment, or changes in its customers' characteristics

Business reality was characterized by a high degree of uncertainty, increasing risk, fierce competitive conditions, with substantial changes in regulations, with financial crises in countries around the world.

Technological changes

The private banking segment has at its disposal technology systems, which provide detailed reports to customers regarding their investments and assets and assists the counselors to better manage and monitor the customers' portfolios.

Currently, advanced new and dynamic websites are available for the benefit of customers, which assist in presenting the Bank and Group and its range of activities around the world. The information and the way in which it is presented are utilized as a premier level marketing tool *vis-à-vis* the customers and *vis-à-vis* the competition in Israel and worldwide.

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 sales promotion

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, the Bank takes steps to retain customers and increase 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, sponsorships and collaborations with leading cultural institutions in Israel, 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 customer targets. 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.

Human capital

In 2012, the average number of positions assigned to the segment was 875, of which 454 were management positions, compared with 818 positions in 2011, of which 401 were management positions**.**

Employees of the private banking segment undergo comprehensive training, including wide-ranging professional and management training courses, including professional courses and management training for the management staff. In addition, the employees attend extensive workshops for acquiring high service skills.

Cooperation agreements

As stated, the private banking segment offers customers a broad range of products, within the framework of open architecture (reflected in cooperation with international entities). Through this cooperation, Leumi offers a range of advanced investment products constituting the main attraction for foreign resident investors – both existing and new – which consequently increases the volume of assets that they hold in the Group.

The following table presents a summary of the results of operations of the Private Banking Segment:

						Overseas activity				
	Banking and finance	Credit cards	Capital market	Mortgages	Real estate	Banking and finance	Capital market	Mortgages	Real estate	Total
	2012									
	NIS millions									
Net interest income:										
From external sources	**(199)**	**-**	**-**	**1**	**(4)**	**41**	**-**	**41**	**(2)**	**(122)**
Intersegmental	**324**	**-**	**-**	**(1)**	**15**	**155**	**-**	**(26)**	**5**	**472**
Non-interest income:	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
From external sources	**(5)**	**1**	**164**	**-**	**12**	**241**	**192**	**5**	**1**	**611**
Intersegmental	**43**	**1**	**-**	**-**	**-**	**7**	**-**	**-**	**-**	**51**
Total income	**163**	**2**	**164**	**-**	**23**	**444**	**192**	**20**	**4**	**1,012**
Expenses in respect of credit losses	**(3)**	**-**	**-**	**-**	**-**	**4**	**-**	**-**	**-**	**1**
Operating and other expenses:	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
To external sources	**173**	**2**	**68**	**-**	**12**	**414**	**211**	**12**	**2**	**894**
Intersegmental	**-**	**1**	**-**	**-**	**-**	**2**	**1**	**-**	**-**	**4**
Profit (loss) before taxes	**(7)**	**(1)**	**96**	**-**	**11**	**24**	**(20)**	**8**	**2**	**113**
Provision for taxes (tax benefit)	**(1)**	**-**	**32**	**-**	**4**	**4**	**(9)**	**2**	**-**	**32**
Net profit (loss)	**(6)**	**(1)**	**64**	**-**	**7**	**20**	**(11)**	**6**	**2**	**81**
Return on equity %										**8.3%**
Average balance of assets	**1,891**	**54**	**17**	**35**	**429**	**9,860**	**-**	**1,029**	**-**	**13,315**
Average balance of liabilities	**19,546**	**-**	**7**	**-**	**1,362**	**18,417**	**-**	**15**	**189**	**39,536**
Average balance of risk assets	**2,229**	**39**	**10**	**25**	**429**	**7,743**	**-**	**360**	**-**	**10,835**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**4,953**	**-**	**-**	**-**	**1,715**	**-**	**-**	**6,668**
Average balance of securities	**-**	**-**	**40,193**	**-**	**-**	**-**	**36,810**	**-**	**-**	**77,003**
Average balance of other assets under management	**227**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**227**
Margin from credit-granting activities	**20**	**-**	**-**	**-**	**5**	**57**	**-**	**15**	**-**	**97**
Margin from deposit-taking activities	**105**	**-**	**-**	**-**	**6**	**139**	**-**	**-**	**3**	**253**
Total net interest income	**125**	**-**	**-**	**-**	**11**	**196**	**-**	**15**	**3**	**350**
Balance of credit to the public	**1,775**	**64**	**44**	**44**	**423**	**4,919**	**-**	**901**	**-**	**8,170**
Balance of deposits of the public	**19,361**	**-**	**-**	**-**	**1,407**	**17,379**	**-**	**15**	**176**	**38,338**

Private Banking segment (continued)

						Overseas activity				
	Banking and finance	Credit cards	Capital market	Mortgages	Real estate	Banking and finance	Capital market	Real estate	Mortgages	Total
	2011									
	NIS millions									
Net interest income:										
From external sources	(171)	-	-	1	3	50	-	(2)	38	(81)
Intersegmental	319	-	-	(1)	9	180	-	5	(19)	493
Non-interest income:	-	-	-	-	-	-	-	-	-	-
From external sources	31	1	154	-	9	140	131	1	6	473
Intersegmental	12	1	-	-	-	9	-	-	-	22
Total income	191	2	154	-	21	379	131	4	25	907
Expenses in respect of credit losses	(10)	-	-	-	1	(23)	-	-	1	(31)
Operating and other expenses:	-	-	-	-	-	-	-	-	-	-
To external sources	170	2	53	-	10	311	122	2	14	684
Intersegmental	-	1	-	-	-	2	1	-	-	4
Profit (loss) before taxes	31	(1)	101	-	10	89	8	2	10	250
Provision for (benefit from) taxes	12	-	33	-	3	24	1	-	2	75
Profit (loss) after taxes	19	(1)	68	-	7	65	7	2	8	175
Net profit attributable to non-controlling interests	-	-	-	-	-	(2)	-	-	-	(2)
Net profit (loss)	19	(1)	68	-	7	63	7	2	8	173
% Return on equity										22.0%
Average balance of assets	1,646	57	9	40	429	8,140	-	14	913	11,248
Average balance of liabilities	19,929	-	-	-	995	16,257	-	198	14	37,393
Average balance of risk assets	1,430	43	10	31	432	7,144	-	14	320	9,424
Average balance of mutual funds and supplementary training funds	-	-	4,754	-	-	-	1,636	-	-	6,390
Average balance of securities	-	-	38,201	-	-	-	29,870	-	-	68,071
Average balance of other assets under management	224	-	-	-	-	-	-	-	-	224
Margin from credit-granting activities	19	-	-	-	6	63	-	-	19	107
Margin from deposit-taking activities	129	-	-	-	6	167	-	3	-	305
Other	-	-	-	-	-	-	-	-	-	-
Total net interest income	148	-	-	-	12	230	-	3	19	412
Balance of credit to the public at 31 December 2011	2,010	57	8	34	414	5,405	-	-	1,146	9,074
Balance of deposits of the public at 31 December 2011	19,876	-	-	-	1,012	18,866	-	231	14	39,999

Main changes in volume of activity in the segment

The total monetary assets of customers under management of the private banking segment totaled NIS 123.4 billion as at 31 December 2012, compared with NIS 120.1 billion at the end of 2011, an increase of 2.7%.

Deposits of the public in this segment increased by some NIS 1.7 billion, or 4.2%. Credit to the public in this sector fell by some NIS 0.9 billion. There was an increase in the value of securities, including mutual funds, of some NIS 4.95 billion, 6.2%, as a result of the purchase of Banque Safdié, which was partially offset by a decrease in the market value of securities

Changes in net profit

Net profit of the private banking segment in 2012 amounted to NIS 81 million, compared with NIS 173 million in the corresponding period in 2011, a decrease of NIS 92 million. The decrease in profit is derived mainly from an increase in operating expenses amounting to NIS 210 million, mainly from activity abroad, as a result of the merger of Banque Safdié in Switzerland, and from credit loss expenses amounting to NIS 1 million, compared with income in respect of credit losses amounting to NIS 31 million in 2011. On the other hand, the increase in expenses amounting to NIS 105 million, mainly in Switzerland, partially offset the abovementioned changes.

6. Financial Management Segment – Capital Markets

General

This segment centralizes the financial management of the Bank and of the Group and the management of the dealing room, coordinates the contacts, and provides various services to banks and institutional investors. The areas of activity of the segment are as follows:

- Management of the *nostro*, by way of the investment of the Bank's independent financial means in tradable and non-tradable investment instruments including direct investments in the companies' tradable and non-tradable shares;
- Management of the dealing rooms, which provide trading services to customers of the Bank, primarily in currencies, securities and derivative instruments;
- Management of market risk exposures – including the management of basis, interest and liquidity exposures;
- Price management – by setting transfer prices and costing special financial transactions;
- Management of banking activity of customers that are institutional investors;
- Public and private issues of Leumi, including deferred notes and debentures;
- Development of financial instruments;

Structure and business strategy in the segment

The financial management activity is carried out by the Capital Markets Division and in the subsidiaries in Israel and abroad by the market risk managers in the subsidiaries. The activities include 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 is based on the Group's capital adequacy policy and its policies for managing risks, including market risks and the *nostro*, while addressing the management of the current liquidity and durability under stress conditions, and the interest and financial margin policies. The business objectives of the financial management segment are to meet profit targets adapted to risk, with activities being conducted within the framework of restrictions on risk exposure set by the Board of Directors. In the context of implementing the business strategy, the Division develops advanced financial instruments, including structured products and innovative products in the dealing room, in collaboration with the Bank's other operating segments.

Legislative restrictions, regulations and special constraints that apply to the segment

The segment'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.

Profit of the segment

The segment's profit is mainly influenced by the *nostro* activities and the dealing rooms, as well as the results of non-banking companies included on equity basis. The principal components of net profit are as follows:

- Results of market risk management, including the changes that have 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 the raising of capital 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 derivative instruments 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/expenses deriving from the investment for pension, jubilee and regular holiday reserves;
- Particular costs relating to pension liabilities;
- Profits of companies included on 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 (the *nostro*) portfolios and management of the dealing rooms.

Principal developments in the segment

During the year, the Bank continued to reduce significantly its holdings in securities issued by foreign banks, including subordinated securities. At the same time, the investment in debentures with high liquidity and of a high quality was increased, principally in United States government debentures. Because of this, exposure to market and credit risks on foreign markets fell and liquidity in foreign currency was significantly improved. Further improvement in liquidity and foreign currency was achieved by the raising of foreign currency public deposits for longer periods.

During 2012, the Bank continued in expanding the operating services granted by the Bank to the institutional customers, particularly in the operation of provident funds and mutual funds.

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. Human capital, requiring managerial, analytical, professional and commercial abilities, in the area of capital markets in Israel and abroad. These abilities relate 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 2012, the average number of positions assigned to the segment was some 661 positions, of which 302 were management positions, compared with 620 positions in 2011, 272 of which were management staff positions. Most of the employees have academic qualifications and, in addition, the employees attend professional courses in various fields and management courses arranged by the Bank

Below is a summary of the results of operations of the Financial Management Segment – Capital Markets:

	2012	2011
	NIS millions	
Net interest income:		
From external sources	**184**	79
Intersegmental	**198**	292
Non-interest income:		
From external sources	**834**	(281)
Intersegmental	**(245)**	330
Total income	**971**	420
Expenses in respect of credit losses	**(29)**	77
Operating and other expenses:		
To external sources	**1,762**	1,275
Intersegmental	**44**	42
Loss before taxes	**(806)**	(974)
Benefit from taxes	**(248)**	(421)
Loss after taxes	**(558)**	(553)
Group share in profits (losses) of companies included on equity basis after effect of tax	**(69)**	148
Net profit attributable to non-controlling interests	**-**	(9)
Net profit (loss)	**(627)**	(414)

In 2012, the net loss of the segment amounted to NIS 554 million, compared with a loss of NIS 414 million in 2011. This segment includes the Group's share in the profits of companies included on equity basis.

The change is explained by the following factors:

a. An increase in operating expenses amounting to NIS 498 million, deriving from an increase in operating expenses that were not loaded on the other activity segments, mainly expenses and a provision for the U.S. customers amounting to NIS 400 million, and a provision for early retirement of NIS 323 million, which was partially offset by a decrease in the pension liability as a result of an increase in the profits of severance pay and pension funds, compared with losses in the previous year.

b. A decrease in the Group's share in the profits of companies included on equity basis amounting to NIS 217 million, net.

c. An increase in income amounting to NIS 551 million deriving from an increase in exchange rate differences and derivatives amounting to NIS 340 million and from a decrease from losses in investment in shares amounting to NIS 140 million.

d. Income in respect of credit losses amounting to NIS 29 million, compared to an expense amounting to NIS 77 million in 2011.

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 2,129 million on 31 December 2012, compared with NIS 2,270 million on 31 December 2011.

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

	Balance sheet value			**Market value**		**Capital adequacy requirements**	
	NIS millions			NIS millions			
Name of Company	**31 December 2012**	31 December 2011	Change %	**31 December 2012**	31 December 2011	**31 December 2012**	31 December 2011
The Israel Corporation Ltd.	**1,567**	1,748	(10.4)	**3,367**	3,291	**141**	157
Others	**562**	522	7.7	**-**	-	**51**	47
Total	**2,129**	2,270	(6.2)	**3,367**	3,291	**192**	204

The contribution of the companies included on equity basis to the Group in 2012 was negative, amounting to a loss of NIS 67 million, compared with a profit of NIS 148 million for the corresponding period in 2011. The decrease in the contribution to the Group's profit in 2012 arose from losses of the Israel Corporation Ltd. ("the Israel Corporation"), compared to 2011.

The contributions of the companies to the Group's net profit (in NIS millions) are as follows:

	2012	2011	% change
The Israel Corporation Ltd.	**(110)**	97	-
Others	**43**	51	(15.7)
Total	**(67)**	148	-

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 provides, *inter alia*, in section 24A of the Law, that a banking corporation may hold more than 1% of the means of control in one conglomerate only a "real (non-banking) holding corporation" (a corporation whose capital exceeds some NIS 2,000 million and that operates in more than three branches of the economy). The Bank holds one conglomerate - The Israel Corporation Ltd.

It should be noted that pursuant to the legislation enacted following the reforms in the capital market, a bank is entitled to hold 5% of the equity of an insurance company and 10% of the equity in a corporation that controls an insurance company. In addition, pursuant to the amendment to the Banking Law (Licensing) from March 2010, a bank is entitled to have holdings in only one insurance company where the shareholders' equity, pursuant to Section 35 of the Supervision of Financial Services Law (Insurance), 1981, exceeds NIS 2,000 million.
As of the report date, Leumi holds 9.79% of the share capital of Migdal Insurance and Finance Holdings Ltd. In January 2013, the Bank sold some of the shares that it held, such that, at the date of publishing the report, Leumi holds 4.71% of the share capital of Migdal. The Bank undertook, *vis-à-vis* the purchasers, that it will not sell additional sales of Migdal until 8 April 2013.

Avgol Industries 1953 Ltd.

On 29 June 2011, Leumi Partners Ltd. (a wholly-owned company of the Bank) (hereinafter: "Leumi Partners") signed an agreement with Petrochemicals Investments (2006) Ltd., Yehoshua Goldwasser, Music-Net Ltd., Ahai Boneh, Ahai Boneh Holdings Ltd., Avraham Zilberfeld and Avzil Holdings Ltd. (hereinafter "the sellers") for the acquisition from the sellers of a total of 34,253,163 ordinary shares of Avgol Industries 1953 Ltd. (hereinafter "the Company"), representing, as of that date, some 11.5% of the issued and paid-in capital of the Company (in full dilution) and options to purchase 25,317,555 ordinary shares of the Company (hereinafter: "the options"), representing, as of that date, some 8.5% of the issued and paid-in capital if the Company (in full dilution) in consideration of NIS 110 million (hereinafter: "the agreement"). The options are exercisable for a period of three years from the date of signing the agreement in consideration of an exercise price of NIS 3.25 per share, net of dividend. The agreement includes customary rights to protect the investment of Leumi Partners. The transaction pursuant to the agreement was completed on 29 June 2011.
In December 2012, Leumi Partners exercised the option that it was granted to purchase shares of the company for consideration of NIS 63 million, such that, following the exercise, Leumi Partners holds 20% of the shares of Avgol.

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 mainly includes 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. Leumi Capital Market Services engages mainly in the provision of operating services to management companies in the field of provident funds and 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. In November 2011, the company began providing operating services in the field of mutual funds.

Leumi Capital Market Services provides operating services to 18 management companies. The value of the assets being operated by the company amounted to some NIS 83 billion on 31 December 2012.

In 2012, the loss of the Others segment totaled NIS (125) million, compared with a profit of NIS 252 million in 2011.

The following table presents a summary of the main changes, in NIS millions:

	2012	2011	Difference
Bank	**20**	19	1
Other companies in Israel	**9**	6	3
Companies abroad	**10**	21	(11)
Tax adjustments (1)	**(164)**	206	(370)
Total	**(125)**	252	(377)

(1) Tax differentials between the tax calculations in the segments and the effective tax in the consolidated financial statements.

Activities in Products

A. Capital market activities

The Group's activities in the capital market include investment 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 custodial and sub-custodial 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. Net profit in capital market activity amounted to NIS 115 million, compared to NIS 264 million in the corresponding period in 2011. The decrease in net profit was attributable to a reduction in operating income amounting to NIS 149 million, deriving mainly from an increase in operating expenses amounting to NIS 239 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 Underwriters:

	House-holds	Small businesses	Corporate banking	Commercial banking	Private banking	Financial management and Others	Overseas activities	Total
	2012							
	NIS millions							
Net interest income	**3**	**-**	**-**	**-**	**-**	**6**	**-**	**9**
Noninterest income	**456**	**23**	**15**	**43**	**164**	**85**	**215**	**1,001**
Total income	**459**	**23**	**15**	**43**	**164**	**91**	**215**	**1,010**
Operating and other expenses	**314**	**12**	**17**	**96**	**68**	**114**	**221**	**842**
Profit (loss) before taxes	**145**	**11**	**(2)**	**(53)**	**96**	**(23)**	**(6)**	**168**
Net profit (loss)	**93**	**7**	**(1)**	**(34)**	**64**	**(13)**	**(1)**	**115**

	House-holds	Small businesses	Corporate banking	Commercial banking	Private banking	Financial management and Others	Overseas activities	Total
	2011							
	NIS millions							
Net interest income	3	1	-	2	-	5	-	11
Noninterest income	500	25	20	41	154	104	144	988
Total income	503	26	20	43	154	109	144	999
Operating and other expenses	304	12	11	33	53	59	131	603
Profit before taxes	199	14	9	10	101	50	13	396
Net profit	130	9	6	7	68	33	11	264

B. Credit cards - Leumi Card

This activity is carried out by the subsidiary, Leumi Card, and includes mainly the activity of issuing and operating credit cards to customers, providing financial services and solutions to cardholders and providing clearing and payment securing services against transactions executed by credit cards .

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.

As from 2001, Leumi Card has operated as the company issuing credit cards under the brand names, "Visa" and "MasterCard".

Leumi Card, Bank Leumi and Arab Israel Bank Ltd. (""Arab Israel Bank") jointly issue the credit cards to their customers. 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.

In addition, Leumi Card operates in the field of clearing transactions under the brand names, "Visa" and "MasterCard" for businesses.

According to data from the Central Statistical Bureau, the comparison between 2012 and 2011 indicates an increase in the growth rate of purchasing cycles by credit card. A growth rate of 6.7%in fixed prices in 2012, compared with 3.7% in 2011. The improvement in the growth rate in the credit card sector is reinforced against the background of a decline in the growth rate in the economy between the two periods.

During 2012, Leumi Card continued to offer card holders a range of financial services and solutions.

To date, the company has issued more than 2 million cards under the brand names, Visa and MasterCard.

The activity turnover of the cards in Leumi Card increased by 7.7% in 2012, compared to 2011.

The company offers business customers a range of services in the area of credit, including: clearing services, securing payment against vouchers for transactions made by credit card in exchange for a commission collected from a business, credit products offered to businesses within the framework of the clearing activity, such as: loans, discounting of vouchers and advancing payments.

In addition, the company expanded its services in the field of Business-to-Business payments. Pursuant to these services, the company offers its customers an efficient and innovative tool to manage financial activity between a supplier and its customers through a payment system developed in Leumi Card.

The number of cards in use at 31 December 2012 increased by 5.0% compared with 2011.

On 17 April 2012, a license agreement was signed by Leumi Card and Isracard Ltd., by virtue of which Leumi Card is granted a clearing and issuing license and the option for providing services for debit cards under the brand name of Isracard ("the License Agreement"). The agreement came into force on 15 May 2012. Further to the license agreement, the activity of clearing the cards under the Isracard brand is expected to be conducted in a similar fashion to the clearing of cards in the joint interface between credit card companies in the sector for clearing Visa and Mastercard cards.

On 13 September 2012, the Antitrust Commissioner granted a fixed exemption to the License Agreement. It was made dependent on a number of conditions, *inter alia*, it was provided that Isracard would not be able to collect the rate of license fees established between it and the company in the License Agreement, but rather a lower rate. In addition, as part of the conditions of the exemption, conditions were stipulated prohibiting the transfer of information between the companies, which is not for the purpose of implementing the agreements or which is not by virtue of the law or the exemption directive.

Like Mastercard Global, Isracard, has requested the Antitrust Court to issue an immunity injunction for the numerical data included in the Commissioner's exemption and the explanations on which it is based, and most of the rate of the license fees stipulated in the exemption. This request is pending in the Antitrust Court, which initially issued a temporary immunity injunction at the request of Isracard and Mastercard Global.

On 11 February 2013, Isracard submitted a request to the Antitrust Court to approve a license agreement. In the request, Isracard claims that there is no justification for the Commissioner's determination and that the conditions established in the context of a license agreement signed with Cal should apply to the license agreement.

In the opinion of Leumi Card, the license agreement will lead to a significant increase in competition in the area of clearing debit cards in Israel.

Profitability

The income of Leumi Card, before operating, marketing, administrative and general expenses, totaled some NIS 954 million in 2012, compared with some NIS 940 million in 2011.

Leumi Card ended 2012 with a net profit of NIS 180 million, compared with NIS 177 million in 2011.

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
	2012					
	NIS millions					
Net interest income	**201**	**18**	**19**	**8**	**-**	**246**
Noninterest income	**673**	**61**	**89**	**36**	**2**	**861**
Total income	**874**	**79**	**108**	**44**	**2**	**1,107**
Expenses in respect of credit losses	**18**	**-**	**1**	**-**	**-**	**19**
Operating and other expenses	**631**	**55**	**77**	**32**	**3**	**798**
Profit (loss) before taxes	**225**	**24**	**30**	**12**	**(1)**	**290**
Profit (loss) after taxes	**156**	**17**	**23**	**8**	**(1)**	**203**
Net profit attributable to non-controlling interests	**27**	**(2)**	**(4)**	**(2)**	**-**	**(35)**
Net profit (loss)	**129**	**15**	**19**	**6**	**(1)**	**168**

	Households	Small businesses	Corporate banking	Commercial banking	Private banking	Total
	2011					
	NIS millions					
Net interest income	187	19	19	8	-	233
Noninterest income	692	55	78	30	2	857
Total income	879	74	97	38	2	1,090
Expenses in respect of credit losses	21	(2)	(3)	(1)	-	15
Operating and other expenses	608	50	74	27	3	762
Profit (loss) before taxes	250	26	26	12	(1)	313
Profit (loss) after taxes	178	19	19	9	(1)	224
Net profit attributable to non-controlling interests	(28)	(2)	(4)	(1)	-	(35)
Net profit (loss)	150	17	15	8	(1)	189

Interchange Fee

For information see Note 18 (H) 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 page 142 under the Chapter "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
	2012					
	NIS millions					
Net interest income	**206**	**527**	**195**	**11**	**115**	**1,054**
Noninterest income	**66**	**271**	**53**	**12**	**39**	**441**
Total income	**272**	**798**	**248**	**23**	**154**	**1,495**
Expenses in respect of credit losses	**7**	**(59)**	**(4)**	**-**	**94**	**38**
Operating and other expenses	**109**	**160**	**65**	**12**	**55**	**401**
Profit before taxes	**156**	**697**	**187**	**11**	**5**	**1,056**
Net profit (loss)	**101**	**451**	**121**	**7**	**(3)**	**677**

	Small businesses	Corporate banking	Commercial banking	Private banking	Overseas activity	Total
	2011					
	NIS millions					
Net interest income	200	519	194	12	125	1,050
Noninterest income	64	250	60	9	30	413
Total income	264	769	254	21	155	1,463
Expenses in respect of credit losses	17	316	43	1	57	434
Operating and other expenses	106	133	71	10	50	370
Profit before taxes	141	320	140	10	48	659
Net profit	92	210	91	7	31	431

Profit centers in the Group

The following table presents details on the contribution of the Group's principal profit centers to the net operating profit:

	2012	2011	Change
	NIS millions		%
The Bank	**330**	959	(65.6)
Consolidated companies in Israel (1)(4)	**562**	432	30.1
Consolidated companies abroad (2)	**143**	395	(63.8)
Companies included on equity basis (1)	**(104)**	105	-
Net operating profit (3)	**931**	1,891	(50.8)
Profit of the subsidiaries abroad, in nominal terms (US$ millions) (3) (4)	**42.1**	47.5	(11.4)

(1) Companies including on equity basis of subsidiaries in Israel were included in consolidated subsidiaries in Israel.
(2) Following particular adjustments to Israeli accounting principles.
(3) As reported by the subsidiaries abroad, including minority interests.
(4) Including the profits of Leumi Mortgage Bank whose activity was merged with Leumi on 31 December 2012.

Following are the principal changes in the contributions of the profit centers (after translation adjustments):

- The decrease in net profit after taxes in the Bank derives from an increase in operating and other expenses, as a result of a provision in respect of the U.S. customers and a provision for early retirement, an increase in credit loss expenses and an increase in the rate of tax provision. Most of the explanations for the above changes are presented as part of the discussion on the Group's results.

  For further information, see page 67.

- The increase in the net operating profit of consolidated companies in Israel derives mainly an increase in profits of Leumi Mortgage Bank, and a reduction in the losses of Leumi Partners.
- The decrease in the net profit of overseas subsidiaries derives from a change in exchange rates in respect of overseas investments, which were positive in 2011 and recorded in the statement of profit and loss, compared with 2012 in which most of exchange rate differences were recorded in other comprehensive income. In addition, there was a decrease in the profits of Leumi UK and Leumi Switzerland.
- The decrease in the profit of companies included on equity basis derives from a fall in the profit of the Israel Corporation.

With effect from 1 January 2012, the Bank has applied IAS 21, and within this context, it was decided that exchange rate differentials in respect of the investment in subsidiaries in the United States and in Switzerland will be recognized in other comprehensive income and presented in a capital reserve and the exchange rate differentials in respect of investments of the other foreign subsidiaries will be recognized within profit and loss.

The Bank

The decrease in net operating profit is due mainly to:

- a decrease in net interest income amounting to NIS 13 million.
- an increase in expenses in respect of credit losses amounting to NIS 469 million
- an increase in operating and other expenses amounting to NIS 576 million.
- an increase in the rate of tax provision,

On the other hand, the increase in noninterest income amounting to NIS 661 million partially offset the above changes.

Subsidiaries in Israel

The increase in net profit of consolidated companies in Israel is due mainly to a an increase in the profits of Leumi Mortgage amounting to NIS 100 million and to a reduction in the losses of Leumi Partners.

Subsidiaries Abroad

The total contribution to profit of the overseas subsidiaries (excluding branches) as a convenience translation to U.S. dollars amounted to some US$ 42.1 million, compared with some US$ 47.5 million in the corresponding period last year. The overseas subsidiaries' contribution to net profit in shekels and with certain adjustments to Israeli accounting principles, amounted to a profit of NIS 143 million, compared with a profit of NIS 395 million in the corresponding period last year.

- The decrease in the net profit of overseas subsidiaries derives from a change in exchange rates in respect of overseas investments, which were positive in 2011 and recorded in the statement of profit and loss, compared with 2012 in which most of exchange rate differences were recorded in other comprehensive income.

Companies included on equity basis

The decrease in the profits of companies included on equity basis is due to the decrease in the loss of the Israel Corporation.

Activities according to the Group's Structure

The volume of activities in Israel rose in 2012 by (48.9%), and abroad, it rose by (39.6%).

Credit to the public in activities in Israel totaled some NIS 214.7 billion at the end of 2012, compared with NIS 214.3 billion at the end of 2011, an increase of 0.1%. Credit to the public in overseas activities totaled some NIS 26.6 billion at the end of 2012, compared with NIS 27.0 billion at the end of 2011, a decrease of (1.4)%.

Deposits of the public in activities in Israel totaled some NIS 256.2 billion at the end of 2012, compared with NIS 245.9 billion at the end of 2011, an increase of 4.2%. Total deposits in overseas activities totaled some NIS 33.3 billion at the end of 2012, a decline of (0.4)%.

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		
	2012	2011	Change	**2012**	2011	Change	**2012**	2011	Change
Region			%			%			%
Israel	**336,069**	325,272	3.3	**214,668**	214,356	0.1	**256,216**	245,948	4.2
United States	**20,103**	21,765	(7.6)	**13,985**	14,785	(5.4)	**16,336**	16,783	(2.7)
United Kingdom	**9,732**	9,051	7.5	**7,846**	7,696	1.9	**7,332**	5,683	29.0
Switzerland	**7,379**	4,259	73.3	**2,998**	2,312	29.7	**6,484**	4,960	30.7
Luxembourg	**989**	779	27.0	**453**	336	34.8	**2,010**	2,069	(2.9)
Romania	**1,280**	1,230	4.1	**860**	812	5.9	**680**	726	(6.3)
Others abroad	**608**	3,498	(82.6)	**454**	1,023	(55.6)	**480**	3,235	(85.2)
Total	**376,160**	365,854	2.8	**241,264**	241,320	-	**289,538**	279,404	3.6

* 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		
	NIS millions		Change
Region	**2012**	2011	%
Israel (1)	**785**	1,490	(47.3)
United States (2)	**90**	213	(57.7)
United Kingdom (3)	**42**	102	(58.8)
Switzerland (4)	**(18)**	53	-
Luxembourg (5)	**14**	22	(36.4)
Romania (6)	**8**	(21)	-
Others abroad (7)	**10**	32	(68.8)
Total	**931**	1,891	(50.8)

The profit from activities abroad is shown according to their contribution in the consolidated financial statements.

1. Net profit in Israel decreased by some NIS 728 million. Net profit after tax at the Bank in Israel decreased due to the reasons detailed on page 67 above.

   The net profit also increased at a number of subsidiaries in Israel, mainly: Leumi Mortgage Bank, Arab Israel Bank and Leumi Card, and from the decrease in the profits of Leumi Partners.

2. The profits of the subsidiary in the United States increased in U.S. dollar terms relative to the corresponding period last year, as well as in local currency terms, when translated to shekels

3. The profit of the subsidiary in the United Kingdom decreased relative to the corresponding period last year.

4. The fall in profits of the subsidiary in Switzerland in nominal terms derives mainly from an increase in the operational expenditures in comparison with corresponding period last year, which was partially offset by profits after the merger with Banque Safdié.

5. The fall in the profit of the subsidiary in Luxembourg derives from the appreciation of the shekel against the euro and a decline in the company's profitability.

6. The profit of the subsidiary in Romania, compared with the loss in 2011, derives from the allowances for credit losses.

7. The profit relates mainly to Leumi Re, and the reduction derives from changes in insurance costs.

For further details, see Note 27B to the Financial Statements.
For further details on the profits of the subsidiaries abroad, as reported by them, see below, on page 169.

Major Investee Companies*

The Leumi Group operates in Israel and abroad through subsidiaries which are: banks, a mortgage bank (until its merger with Leumi on 31 December 2012), finance companies and financial services companies. The Group also invests in non-banking corporations operating in the fields of insurance, infrastructure, food and real estate.
(See page 180 with regard to investments in non-banking corporations).

The Bank's total investments in subsidiaries and affiliates (including investments and capital notes) amounted to NIS 13,513 million on 31 December 2012, compared with NIS 16,870 million on 31 December 2011, and their contribution to the Group's net profit amounted to NIS 601 million, compared with NIS 932 million in 2011.

- 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		
	2012	2011	**2012**	2011	Change
	%	%	NIS millions		%
The Bank	**3.2**	9.6	**330**	959	(65.6)
Consolidated subsidiaries in Israel, total	**7.5**	6.1	**562**	432	30.1
of which: Leumi Mortgage Bank	**10.5**	7.6	**303**	203	49.3
Arab Israel Bank	**22.4**	30.7	**103**	108	(4.6)
Leumi Card	**15.9**	17.7	**144**	142	1.4
Leumi Partners (3)	**-**	-	**(68)**	(114)	+
Leumi Capital Market Services Ltd.	**14.2**	27.1	**4**	7	(42.9)
Leumi Real Holdings	**2.1**	2.2	**19**	19	-
Leumi Finance	**7.5**	7.5	**12**	12	-
Leumi Leasing and Investments	**2.8**	3.8	**27**	35	(22.9)
Others	**2.4**	4.0	**18**	20	(10.0)
Overseas consolidated subsidiaries, total	**2.9**	9.6	**143**	395	(63.8)
of which:Leumi USA (B.L.C.) (2)	**3.5**	9.0	**90**	210	(57.1)
Leumi UK	**5.3**	16.1	**42**	102	(58.8)
Leumi Private Bank (2)	**-**	8.2	**(18)**	53	-
Leumi Luxembourg	**10.4**	18.6	**15**	22	(31.8)
Leumi Romania	**3.3**	-	**8**	(21)	+
Leumi Re	**11.4**	35.5	**10**	29	(65.5)
Companies included on equity basis, total	**-**	6.1	**(104)**	105	-
Group's total net profit	**3.8**	8.3	**931**	1,891	(50.8)

(1) The profit (loss) shown is according to the company's share in the Group's results.
(2) In 2011, the contribution to profit includes exchange rate on the investment.
(3) Including the profit and/or loss companies included on the equity basis of Leumi Partners.
See Note 27 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 companies.

Consolidated companies in Israel

The Bank's total investments in consolidated subsidiaries in Israel amounted to NIS 4,796 million on 31 December 2012, compared with NIS 7,203 million on 31 December 2011. Their contribution to Group net operating profit amounted to some NIS 562 million in 2012, compared with NIS 432 million in 2011, an increase of 30.1%. The increase stems from an increase in the profits of Leumi Mortgage Bank and a decrease in the loss of Leumi Partners. The Group's return on its investment in the consolidated companies in Israel was 7.5% in 2012 compared with 6.1% in 2011.

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 34 branches, situated mainly in the north of Israel and in the northern Triangle, serving the Arab population in these areas. Arab Israel Bank engages in the entire range of banking activities. The Arab Israel Bank's total assets amounted to NIS 6,104.6 million at the end of 2012, compared with NIS 5,761.0 million at the end of 2011. Net profit of the Arab Israel Bank totaled NIS 103.1 million in 2012, compared with NIS 108.7 million in 2011, a decrease of 5.2%. The net return on shareholders' equity reached 21.8% as of 31 December 2012, compared with 30.2% at the end of 2011.

Shareholders' equity of the Arab Israel Bank amounted to NIS 526.8 million as at 31 December 2012, compared with NIS 423.5 million as at 31 December 2011.

The ratio of equity to risk assets as at 31 December 2012, reached 14.76%, as compared with 15.60 % as at 31 December 2011.

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 46 million in 2012, compared with NIS 41 million in 2011.

Since the beginning of 2012, and as a part of the implementation of the strategic work plan, the Bank has been operating on a number of levels to strengthen the bank in the Arab sector.

Within this framework, the Wealthy Customers Center was established – as a part of the improvement of customer service for deposit customers and providing a more professional and effective solution for the needs of wealthy customers. The momentum of expanding the deployment of the Bank continued and four new branches were opened.

It should be noted that, at the beginning of 2012, a deputy chief executive officer, manager of the Retail, Marketing, Publicity and Profitability Department was appointed who served in this position until the end of the year.

During the year, there were also changes in the duties of the Chairman of the Board of Directors, Secretary of the Bank, along with changes of three directors.

Medium and Long-Term Financing Companies [(1)]

The assets of these companies amounted to NIS 22.1billion at the end of 2012, compared to NIS 19.6 billion in 2011. The business activity of these companies complements the activity of the Bank. The net profit of these companies amounted to some NIS 41.9 million in 2012, compared with NIS 49.8 million in 2011.

(1) Including: Leumi Industrial Development Ltd., Leumi Agricultural Development Ltd., Leumi Finance Company Ltd. and Leumi Leasing and Investments Ltd.

Below are details concerning the main companies:

Leumi Leasing & Investments Ltd.

The company finances the acquisition of equipment for medium and long term periods.

The balance of credit to the public totaled NIS 658 million as at 31 December 2012, compared with NIS 981 million at the end of 2011.

The company's total assets totaled NIS 1,049 million as at 31 December 2012, compared with NIS 1,113 million at the end of 2011.

The net profit in 2012 totaled NIS 27 million, compared with a profit of NIS 35 million in 2011.

In 2012, the company ceased to execute new finance, but continues, at this stage, to manage the existing leasing portfolio.

Leumi Finance Company Ltd.

The company engages in the raising of sources in Israel for the Bank through issues to the public and private placements of notes. The proceeds of these issues are deposited in the Bank for its use, at its discretion and its responsibility.

Total assets of the company amounted to NIS 20,851 million at the end of 2012, compared with NIS 18,307 million at the end of 2011. Shareholders' equity amounted to NIS 158 million as at 31 December 2012. The company's net profit amounted to NIS 12.1 million in 2012, compared to NIS 11.8 million in 2011.

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 33 above regarding the issue of capital notes by the company.

Leumi Partners 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 C below.

Leumi Partners and its subsidiaries employ 37 employees, most of whom are economists, accountants or graduates in other subjects.

Leumi Partners finished 2012 with a loss of NIS 43 million, compared with a loss of NIS 108 million in 2011. The reduction in the loss arises mainly from recording a provision for impairment amounting to NIS 160 million, compared with 239 million in respect of the investment in Partner Ltd.

Shareholders' equity as at 31 December 2012 totaled NIS 473 million, compared with NIS 446 million at the end of 2011.

Below are details concerning developments and main fields of activity:

A. Investments in non-banking companies

Leumi Partners is responsible for the management of the non-banking investment portfolio of the Leumi Group.

Leumi Partners engages in initiating, locating and carrying out direct investments in businesses and companies. Leumi Partners has invested in 50 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 2012 amounted to some NIS 462 million.

The non-banking investment policy of the Leumi Group is in line with the restrictions of the Banking (Licensing) Law, and therefore includes 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.

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.

B. 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 interested 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.

C. Underwriting and management of issues

The subsidiary company Leumi Partners Underwriting Ltd. engages in the management and underwriting of private and public issues of securities in the capital market in Israel.

In 2012, 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 some NIS 15 billion, and led 12 public issues for a total of some NIS 5 billion.

D. Economic analyses and appraisals

The subsidiary Leumi Partners Research engages in economic analyses, economic appraisals and financial counseling, mainly for the Leumi Group and economic entities in the Israeli economy.

The company prepares economic studies and valuations for the purposes of investments, mergers and acquisitions, making loans and debt evaluation.

In addition, the company reviews the large companies traded on the Israeli capital market, as well as a number of Israeli companies traded abroad and bonds traded on the Israeli capital market and for institutional entities.

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, 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, 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 2012 amounted to NIS 11.9 million compared with NIS 13.4 million in 2011. The company’s net profit in 2012 amounted to NIS 3.9 million, compared with NIS 4.9 million in 2011.

For information on the legal claims against the Trust Co., see Note 18 in the Financial Statements.

Competition

The company's main competitors are trustee companies of large accounting/law firms, some of the banking trustee companies and other entities providing 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 issues of debentures and ETF certificates, 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, 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 13.6 million (NIS 15.1 million in 2011)
- Estate and property management , some NIS 0.6 million (NIS 0.9 million in 2011)
- Agent for deposits and loans, share transfers, and management of investment accounts, some NIS 6.8 million (NIS 5.9 million in 2011)
- Trustee for debenture and mutual fund holders, some NIS 3.8 million (NIS 4.7 million in 2011)

Overseas Consolidated Companies, Branches and Agencies

The Group's international activity is carried out by a network of investee companies, branches, agencies and representative offices spread across 17 countries in 60 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. At the same time as implementing the strategic targets of reinforcing international activity, focusing on increasing the profitability of the existing units, and as an integral part thereof, the Bank is strengthening its monitoring and control of the Bank's units abroad. For this purpose, in 2012, organizational change was made in the format of international activity in the Group. The main organizational changes include:

- The appointment of a member of management or head of a division as the official responsible for a unit, which is faithful to the routine business intention of the unit and the management of the interaction between the units and Leumi management, with the aim of enabling the allocation of administrative resources at the highest level and strengthening the link with Group management, to participate in crystallizing the business policies and setting out the unit's strategy. Responsible officials were also appointed to the boards of directors of the units.

- The establishment of an international activity staff as a part of the international activity strategy department. The staff is responsible for the Group's monitoring and control of international activity, an information center, procedures and broad areas in all matters related to international activity *vis-à-vis* the official responsible for the units, Bank management, the Board of Directors and Bank of Israel and represents a supporting factor in receiving the assistance required from Tel Aviv.

- The reinforcement of the professional support in the international activity by the units of expertise, i.e., the professional divisions, e.g., risk management, human resources, audit, accounting, etc. These units represent a central address for supporting the units on professional subjects, and accordingly, have professional responsibility over the areas of activity required for the management of the international activity in their area of expertise. The professional authority of the units of expertise will include, *inter alia*, a delineation of collective policy, professional regulation, periodic reports to Leumi management, to head office and the officer in charge of the units.

Quarterly reports on ongoing developments and special findings in the units are sent to the management every quarter and to the Board of Directors every six months.

The Risk Management Division carries out routine monitoring, analysis, identification, mapping and evaluation of material focuses of risk in the overseas subsidiaries

The Bank's total investment in overseas units at the end of 2012 amounted to NIS 4,940 million, compared with NIS 4,754 million at the end of 2011.

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		
	2012	2011	**2012**	2011	Rate of change
	%		NIS millions		%
Leumi USA (B.L.C.) *	**3.5**	9.0	**90**	210	(57.1)
Leumi UK	**5.3**	16.1	**42**	102	(58.8)
Leumi Switzerland *	**-**	8.2	**(18)**	53	-
Leumi Luxembourg	**10.4**	18.6	**15**	22	(31.8)
Leumi Re	**11.4**	35.5	**10**	29	(65.5)
Leumi Romania	**3.3**	-	**8**	(21)	+
Others	**1.2**	-	**(4)**	-	-
Total of overseas consolidated companies	**2.9**	9.6	**143**	395	(63.8)

* In 2011, the contribution to profit, including exchange rate difference on the investment.

With regard to the treatment of translation adjustments in respect of foreign investments since 1 January 2012, see Note (1).

The following table sets out details of the net profit (loss) of the overseas units, as reported by them:

	2012	2011	Change
	In millions		%
Leumi US (BLC) - US$	**22.5**	17.3	30.1
Of which: Bank Leumi USA - US$	**22.5**	20.1	11.9
Bank Leumi UK - £	**4.6**	12.1	(62.0)
Leumi Private Bank - CHF	**0.2**	5.4	(96.3)
Bank Leumi Luxembourg - euro	**3.0**	3.6	(16.7)
Leumi Romania - ron	**13.6**	(24.0)	+
Leumi Re - US$	**4.6**	7.5	(38.7)
Others - US$	**(0.7)**	(0.5)	-
Overseas branches -US$	**-**	1.3	-
Total in dollar terms	**42.1**	47.5	(11.4)

* 1 Ron = NIS 1.095

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 **2012**	2011
Credit to the public	**7,005**	7,057
Deposits with banks	**3,074**	4,107
Securities	**1,364**	1,251
Other assets	**381**	390
Total	**11,824**	12,805
Deposits of the public	**8,791**	8,261
Deposits from banks	**1,101**	2,569
Other liabilities	**568**	743
Shareholders' equity	**1,364**	1,232
Total	**11,824**	12,805
Total trust deposits and managed securities	**11,305**	10,958

The total balance sheet of the consolidated overseas subsidiaries and branches of the Bank amounted to NIS 44.1 billion (US$ 11.8 billion) at the end of 2012, compared with NIS 48.9 billion (US$ 12.8 billion) at the end of 2011.

* The translation to US$ is a convenience translation of the data according to the representative rates of exchange on 31 December 2012 and 31 December 2011, 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 2012:

	USA	UK	Switzerland	Luxembourg	Romania
Total assets	**5,360**	**2,610**	**2,077**	**623**	**340**
Credit to the public	**3,780**	**2,099**	**804**	**121**	**229**
Deposits of the public	**4,488**	**1,997**	**1,722**	**523**	**182**
Shareholders' equity	**685**	**217**	**259**	**55**	**66**
Trust deposits and managed securities	**3,935**	**409**	**5,686**	**974**	**-**
Net profit	**22.5**	**8**	**-**	**5**	**4**
Return on equity (%)	**3.6**	**3.5**	**0.1**	**10.6**	**6.3**

The net profit for all the consolidated overseas companies, including overseas branches, as published by them, totaled US$ 42.1 million in 2012, compared with a profit of US$ 47.5 million in 2011, a decrease of US$ 5.4 million.

The contribution of the overseas units to the net profit of the Group in shekels in 2012 amounted to a profit of NIS 143 million, compared with a loss of NIS 395 million in 2011.

See Notes 6 and 27 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$ 5.4 billion as at 31 December 2012, compared with US$ 5.8 billion at the end of 2011, and the annual profit amounted to US$ 22.5 million, compared with US$ 17.3 million in 2011, an increase of 30%.

The increase in net profit resulted primarily from a decrease in expenses in respect of credit losses, which was partly offset by a decrease in net interest income and operating income. The return on equity of BLL Corp. reached 3.35% compared with 2.55% in 2011.

As at 31 December 2012, the equity amounted to US$ 685 million. The ratio of equity to total assets was 12.8% and the ratio of equity to risk assets was 15.76%.

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 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.

In September 2010, the bank opened a representative office in Israel, in order to expand its private banking business.

BLUSA's consolidated assets amounted to US$ 5.4 billion on 31 December 2012, compared with US$ 5.7 billion at the end of December 2011. Total shareholders' equity amounted to US$ 541 million on 31 December 2012 compared with US$ 517 million at the end of 2011. Credit to the public totaled US$ 3,735 million at the end of 2012, a decrease of 3.1%, while deposits of the public, which totaled US$ 4,421 million, decreased by 0.04%.

Customers' managed securities portfolios, which are not included in the balance sheet, totaled US$ 3,935 million at the end of 2012, compared with US$ 3,804 million at the end of 2011.

BLUSA ended 2012 with a net profit of US$ 22.5 million, compared with US$ 20.1 million in 2011.

The return on equity of net profit in 2012 was 4.78% compared with 4.37% in 2011.

The balance of the provision for doubtful debts amounted to US$ 54 million at the end of 2012, constituting 1.4% of total credit to the public.

The ratio of equity to total assets is 10.1% (9.2% in 2011) and the ratio of equity to risk assets was 14.47% (13.23% in 2011). These ratios exceed the US supervisory authorities' requirements and transition to the Group's capital adequacy requirements.

Towards the end of 2012, BLUSA began implementing a strategic program ("Running for 10") including a number of initiatives intended to improve the bank's long-term profitability increasing business focus, upgrading core abilities and systems and operational streamlining.

In the fourth quarter of 2012 BLUSA began implementing a process of merging branches for streamlining and cost savings, maintaining a presence in four countries. As a result of these processes, the geographical deployment of BLUSA is: one branch in New York State (the branch at 1400 Broadway merged with the branch at 579 Fifth Avenue), four branches in California, one branch in Florida (the Boca Raton branch merged with the Aventura branch) and one branch in Illinois (the Highland Park branch merged with the Chicago branch) and one other branch in the Cayman Islands.

In July 2012, Mr. D. Brodet, Chairman of the Board of Directors of Leumi Group, was appointed chairman of the board of directors of Bank Leumi USA, in place of Mr. S. Levine, who is continuing to serve as a member of the board of directors.

The Bank's Branches and Agencies

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$ 705 million at the end of 2012 (before offsetting mutual balances), compared with some US$ 1,351million at the end of 2011. Credit to the public totaled US$ 114 million at the end of 2012, similar to the end of 2011. Deposits of the public totaled US$ 104 million at the end of 2012, compared with US$ 116 million at the end of 2011. 2012 ended with a profit of some US$ 27 million, compared to US$ 2 million in 2011.

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. Due to the increase in the operational costs of the branch in recent years, the Bank has taken active steps to reduce the number of customers in the branch.

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 United Kingdom. The bank's center of activity is in London and, in addition, the bank has two subsidiaries – a banking subsidiary on the Island of Jersey, Bank Leumi (Jersey) Ltd. and also a trust company in Jersey, Leumi Overseas Trust Corporation Limited, which is wholly-owned. Bank Leumi Jersey and Leumi ABL Ltd., a subsidiary is engaged in the area of asset-based lending, operating in the field of discounting and factoring of invoices.

Bank Leumi UK is engaged 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 real estate (particularly, retirement homes, hotels and students halls of residence) and residential real estate. The financing is provided to both local and non-resident customers.

Bank Leumi UK ended the year 2012 with a profit of £ 4.6 million, compared with a profit of £ 12.1 million in 2011.

Total consolidated assets of Bank Leumi UK amounted to £ 1,614 million at the end of 2012, compared with £ 1,539 million at the end of 2011.

Deposits of the public increased from £ 985 million at the end of 2011 to £ 1,235 million at the end of 2012. Bank Leumi Jersey's portion of the balance of deposits at the end of 2012 was £ 317 million. Credit to the public decreased from some £ 1,304 million at the end of 2011 to £ 1,298 million at the end of 2012. Bank Leumi Jersey's portion of the balance of credit at the end of 2012 was £ 127 million.

Capital, reserves and surpluses totaled some £ 134 million at 31 December 2012, compared with some £ 119 million at the end of 2011.

On 2 February 2012, Bank Leumi UK increased Tier 2 capital by £ 11 million by the issue of a subordinated capital note to the Bank.

On 20 February 2012, the Bank invested £ 10 million in the share capital of Bank Leumi UK. The increase in capital was approved by the Supervisor of Banks.

On 22 February 2013, Bank Leumi Jersey paid a dividend amounting to £ 4 million to Bank Leumi UK.

In October 2012, the Financial Services Authority ("FSA") in the UK published specific directives for Bank Leumi UK regarding the holding of liquid and qualitative assets for dealing with a stress scenario. The bank holds liquid and qualitative assets in excess of the FSA requirement and because of this, a line of liquidity amounting to £ 120 million, which was approved for the bank in 2010 for withstanding a stress scenario, was canceled.

The ratio of equity to assets amounted to 8.3% (7.7% in 2011).

Mr. Yoel Mintz, Head of the Complex Finance and Real Estate Division, was appointed chairman of the board on 22 May 2012, in place of Mr. Zvi Itzkovitch. who resigned from his post.

Leumi Private Bank S.A. (formerly Bank Leumi Switzerland)

Bank Leumi (Switzerland) (above and below "Bank Leumi Switzerland"), was founded in 1953. The bank operates through three branches in Switzerland – Zurich, Geneva and Lugano, a representative office in Israel and a subsidiary in the Cayman Islands.

On 10 February 2011, an agreement (hereinafter: "the purchase agreement") was signed between Bank Leumi Le-Israel Ltd. (hereinafter: "Leumi"), directly or through a company under its control, and Island Tower Foundation, Helena S. Safdié Levy, Edmundo Safdié, and G.RS. Participations S.à.r.l., the owners of Banque Safdié SA in Switzerland (hereinafter: "Banque Safdié"), according to which Leumi will purchase all of the share capital in the acquired bank, subject to conditions precedent specified in the agreement.

According to the purchase agreement, the basic consideration amount, before adjustments, will be based on the net asset value of the acquired bank, with the addition of a premium on the assets under management of the acquired bank on the date of the transaction's closing, and it will be adjusted in accordance with the results of a due diligence examination.

On 30 November 2011, after the conditions precedent set forth in the agreement, the purchase agreement was completed and Leumi purchased the entire share capital of Banque Safdié. Pursuant to purchase agreement, the total consideration paid at the closing date of the transaction was CHF 143 million, of which CHF 110 million was paid to the sellers and the balance of CHF 33 million deposited on trust to secure adjustments in the consideration derived from changes in the assets managed by Banque Safdié in the 24 months following the date of completing the transaction, and other adjustments in accordance with the wordings agreed between the parties.

On 3 January 2012, the merger with Banque Safdié was formally completed and pursuant thereto, the activity of Banque Safdié was merged with that of Bank Leumi Switzerland. In April 2012, the merger of the automated systems was completed. The name of the merged bank was changed to Leumi Private Bank SA, as approved by the general meeting of the shareholders of the Bank Leumi shares when they convened on 19 December 2011.

On 5 October 2012, an adjustment was made to the purchase price, according to the net asset value and the assets managed by Banque Safdié, as they were on the purchase date. Accordingly, on 11 October 2012, a further payment of CHF 484 thousand transferred directly to the sellers.

On 17 October 2012, the enlargement of the share of the minority shareholder to 5.03% of the share capital of LPB was completed. The Bank issued 2,840 new Class B shares at a price of CHF 1,777.25 per share and received aggregate consideration of CHF 5,048,100.

The post-closing price adjustment will be made in March 2014, on the basis of data correct as of 30 November 2013, i.e. 24 months after the date of completing the transaction, in which time the bank will be conducting due diligence examinations.

As a result of the merger, the level of Group activity in Switzerland, increased, and the bank currently operates in a branch in Lugano, as well as branches in Zurich, Geneva and Lugano.

On 18 December 2012, the board of directors of MBCO (a subsidiary of LPB) decided to distribute a dividend of US$ 17.2 million (CHF 15.7 million).

Total assets of Leumi Private Bank amounted to CHF 1,902 million at the end of 2012, compared with CHF 1,074 million of total assets of Bank Leumi Switzerland at the end of 2011 (before the purchase). Profit in 2012 amounted to CHF 0.3 million, compared to a total of CHF 3.6 million in 2011, a reduction of 91.6%.

The total of capital and reserves, including internal funds, amounted to CHF 237 million at the end of 2012 (of which CHF 47 million were internal funds), compared with CHF 117 million at the end of 2011.

Total assets managed and/or held for customers and not included in the balance sheet at the end of 2012 amounted to CHF 5.2 billion, compared to CHF 3.6 billion at the end of 2011 (before the merger).

Bank Leumi Luxembourg

Bank Leumi Luxembourg 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 and investments in securities.

Total assets at the end of 2012 amounted to some € 473 million, compared with some € 611 million at the end of 2011.

At the end of 2012, deposits of the public totaled some € 397 million compared with some € 413 million at the end of 2011. Trust deposits and securities held by customers of the bank, and are not included in the balance sheet, totaled € 739 million at the end of 2012, compared with € 663 million in 2011.

Bank Leumi Luxembourg ended 2012 with a profit of € 3.0 million, compared with a loss of € 3.6 million in 2011.

The capital means of Bank Leumi Luxembourg totaled some € 40 million, compared with € 37 million at the end of 2011.

A project to replace the infrastructure system in Leumi Luxembourg was executed. The system is expected to up and running in mid-2013.

Leumi International Investments N.V. ("L.I.I.")

The purpose of the company was to serve as a vehicle to issue notes of the Bank Leumi Group to the public overseas. The proceeds from past issues were intended for the use of the Group. At the date of the report, the company repaid the entire balance of its debt to the public and the Bank is taking steps towards its closure.

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. The name of the company was changed to Bank Leumi Romania in August 2006.

Since the acquisition, the Bank increased Bank Leumi Romania’s shareholders’ equity by some US$ 83 million.

Leumi Romania is a banking corporation in Romania, and operates 23 branches, and engages in financial activity that includes, *inter alia*, the accepting of deposits, the extension of credit, international trade and foreign currency activities.

In view of the economic situation in Romania and following an examination of the future potential of activity, in 2012, the bank shut six branches and one agency. This was in addition to the contraction of six branches in 2010 and 2011.

Leumi Romania ended 2012 with a profit of some 13.6 million Romanian ron (some US$ 3.6 million), compared with a loss in 2011 of some 24.0 million Romanian ron (some US$ 7.2 million). The shift to profit arises mainly from a reduction in credit loss expenses amounting to 50.0 million ron.

In recent years, Romania has suffered from the harshest recession for 20 years, although in 2011, it achieved positive growth of 2.5%. In addition, inflation was significantly reduced towards the end of 2011 from 8% to 3% per annum. 2011 was notable for a number of structural reforms which included the privatization of several government companies, reducing the cost of labor in the government sector. The Standby Arrangement assistance program for Romania was renewed in 2011 for an additional two years.

The banking system in Romania, is still vulnerable to external shocks particularly due to the high proportion of foreign banks, mostly Austrian and Greek. The capital adequacy ratio of the banks is good, although unpaid loans are on a rising trend.

In 2008, the Bank made available to Leumi Romania a line of credit in the amount of US$ 100 million, 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 2012, the balance of the deposit stands at some US$ 86 million.

In 2009, further to the line of credit, Bank Leumi provided the bank with a liquidity line amounting to US$50 million, to be used in the event of a liquidity crisis in the bank. The provision of the line of liquidity arose from a request from the Romanian central bank, and as a result of an analysis of the bank's liquidity situation in a scenario. The request was approved by the Board of Directors and by the Bank of Israel.

The total assets of Bank Leumi Romania amounted to 1,150 million Romanian ron (US$ 308 million) at the end of 2012, compared with 1,128 million Romanian ron (some US$ 337 million) at the end of 2011. Deposits of the public amounted to 614 million Romanian ron (some US$ 164 million) at the end of 2012, compared with some 633 million Romanian ron (some US$ 189 million) at the end of 2011, and credit to the public amounted to 775 million Romanian ron (some US$ 208 million), compared with some 713 million Romanian ron (some US$ 213 million) at the end of 2011.

The capital, reserves and surplus amounted to some 224 million Romanian ron (some US$ 60 million) at the end of 2012, compared with 196 million Romanian ron (some US$ 59 million) at the end of 2011.

1 Romanian ron = US$ 0.297 (31 December 2011- US$ 0.299)

On 6 March 2013, Mr. Yoel Mintz, Head of the Complex Finance and Real Estate Division, was appointed as chairman of the board of directors of Bank Leumi Romania, in place of Mr. Zvi Itzkovich, who retired from his post due to his retirement from the Bank.

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$ 47 million at the end of 2012, compared with US$ 43 million at the end of 2011.

Capital, reserves and retained earnings totaled some US$ 11 million on 31 December 2012, similar to 2011.

2012 ended with a loss of some US$ 398 thousand compared with a loss of some US$ 110 thousand in 2011. The balance of off-balance sheet activity totaled some US$ 301 million in 2012, compared with US$ 274 million at the end of 2011.

In January 2013, a court in Brazil handed down a verdict of public service and fines against two people who had acted as representatives of the bank in Porto Alegra, with regard to events connected to the transfer of monies via moneychangers during 2003-2004.

Leumi Re Ltd.

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 Ltd., 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 2012 amounted to US$ 38.3 million, compared with US$ 36.7 million at the end of 2011, and the **insurance reserves** amounted to some US$ 18.5 million at the end of 2012, compared with some US$ 21.5 million at the end of 2011. **Shareholders’ equity** amounted to some US$ 14.5 million as of 31 December 2012. Profit for 2012 amounted to US$ 4.6 million, compared with a profit of US$ 7.5 million in 2011.

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.

Activities of companies included on equity basis

Total investments of the Group in companies included on equity basis amounted to NIS 2,129 million as at 31 December 2012, compared with NIS 2,270 million as at 31 December 2011. The contribution to net operating profit of the companies included on the equity basis amounted to a loss of NIS 67 million in 2012, compared with NIS 148 million in 2011.

For further details, see pages 160.

Exposure to Risks and Methods of Risk Management

Risk management

The Bank is engaged in a wide spectrum of financial activities that involve the taking of risks, primarily credit risks and market risks and liquidity. These risks are accompanied by operational risks and compliance risks inherent in business activity. Risk management in Leumi is considered an essential condition for fulfilling the Group's long-term goals. The main goal of risk management in Leumi is maintaining the stability of the Bank and the Group, and complying with the risk appetite established by the Board of Directors. This includes minimizing material losses and events that may significantly impair the Bank's reputation. In addition, the goal of risk management is to support the achievement of business goals, with continued activity to upgrade the risk management infrastructure and analysis of the risk picture, enabling more educated decision-making and expansion of activity.

Risk management framework

Risk management in Leumi is led by the Chief Risk Officer, who is a member of management in the Bank, and Head of the Risk Management Division. The Chief Risk Officer is responsible for managing the main risks in the Bank and in the Group, with the legal risk management under the authority of the Bank's Chief Legal Advisor. In the risk management structure which has been established, the Risk Management Division is an independent entity which places emphasis on overall supervision and is involved in making material decisions in real-time. Reporting to the Chief Risk Officer are the heads of the departments for managing credit risks, market risks, operating risks and an overall risk-return manager. With effect from 2013, the Compliance Division reports to the Chief Risk Officer.

Risk management in Leumi is based on three lines of defence. The first line of defence is the corporate divisions, which are responsible for taking, analyzing and understanding risk throughout the life of the transaction and activity; the second line of defense is the Risk Management Division, which is responsible for leading policy and risk limitation, in conjunction with the business party and the directives of the Board of Directors, and the challenge of the corporate divisions in important decisions; and the third line of defense is the Internal Audit Division, which retrospectively monitors the first two lines of defense. In addition to these three lines of defense, the Board of Directors is involved in the determining, supervising and contesting the risk levels to which the Bank and the Group are exposed.

The main areas of responsibility of the Risk Management Division correspond to those defined in Proper Conduct of Banking Management Regulation no. 310, dealing with risk management published in December 2012. These include directing Leumi's risk policy with regard to all of the main risks, assisting the Board of Directors in crystallizing the Bank's risk appetite, making independent analyses when strategic decisions are reached and in the approval procedures for approving new products, and form an overall and up-to-date picture of the risk for making real-time decisions.

As a rule, the leadership of the management and control of risks at the level of the single transaction and specific project would be under the responsibility of the business divisions that are close to the customer and to the ground, and with the partnership of the Risk Management Division in real-time, in large transactions and projects at the Bank and Group level. In Proper Conduct of Banking Management Regulation no. 311, published in December 2012, dealing with credit risk management, the Banking Supervision Department requires an involvement of the risk management function at the transaction level, higher than that required until now. The provision stipulates that the risk management function is to express an opinion on approval for specific loans in excess of NIS 25 million and that the classification of allowances should be carried out by a party that is independent of the business party. Leumi is prepared to comply with the said requirements according to the time-table provided in the regulation.

Control and inspection of risk management are conducted by the management committees for the management of the various risks, as well as the Risk Management Committee of the Board of Directors, as set forth below:

- The Risk Management Committee of the Board of Directors
- The Upper Risk Management Committee headed by the President and CEO, of which all of the members of the management are members.
- Risk management committees according to various topics headed by the Chief Risk Officer and with the participation of factors from the various divisions: credit, market, operational, overall risk.

The committees outlined above discuss aspects of exposures to the various risks and determine internal restrictions in accordance with the conditions of the market and the Bank's risk appetite.

Risk management in the subsidiaries is conducted in accordance with the principles prescribed at the Group level. A chief risk officer is appointed in each subsidiary in Israel and abroad, and there are policy documents relating to the management of the principal types of risk, derived from the Group policy in each of the risk areas. Risk appetite, limits and authorities are determined, and there are also control systems and periodic management reports examining the limits against the actual position. The risk managers in the subsidiaries report to the CEO of the subsidiary and, on a professional level, to the Chief Risk Officer of the Group.

Main risks

The main risk of the Group is credit risk, which includes credit to the public, banks, governments, securities, derivatives and the like. This risk is in accordance with the core business of the Group and is reflected in activity with corporate, commercial and retail customers, as well as *nostro* activity. The Bank's policy in Israel is to take steps towards a maximum dispersal of risk. The Bank's aim is to ensure that management of the credit portfolio, the determination of the level of working facilities with borrowers, limitations on the credit portfolio and the measurement of concentrations are in terms of risk indices and not only in terms of exposure. The allocation of dealing with customers among lines of business is carried out according to the level 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 (For details of credit risk and the method of management, see below in this chapter.).

Market risk, including liquidity risk, is the second most important risk. The routine management of market risks is intended to support the achievement of business targets, while estimating the forecast profit 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 and the risk committees at different levels delineates the impact of exposure on the economic value, the accounting profit, capital reserve and liquidity position. (For details of credit risk and the method of management, see below in this chapter.)

In the Bank's activity as a financial intermediary, there are operational risks that also include legal risks, compliance risks, the areas of business continuity and information security. Operational risk management is conducted in accordance with the generally accepted (best practice) standards in all parts of the Group. (For details of credit risk and the method of management, see below in this chapter.)

Tools used in managing risk

The methods and procedures for working in the area of risk management in Israel and abroad are examined and revised on an ongoing basis, taking into account the policy of the Bank, changes occurring in the business environment, and the directives and requirements of the Bank of Israel, as well as other relevant regulatory authorities in Israel and abroad. Set forth below is a condensed review of the principal tools used for estimating the risks and the basis for making decisions. The main tools used in the management of risk are: the establishment of risk policies and restrictions - for each type of risk; the setting of work processes for analyzing and managing risk at the single transaction level and at portfolio level; periodic reports for evaluating risk on the basis of qualitative and quantitative indicators of Leumi's portfolio, taking account of changes in the environment in which the Bank operates. These reports are discussed in forums and various committees defined for the subject; conducting various potential scenarios, at various levels of severity, for assessing the potential losses and implications for the Bank. On the basis of these scenarios, conducted at both Bank level, and at the level of the specific type of activity and risk, a plan of action to be carried out to contend with the risks is defined.

The assessment of risk at the overall level of the Bank and the level of the activity and single transaction is based on several structured methodologies, some based on expert assessments in area of activity, and some, on the basis of historical data and statistical models of various types. The changes in the risk environment in Israel and around the world, as well as the changes in the perception of risk, require the Bank to revise its assessments and the methodologies it employs, while constantly being challenged by the interested parties.

Risk environment and its impact on the Bank

Compared to 2011, at the end of which the debt crisis became stronger, in 2012, there was a certain moderation in the risk environment and the prospects of a stress scenario occurring declined, following aggressive intervention by the central banks on global and domestic markets, in order to avert a crisis. Nevertheless, the basic economic data, which led to the current economic slowdown in Europe, the United States, and as a consequence, in Israel, too, did not change significantly. Accordingly, looking forward, the level of uncertainty remains high and the slowdown is expected to continue.

Business factors and the Risk Management Division are monitoring these developments and are taking decisive steps to minimize the risks.

The main risk areas which are expected to impact the Bank's activities in the coming year are as follows:

1. **Continuation of the global and domestic economic slowdown**

   Global economic slowdown leads to a slowdown in the local economy and represents a primary risk factor for the activity and profitability of borrowers and the banks. From the aspect of credit, this slowdown affects companies from various segments, in particular, from the retail trade sector (mostly in the field of trade in durable products). A slowdown is also evident in companies in the airline industry and in energy and fuel companies (although the discovery of gas is expected to assist these companies in the medium term). These segments join up with difficulties experienced by holding companies that have high levels of leverage and companies dependent on raising resources in the debenture market. From the aspect of exposure to market risks, the global economic environment is likely to continue to be reflected in volatility on financial markets and throughout the coming year. The Bank has significantly reduced exposures in the *nostro* portfolio to foreign banks in the past two years and is taking steps to adapt the composition of the portfolio to the current position of the markets and the low interest rate environment.

2. **Tighter capital and liquidity requirements**

   Since 2008, the year in which the financial crisis became stronger, and throughout the years that have elapsed since then, in which the crisis has also spilled over to the debt of governments of European countries, the requirements on banks, both in Israel and around the world, have become stricter, against a backdrop of the lessons absorbed and still being learnt from the crisis. The main changes are reflected in the particularly severe capital requirements and liquidity requirements. These are outlined in the chapter below, in the section which discusses the Basel III directives. The impact of those requirements on the economy and on the banks in Israel and around the world is considerable, and is expected to concern us in the coming years. The effect is expected to be expressed, first and foremost, in a certain reduction in the supply of credit to particular segments and an increase in interest margins – particularly for high-risk large borrowers.

3. **Domestic real estate market**

   The real estate sector has the largest rate of exposure in Leumi's total credit portfolio. In the past year, the Bank tightened its underwriting procedures in some segments of the real estate sector where risk is higher, and took steps to screen transactions more closely, against a backdrop of the concentrations in exposure to this sector. At the same time, the Bank is prepared at any time for the possibility of a severe crisis in the sector, which could result from a worsening of the economy or government policy, which will be reflected in a sharp fall in housing prices and in a negative impact on borrowers in the sector. In the area of mortgages, the Bank makes certain that any increase in performance is within the risk parameters, the purpose of which is to minimize the damage the Bank might incur if there are any adverse changes in the state of the economy and the borrowers, or in the event of a material increase in interest rates.

4. **Compliance risk and legal risk**

   The severity of compliance risk increased during the past year and will do so in the foreseeable future, in view of the increasing regulation and enforcement in Israel and throughout the world, particularly in connection with cross-border activity with foreign customers and enforcement of the tax laws by various governments around the world.

5. **Risk of cyber attacks**

   Leumi invests a great deal of resources in defending against data protection risks including cyber risks, both in specialist personnel, and in infrastructures, in order to reduce exposure to this risk. Cyber events that have occurred in Israel and around the world in the past year indicate an increase in the risk. Adverse changes in the geopolitical environment also act to increase the risk, as cyber is one of the arenas for organizations and states. All these highlight the importance of the measures taken to minimize exposure to the risk, which, in certain cases, can cause substantial damage to the Bank's customers and its systems.

Definition of severity of the risk factors

The methodology for classifying the degree of severity of exposures to the various risks, as outlined in the table of severity of risk factors, is based on estimating exposure to the various risks and the quantification of the impact of the scenarios materializing on the Group's capital, i.e., its stability. The degrees of severity defined below are based on potential stress scenarios and present the level of exposure divided into three levels: low, medium and high. This is as a function of the extent of the impairment, in relation to the Group's capital in the event of the risk materializing. According to the methodology, a risk whose realization is likely to lead to a loss which will reduce the capital adequacy ratio of Leumi by up to 1%, is classified as a low risk; a risk whose realization will result in damage leading to a reduction in the capital adequacy ratio of more than 1% is classified as medium; and a risk whose realization will result in damage leading to a reduction in the capital adequacy ratio of more than 2% is classified as high. In addition, there is a fourth level of severity - critical, which describes the fear of departure from the capital adequacy targets established in the stress scenarios, as a result of a sudden variation in a market environment under the conditions of a serious crisis. In the event of such a departure, a program to reduce exposure will be initiated immediately.

It is important to note that the said methodology for assessing the severity of the risk factors is one of many employed by the Bank. The Bank regularly checks the effect of various events that may occur not only on capital adequacy and stability, but also on the current profit, on goodwill, etc. These assessments are discussed in a forum of members of management and in the Board of Directors.

The table of severity of risk factors presented below presents an assessment of the severity for each of the various risks derived from evaluating the effect of the realization of stress scenarios determined on the Bank's capital. It should be noted that none of the exposures to the risk factors is defined as high or critical, and the breakdown of the risks obtained corresponds to the Group's risk appetite and goals.

With regard to the financial statements for 2011, no change took place in risk classification according to risk level, as the increase in the risk environment described above, in the section on Risk Environment and its Impact on the Bank, did not result in any significant change in the assessment of the effect of each risk factor on the Bank's capital and its stability.

Some of the information included in this chapter is "forward-looking information". For an explanation of this term, see "Description of the Banking Corporation's Business and Forward-Looking Information" on page 55 above.

Table of severity of risk factors

	Risk	Definition	Degree of severity
1	Overall credit risk	Risk of a loss as a result of the possibility that counterparty does not comply with its obligations. The reference is to credit to the public, derivatives, deposits in banks, investments in debentures and capital holdings.	Medium
1.1	Single borrower risk and securities	Amount of risk described by the likelihood of failure of borrowers, the loss given a failure, which is also affected by the collateral, and the exposure at a time of failure of individual borrowers	Medium
1.2	Large borrower and group of borrowers concentration risk	Credit risk arising from the relative size of borrowers in the credit portfolio of the Bank.	Low
1.3	Industry and sector concentration risk	Credit risk arising from concentration of credit to borrowers in certain sectors and segments of the economy	Medium
2.	Overall market risk	Risk of exposure of the Group's assets to changes in exchange rates, interest, inflation and asset prices, the correlation between them and their volatility levels	Medium
2.1	Base risk	Risk due to fluctuations of the exchange rate, including inflation (trading portfolio and banking portfolio).	Low
2.2	Interest risk	Risk due to fluctuation in interest rates (trading and banking portfolio)	Low
2.3	Margin and share prices risk	Risk as a result of fluctuations in share and bond prices in the commercial portfolio and in the banking portfolio for assets remeasured at market price	Low
2.4	Liquidity risk	The risk of inability to withstand the uncertainty in relation to the possibility of raising funds and/or realizing assets, in an unexpected manner and within a short time-frame, without incurring a material loss.	Low
3.	Operating risk	Risk of loss arising from weaknesses or failures in processes, people or internal systems, or external events. This risk includes legal risk, but does not include strategic risk or reputational risk.	Low
3.1	Legal risk	The risk arising from activity which does not correspond with legislation (civil), legal errors and class actions conducted against the Bank.	Low
4	Reputational risk	The risk that a negative publication would cause a fall in the customer base, a fall in revenues, liquidity or high legal costs	Low
5	Compliance risk	The risk that can arise from non-compliance with requirements of the authorities, which will be expressed in penalties on the Bank or on employees	Low
6	Holistic systemic risks	Risks caused as a result of external events that could lead to the materialization of a number of risks simultaneously	Medium

Definitions of risks in the above table:

1. Credit risk

The risk of loss resulting from the possibility of a borrower not meeting its obligations. This refers to credit to the public, derivatives, bank deposits, investments in debentures, and holdings in equity. The severity of overall credit risk is medium. (See further details on risk management in the chapter below.) Details of sub-risks included in the definition of credit risk according to the Group mapping are as follows:

1.1 **Risk in respect of single borrowers and collateral**: The risk of the entry of a counterparty into default, leading to failure to meet contractual monetary obligations. The risk includes:

- Entry into default of counterparty in derivatives.
- Residual risk in respect of inability to realize collateral.
- Country risk deriving from the exposure of borrowers operating in foreign countries
- Credit risk in shares deriving from the exposure to default in respect of a holding of shares for investment purposes.

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 who are 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 according to the Group mapping:

1.2.1 Significant exposure to a large borrower or group of borrowers. The severity of the risk level is defined as low;

1.2.2 Sectoral and segmental exposure. The severity of the risk is defined as medium;

The severity of the overall risk and sub-risks was examined in the framework of stress scenarios which reviewed what damage there was in respect of concentrations of credit in the portfolio as a result of a serious crisis occurring. The severity of overall concentration risk is assessed as medium.

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 and their level of volatility. The severity of overall market risk is medium. (For further details on risk management, see below in this chapter).

2.1 Basis risk. The severity of the risk is defined as low;

2.2 Interest risk. The severity of the risk is defined as low;

2.3 Bond margin and share prices. The severity of the risk is defined as low.

The severity of the general risk and sub-risks were evaluated in accordance with the most severe stress scenario in the set of scenarios for these risks. The severity of overall market risk is defined as medium.

2.4 **Liquidity risk**: Uncertainty with regard to the possibility of raising funds and/or realizing assets, unexpectedly within a short timeframe, without causing material loss. This risk has been determined as low, since the Bank complies with the liquidity ratios that it sets for itself, including probability indices, and the subsidiaries also comply with the indices that they have set for themselves. Monetary damage in a very severe liquidity scenario is also 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. The evaluation of the level of severity relates to damages at a high level of severity and a review of historical events. The level of severity of the risk is defined as low. For more information on management of the risk, see below in this chapter.

3.1 Legal risk:

The risk of loss resulting from the inability to legally enforce the performance of an agreement or contingent liability. The definition includes risks deriving from legislation, regulations, case law and regulatory directives, risks deriving from operations not backed by adequate agreements or without legal counseling or according to deficient legal counseling. A plan for managing legal risks is implemented in the Group whose objective is to identify, prevent, manage and minimize legal risks. In view of the results of an analysis of the legal consulting division for a potential stress scenario, the Group's legal risk is categorized as low. For more information on management of the risk, see below in this chapter.

3.2 Compliance risk

The risk that may derive from non-compliance with regulatory requirements and laws of the various authorities in Israel and abroad.

4. Reputational risk

The 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 compliance with the various regulatory provisions, maintaining high levels of control, and orderly work procedures by the Management and the Board of Directors and their ability to monitor the current operations. Leumi has a code of ethics governing conduct *vis-à-vis* employees, suppliers and the environment. Leumi Group ensures that the products and services it supplies are of the highest quality. The treatment of employees and customers is reflected in 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.

5. Holistic 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's set of scenarios including the occurrence of a number of risks together. The degree of severity is classified as medium.

Basel Directives and Assessments in Leumi

The data in Leumi's financial statements, the calculation of the risk assets and the capital adequacy ratio as at 31 December 2012 are calculated and presented in accordance with the directives according to the standard approach in Basel II. The capital adequacy ratio amounting to 14.87% which Leumi presents at 31 December 2012 according to assessments of the Group covers the required capital in respect of the First Pillar and the Second Pillar, including the stress scenarios used by the Group in its internal assessments.

In this report, certain data required by Pillar 3 have been expanded and/or added in accordance with the instructions of the Banking Supervision Department, as detailed below:

Subject	Table	Directors Report	Financial Statements
General	1	Page 11	-
Capital Structure (Qualitative and Quantitative)	2	Page 29	Note 13
Capital Adequacy (Qualitative and Quantitative)	3	Page 31	-
Risk Exposures and Assessment – General Qualitative Disclosure		Pages 182-189	
Credit Risk Qualitative Disclosure	4(a)	Pages 194-197	-
Credit Risk Exposures by Principal Types of Credit	4(b)	Page 198	
Exposures by Geographic Area to Foreign Countries	4(c)	Page 218	Exhibit F
Credit Risk Exposures by Third Party and Principal Types of Credit	4(d)	Page 199	
Credit Exposures by Repayment Period	4(e)	Page 200	
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 Allowance for Credit Losses	4(h)	-	Note 4A.1
Credit Exposures by Risk Weighting	5	Pages 201-204	
Reduction of Credit Risk (Qualitative and Quantitative)	7	Pages 205-207	-
Credit Exposures in Derivatives by Counter Party (Qualitative and Quantitative)	8	Pages 208-211	-
Securitization (Qualitative and Quantitative)	9(f), 9(g)	Page 109-110	Note 3
Market Risk (Qualitative and Quantitative)	10	Pages 221-230	-
Operational Risk - Qualitative Disclosure	12	Pages 233-237	-
Investment in Shares (Qualitative and Quantitative)	13(b)	Pages 112-113	-
Investment in Shares of Companies Included on Equity Basis	13(b)	Pages 160-161	-
Interest Risk	14	Pages 224-227	Exhibit D

ICAAP (Internal Capital Adequacy Assessment Process)

The process of assessing capital adequacy serves to examine the capital required for supporting the various risks to which the Group is exposed, in order to ensure that the Group's capital actually exceeds the said capital requirements at any time. As part of the process, the risk appetite and the risk-bearing capacity are defined, a comprehensive process of mapping and assessment of risks to which the Group is exposed is carried out, a comprehensive framework for analyzing stress scenarios in the context of the management of the Group as a going concern is developed, and processes of managing the risks and the risk management structure in the Group are examined.

The process in the Group is divided into two main components:

1. A continuous process of risk management in the Group, examining compliance by risk management with standards required by the Basel II directives and, in the future, Basel III, directives, and with Leumi's risk appetite, the identification of strengths and weaknesses and the construction of work programs to improve and update the risk management processes, also, *inter alia*, in light of economic reviews and update of economic forecasts. The assessment of risk management processes is closely linked to capital adequacy assessment, and the allocation of capital is carried out in accordance with the severity of the risks and the quality of their management.

2. Assessment of the Group's capital adequacy and an examination of the capacity to bear losses. When assessing capital adequacy, the Bank takes into account the Group's strategic plans and its future capital needs, in particular according to regulatory requirements, as reflected in the three-year plan, in light of economic forecasts.

The results of the process are formally collated in the ICAAP document which was submitted to the Supervisor of Banks at the end of May 2012. On the basis of this document, a dialogue takes 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 is examined by the Supervisor of Banks as part of the Supervisory Review Process (SRP). The updated document for this year is currently being prepared.

Basel III – Trends and Forward-looking Information

In June 2011, the Basel III directives (published in December 2010) "Increasing the Resilience of the Banking System" were updated by the Bank for International Settlements (BIS). These directives rely on the Basel II directives and come to update several aspects learned from the lessons of the recent financial crisis. These directives were due to come into force at the beginning of 2013. However, as of date, they have yet to come into effect, and their implementation date around the world has yet to be finally determined.

The purpose of the directives proposed by the BIS is to reinforce the standing of the banking system at a time of crisis, in view of the lessons learned from the crisis of 2008-2009, introducing improvements in the area of risk management and with an emphasis on:

- Improving the quality of capital and an increase therein.
- Improving the liquidity ratios and determining consistent standards for measuring liquidity.
- Reducing the pro-cyclical influence of the economic situation on the capital requirements.
- Increasing transparency of the risk management methods.
- Reducing risks as a result of the realization of counter-party risks.

A draft translation of the Basel III document was published by the Banking Supervision Department in November 2011. This draft is a verbatim translation of the original.

In March 2012, the Supervisor of Banks sent a directive to all banking corporations according to which, all banking corporations will be required to comply with a minimum core capital equity ratio of 9% by 1 January 2015.

In addition, a large banking corporation, the total of whose balance sheet assets on a consolidated basis constitutes at least 20% of the total balance sheet assets of the Israeli banking system, will be required to comply with a minimum core capital ratio at the rate of 10%, by 1 January 2017. This additional directive applies to the Bank.

The Bank of Israel has set up working teams including representatives of the banks and has transferred working files for conducting quantitative influence surveys (QIS) for assessing the effect of the transition to the Basel III directives on the capital adequacy ratios and liquidity ratios of the banks in Israel.

On 15 June 2012, the Bank forwarded to the Bank of Israel the results of the quantitative influence survey relating to the effect of the Basel III directives on the capital adequacy ratios, and on 31 July 2012, the Bank forwarded to the Bank of Israel the quantitative influence survey relating to the effect on liquidity.

On 30 December 2012, the Supervisor of Banks sent a draft for adoption of the Basel III recommendations in Israel, including a draft amending Proper Conduct of Banking Business Management no. 202 "Measurement and Capital Adequacy – Regulatory Capital".

The following is a number of points of emphasis from the Bank of Israel drafts for the adoption of Basel III directives:

1. All banking corporations in Israel will be required to comply with an overall capital ratio of 12.5%, by 1 January 2015.

In addition, a large banking corporation, with total balance sheet assets on a consolidated basis representing at least 20% of total balance sheet in the Israeli banking system, will be required to comply with an overall capital ratio of 13.5%, by 1 January 2017. This additional regulation applies to Leumi.

The draft also includes reference to Tier 1 shareholders' equity targets, in accordance with a directive from March 2012.

2. The components of Tier 1 shareholders' equity will remain as in the Basel II directives, with the exception of a number of topics:

a. A capital reserve in respect of available-for-sale securities (after tax) will constitute a part of Tier 1 shareholders' equity, whether it is positive or negative;
b. For recognition of minority interest, a restriction has been added, which is dependent in capital surpluses in the investee company;
c. A dividend which is declared after the balance sheet date will not be deducted from Tier 1 shareholders' equity, in contrast to the Basel II directives.
d. Additional changes in structure of deductions from capital.

3. The distinction between Upper Tier 2 capital and Lower Tier 2 was canceled, as was Tier 3. However, the restriction whereby Tier 2 capital must not exceed 100% of the Tier 1 shareholders' equity was retained, and the qualifying capital instruments to be included in Tier 2 capital must not exceed 50% of the Tier 1 shareholders' equity (after the required deductions from this capital). This restriction does not include the capital instruments that were included prior to the effective date of this regulation in Upper Tier 2 capital, subject to transitional provisions.

4. Eligibility criteria are provided for Tier 1 capital and Tier 2 capital, including the requirement that the instruments have a mechanism for absorbing losses when there is a fall in certain Tier 1 shareholders' equity adequacy requirements. The inventory of the existing capital instruments when the Basel III requirements become effective will gradually be deducted from the capital base.

5. Collective allowance for credit losses, before the effects of tax, will be recognized as part of Tier 2 capital, up to 1.25% of credit risk assets according to the standardized approach.

6. A surplus investment in a single non-bank corporation of more than 5% of Tier 1 shareholders' equity will receive the proportion of risk of 1250%.

7. The capital requirement has been provided in respect of CVA (credit valuation adjustment) losses that may be incurred as a result of a deterioration in the qualitative of the credit of a counterparty in an OTC derivative transaction.

8. A transitional period of four years has been provided for the full implementation of the Basel III requirements. The transitional period is four years.

9. According to an estimate, based upon the Bank's interpretation of the Bank of Israel's drafts, relating to the adoption of the Basel III directives, assuming full and immediate implementation (without taking into account the transitional provisions), on 31 December 2012, the Tier 1 shareholders' equity ratio of Leumi Group was 8.26%, compared with 8.55%, according to the Basel II directives.

   The reduction in the capital adequacy ratio derives mainly from an increase in the risk assets, which is mainly the effect of a surplus investment in a single non-banking corporation (a decrease of some 0.11%), and the effect of deferred taxes, a collective allowance and counterparty risk in derivatives. The increase in risk assets was partly offset as a result of the association of the positive capital reserve in respect of available-for-sale securities with Tier 1 shareholders' equity (an increase of some 0.19%). On the other hand, a number of interpretations, mainly relating to cross-holdings in a financial corporation and investments in capital components of financial corporations, which have not been included in the abovementioned ratio, have not yet been clarified.

On 13 January 2013, the Bank of Israel published an amendment to Proper Conduct of Banking Business Regulation no. 342 regarding the management of liquidity risk. The directive represents a milestone in the adoption of the international regulatory directives regarding liquidity, which have been developed in light of the crisis in 2008 and 2009. The purpose of the revised regulation is to begin gradually to adopt the Basel III directives for managing liquidity risks, and at its center, is the definition of minimum ratios between liquid assets and liabilities which, it is estimated, will materialize within a specified time period. In particular, it involves the definition of minimum ratios between liquid assets and liabilities which, it is estimated, will materialize within a specified time interval. In particular, this involves the definition of a minimum liquidity ratio for a period of a month (a liquidity coverage ratio - LCR) and the definition of stable funding ratio for a period of a year (a net stable funding ratio - NSFR). The Bank is prepared for implementation of the directive and the computation of the liquidity ratios.

Credit risks

Credit risk is the risk of the Bank incurring a loss as a result of the possibility that a borrower or counterparty of the banking corporation does not meet its liabilities *vis-à-vis* the banking corporation, as agreed.

The Bank's credit and credit risk policy document gives major expression to the Bank's credit risk strategy. This is together with the existing procedures for identifying, measuring, monitoring supervising and controlling the credit risk. The credit policies and procedures currently in force relate to the credit risks in all of the Bank's activities, and apply both to the single credit and to the entire credit portfolio.

In addition to the Bank's credit policy document, there is a credit and credit risk policy document at the Group level which outlines the framework and supra-principles for the policy documents of each of the Group companies in Israel and abroad (the United States, the United Kingdom and Romania). The Bank's credit policy, representing a recommendation and guideline for crystallizing the Bank's credit policy in each of the subsidiaries in Israel, is also presented for the subsidiaries in Israel.

The supplement to all the above is a document relating to business goals, as determined by management and forming a basis for the Bank's work program.

The Bank's credit and credit risk policy document in Israel is updated each year, discussed by the Bank management and approved by the Board of Directors of the Bank. The document outlines policy for the Bank's activity in Israel and gives expression to the state of the economy in the world and in Israel and to the risk environment evaluated for the coming year.

The principles guiding the Bank include:

- Focusing on exposures in activities where the Bank has the expertise required to assess and manage the inherent risks.
- Involvement with varying types of credit with the aim of achieving risk dispersal.
- For each credit risk, there should be segregation between the unit dealing with the credit risk and an independent unit exercising control over the credit risk and over the management of the credit risk.
- Preparing a risk analysis before starting new lines of business or launching new products.
- The segmentation principle: allocating the handling of customers along business lines is carried out according to the operating turnover of the customer and the size of the obligo facility available to him, and according to the complexity/specialization of the type of transaction.
- Every unit in the Bank that creates 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.
- Carrying out routine and periodic control of credit exposures, with the aim of identifying weaknesses as early as possible and taking the appropriate steps.
- Evaluating credit risk in a quantitative manner, and deciding on a risk rating for every customer. To achieve this aim, the Bank has models and automated systems for supporting the process of reviewing the risk level of the borrower, and evaluating the expected loss.
- Determining an outline operating plan that creates differentiation between three types of operations:
    - Activities of segments the Bank is interested in financing and would like to expand;
    - Activities for selective financing;
    - Activities the Bank tends to avoid.

  Details of the outline operating plan are presented in the Credit Policy Document of the Bank and are updated once a quarter as necessary.

- Determining, managing and monitoring internal quantitative limit. In addition, the distribution of risk ratings of borrowers in the Bank is monitored by various cross-sections.
- The Bank has been working for a number of years, to increase vigilance and general awareness among customer managers and the potential negative implications of the environmental aspects on projects it finances. The Bank takes steps to identify the sensitive industries and to integrate a component of this exposure when making credit decisions.

Control and management procedures

In the area of credit management, the procedures for the control and supervision of risks have improved, *inter alia*, by intensifying the "segmentation" of corporate customers in the appropriate lines of business and in the framework of specialist branches, and by the establishment of specialist centers for the area of credit in the Retail Division.

The examination of the credit frameworks of the Bank's large borrowers and the approval of the transactions or their transfer for discussion within the appropriate credit committee have been carried out by the Credit Risk Management Unit in the Credit Branch in the Corporate Division, in the Construction and Real Estate Department and in the Commercial Banking Division.

For further details, see paragraph "Organizational structure and management responsibility for credit risks".

As part of the control and supervision over credit, there are directives and regulations relating to the type of credit, terms of financing, method of reliance on the various collaterals, type of transaction and periods of credit, in the context of which the control and supervision over executing policy were tightened. On the individual level, special emphasis has been placed on the examination of the business condition among customers whose risk level has increased. Control is exercised by the use of control tools and improvement in the efficiency of working procedures. The Bank maintains constant monitoring of the effect of erosion and exposures created among the relevant borrowers, including intense discussion regarding customers defined as sensitive.

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 and automatic systems have been assembled in the Bank 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 has begun to employ an advance system for managing the loan portfolio, with the aim of upgrading its capability to control the various risks, and particularly credit concentrations, maintaining the limits of risk factors in the area of credit, directing activities with the objective of improving the ratio of return on risk, and facilitating a more accurate pricing system of credit risks.

As stated, the Board of Directors of the Bank approves the Bank's credit and collateral policy, as well as internal limits - sectoral and other.

Outline according to economic sector

As part of policy, three categories of economic sectors are specified according to the risk rating of each sector – the sectors at a low, medium and high level of risk plus a definition of what is included in the "green channel" and what is outside it. This outline plan is routinely updated in accordance with periodic analyses of the various sectors and segments of the economy according to the risks and prospects inherent in each sector. The sector outline plan represents a further consideration in specific decisions regarding the grant of credit, together with an individual examination of risk features of the borrower/transaction and its risk rating.

For further details on this subject, see the paragraph on "Credit concentration".

Credit policy in overseas subsidiaries

In each of the Bank's overseas units, the subsidiary's credit policy is approved by the local board of directors. Periodically, each of the overseas units presents a summary description of credit in its area, and the main characteristics of its credit portfolio, to the Board of Directors of the Bank. As in Israel, the credit policy of overseas subsidiaries is based on spreading risks, while setting limits for exposure in the various sectors of the economy and operating segments. However, the level of sectoral concentration in the subsidiaries is higher, compared with the Bank in Israel, due to their relative small size and the need to focus on specific niches. In addition, collateral policy is prescribed within the scope of the credit policy, including principles and rules regarding the various types of collateral, the extent of reliance thereon, etc. This is done in accordance with and subject to all the banking regulations and directives of each country. Various levels of credit-granting authorities are set for each subsidiary. In addition, in those subsidiaries providing commercial credit, there is a process for rating borrowers according to levels of risk and in subsidiaries with a substantial credit volume, there is a loan review unit which performs routine examinations of the risk level of the Bank's customers.

Reporting on credit risk

The Bank is meticulous in maintaining routine and up-to-date reporting to members of the Bank Management, the Board of Directors and the Banking Supervision Department. Reporting to the Banking Supervision Department includes reports on various credit matters, including credit risk by sectors of the economy, financial instruments, the structure of shareholders' equity and the minimum capital ratio, large individual borrowers and groups of borrowers, credit for financing the acquisition of means of control, problem loans, and supplementary provision, credit exposures of subsidiaries abroad, related persons, etc.

Reports to Bank Management and to the Board of Directors relate to the development of credit for exceptional or major transactions, the results of quarterly reviews of the breakdown of the credit rating of borrowers, in particular, and of the overall credit portfolio in general, quarterly reports on concentrations of credit by sector of the economy, individual borrowers and groups of borrowers, loans for financing the acquisition of means of control, countries, Israeli and foreign banks in relation to the limits set by the Banking Supervision Department and internal limits, the distribution of problem credit among the various units of the Bank, and information on specially sensitive customers, etc.

Organizational structure and management responsibility of credit risk

Credit risk management department in the Risk Management Division

The Credit Risk Department operates in the Risk Management Division, which reports to the Chief Risk Officer of the Group (CRO). The department is responsible for credit risk management at the portfolio level, including the formulation of the credit and credit risks policy document for approval by management and the Board of Directors, monitoring and analyzing risks in the entire credit portfolio, independently examining and controlling specific credit portfolios and developing quantitative models and tools for measuring and controlling credit risks. In the coming year, the Bank will prepare for the adjustment and implementation of the areas of responsibility, pursuant to the new Proper Conduct of Banking Business Regulation (311), issued by the Banking Supervision Department.

Credit risk management in the Risk Management Division

In order to structure the decision-making process as a function of the risk entailed in financing borrowers, CRM units operate within the Corporate Division, the Construction and Real-Estate Department, the Diamonds Department and the Commercial Division. The purpose of the CRM units is to optimize decision-making in credit portfolios. CRM units are responsible for the in-depth analysis of credit applications from business units, validating borrowers' risk ratings, systematic credit monitoring, making recommendations on classifications and provisions, developing methodologies and financing "formats", developing control processes and implementing working procedures and rules for granting credit at Bank level. The main work of the units focuses on making an independent examination of customer relationship managers' recommendations for determining or extending credit facilities for financing customers under their care, and identifying customers whose situation has deteriorated, while indicating the main risks characterizing the credit portfolio and making recommendations for the continued customer service. As part of the rationale behind the establishment of the Credit Risk Management units, and with the aim of improving and simplifying the decision-making process and shortening timeframes for providing credit, a change was made in the hierarchy of credit authorities at the various levels so that some credit applications are approved by the business factors, subject to conditions stipulated by Credit Risk Management units. 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 Credit Risk Management unit is an "Appraisals Department", whose duties, *inter alia*, are to examine and validate appraisals of real estate assets pledged to the Bank, carried out by certified appraisers, and to determine the maximum collateral value of the properties.

A unit operates in the Commercial Division with similar characteristics to the Corporate CRM Department described above, which reviews and analyses the bulk of the credit portfolio of the Division.

In the Banking Division, the Consumer Credit Risk Management department is under the responsibility of the retail CRM sector, which is responsible for the entire retail credit portfolio.

The sector regularly provides the management of the Division with an overview, an analysis of trends and expectations, with regard to consumer credit risk in the divisional credit portfolio. For this purpose, the sector uses, in addition to the vast knowledge accumulated in the area, various models it has developed and the data bases under its responsibility.

The sector carries out and manages designated activities in consumer credit *vis-à-vis* the branches and the districts, leads committees in this area and is responsible for the training and assimilation procedures of the CB/CS model in the branches and districts and the Basel II directives.

In addition, during the past year, an organizational change was made in the Banking Division, such that the professional functions related to credit risk were removed from the responsibility of the regional managements, and are now managed in "credit centers". These are independent units, reporting directly to the divisional risk manager and manned by professional and experienced risk officers. Each credit center operates with the branches in the regions defined within its area of responsibility, and deals with each credit approval beyond the authority of the branches (some under the authority of the center itself, and some, transferred to handled by the division management). Furthermore, the center is engaged in aspects of monitoring and credit control, regulating and supervising the branches' activity in this area.

Special Credit Department

The Special Credit Department operates under the responsibility of the Head of the Commercial Division. The department specializes in dealing with companies in difficulty, and consists of the following two sectors:

1. **ITSC (Intensive Treatment of Sensitive Customers) Sector** – a professional unit dealing with active customers presently in difficulty, under the assumption that the company can be brought back to normative operations if it is correctly managed and financed.

2. **Collections Sector** – deals with inactive customers or those whose operations are about to be shut down. The two sectors above are often aided by relevant external parties such as external lenders, CPA's, architects/engineers, lawyers, etc.

Tools for credit risk management

In managing credit risk, use is made of quantitative models for rating the risk of borrowers and evaluation and monitoring of risk at portfolio level.

The grant or renewal of retail credit (private and small business customers) up to a defined maximum sum is examined under a credit-scoring system based on the level of risk which is estimated from long-term activity. Corporate and commercial credit (transactions above the abovementioned ceiling) and major private customers are rated under the credit rating system which operates at the Bank. This credit rating assists management in the decision-making process, in pricing the credit, and in monitoring its quality over time. Credit risk is dependent on the probability of default by the borrower within one year of the rating in a given period, or PD (probability of default), the extent of the exposure in respect of the borrower at the time of default, EAD (exposure at default), and the loss from the borrower in a given default, or LGD (loss given default). The borrower evaluation system, coupled with the system for measuring profitability from the customer, provides a basis for connecting the level of risk and the pricing for the customer and improving various routine management aspects.

At the portfolio level, the Bank is assisted by an economic capital model, which is based on the rating of the borrowers, in order to assess the credit risk at the level of the total credit portfolio and at its different cutoffs.

Conclusion-drawing process

The Bank has a process for drawing conclusions on credit matters, with the participation of the managers of the various units of the Bank. Committees for drawing conclusions have been established in the various divisions for this purpose. These committees convene periodically in order to discuss incidents of default, analyze the implications and significance of the findings of the incident, and formulate recommendations for improving work processes and enhancing business efficiency. The recommendations accepted by the committees are, where necessary, implemented in revisions to credit and collateral policy, in amendments to working procedures at the Bank, and in updates of training programs.

Capital requirements in respect of credit risk

For information regarding the capital requirements in respect of credit risk pursuant the Basel II directives, the standard approach, see page 31.

Risk exposures according to main type of credit exposure (Table 4(b) – Basel II):

	31 December 2012	31 December 2011	**31 December 2012**	31 December 2011
Type of credit exposure	Gross credit risk exposures		Average gross credit risk exposures	
	NIS millions			
Credit	**297,282**	296,643	**291,169**	278,944
Debentures	**43,043**	37,229	**42,445**	35,557
Others	**15,530**	14,199	**14,531**	13,795
Guarantees and liabilities on account of customers	**117,189**	113,112	**117,487**	111,531
Transactions in derivative financial instruments	**6,396**	7,592	**7,072**	13,503
Total	**479,440**	468,775	**472,704**	453,330

Credit risk exposure by counterparty and by main type of credit exposure – (Table 4(d) – Basel II):

	31 December 2012					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Sovereign debts	**41,551**	**30,875**	**-**	**217**	**27**	**72,670**
Debts of public-sector entities	**3,339**	**3,400**	**-**	**114**	**19**	**6,872**
Debts of banking corporations	**11,193**	**2,947**	**-**	**2,100**	**2,241**	**18,481**
Debts of corporations	**116,037**	**4,100**	**-**	**75,217**	**4,022**	**199,376**
Debts collateralized by commercial real estate	**18,582**	**-**	**-**	**1,606**	**-**	**20,188**
Retail exposures to individuals	**29,941**	**-**	**-**	**27,998**	**84**	**58,023**
Loans to small businesses	**13,795**	**-**	**-**	**4,164**	**3**	**17,962**
Housing mortgages	**62,844**	**-**	**-**	**5,773**	**-**	**68,617**
Securitization	**-**	**1,721**	**-**	**-**	**-**	**1,721**
Other assets	**-**	**-**	**15,530**	**-**	**-**	**15,530**
Total credit risk	**297,282**	**43,043**	**15,530**	**117,189**	**6,396**	**479,440**

	31 December 2011					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Sovereign debts	41,287	24,666	-	189	21	66,163
Debts of public-sector entities	3,299	1,398	-	180	-	4,877
Debts of banking corporations	10,485	5,331	-	1,939	2,381	20,136
Debts of corporations	123,502	4,683	-	74,603	5,146	207,934
Debts collateralized by commercial real estate	19,180	-	-	1,489	-	20,669
Retail exposures to individuals	27,688	-	-	26,702	44	54,434
Loans to small businesses	13,816	-	-	4,021	-	17,837
Housing mortgages	57,386	-	-	3,989	-	61,375
Securitization	-	1,151	-	-	-	1,151
Other assets	-	-	14,199	-	-	14,199
Total credit risk	296,643	37,229	14,199	113,112	7,592	468,775

Breakdown of portfolio by repayment period and by main type of credit exposure – (Table 4(e) – Basel II):

	31 December 2012					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Up to one year	**156,095**	**20,874**	**2,796**	**75,118**	**4,364**	**259,247**
From one to five years	**68,517**	**13,879**	**1,427**	**26,576**	**4,794**	**115,193**
More than five years	**72,350**	**8,290**	**2,972**	**15,495**	**6,641**	**105,748**
Non-monetary items	**320**	**-**	**8,335**	**-**	**2,340**	**10,995**
Benefits to be offset					**(11,743)**	**(11,743)**
Total	**297,282**	**43,043**	**15,530**	**117,189**	**6,396**	**479,440**

	31 December 2011					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Up to one year	162,556	16,965	2,812	70,093	6,151	258,577
From one to five years	64,748	12,502	743	28,877	2,600	109,470
More than five years	69,184	77,762	2,345	14,142	7,012	100,445
Non-monetary items	155	-	8,299	-	1,653	10,107
Benefits to be offset					(9,824)	(9,824)
Total	296,643	37,229	14,199	113,112	7,592	468,775

Credit risk in accordance with the standardized approach (Table 5 – Basel II)*:

The tables below give details of credit exposure according to risk weighting, allocating the exposure by counterparty, before and after deduction of credit risk in respect of recognized collateral.

* See Tables 4(b) and 4(d) above for details.

Amount of exposure before expenses in respect of credit losses, and before deduction of credit risk (2)

	31 December 2012											
	0%	20%	35%	40%	50%	75%	100%	150%	225%	650%	Deduction from equity	Gross credit exposures (1)
	NIS millions											
Sovereign debts	**69,264**	**2,623**	**-**	**-**	**507**	**-**	**276**	**-**	**-**	**-**	**-**	**72,670**
Debts of public-sector entities	**-**	**3,378**	**-**	**-**	**3,491**	**-**	**2**	**1**	**-**	**-**	**-**	**6,872**
Debts of banking corporations	**20**	**14,609**	**-**	**-**	**3,013**	**-**	**839**	**-**	**-**	**-**	**-**	**18,481**
Debts of corporations	**-**	**498**	**-**	**-**	**1,261**	**-**	**193,056**	**4,561**	**-**	**-**	**-**	**199,376**
Debts collateralized by commercial real estate	**-**	**-**	**-**	**-**	**-**	**-**	**19,443**	**745**	**-**	**-**	**-**	**20,188**
Retail exposures to individuals	**-**	**-**	**-**	**-**	**-**	**57,670**	**168**	**185**	**-**	**-**	**-**	**58,023**
Loans to small businesses	**-**	**-**	**-**	**-**	**-**	**17,655**	**124**	**183**	**-**	**-**	**-**	**17,962**
Housing mortgages	**-**	**-**	**43,337**	**-**	**-**	**18,303**	**6,758**	**219**	**-**	**-**	**-**	**68,617**
Securitization	**-**	**727**	**-**	**390**	**169**	**-**	**370**	**-**	**42**	**2**	**21**	**1,721**
Other assets	**2,190**	**-**	**-**	**-**	**-**	**-**	**12,899**	**441**	**-**	**-**	**-**	**15,530**
Total	**71,474**	**21,835**	**43,337**	**390**	**8,441**	**93,628**	**233,935**	**6,335**	**42**	**2**	**21**	**479,440**

(1) Before conversion to credit of off balance sheet components as required by the Basel II directives (e.g. weighting of unutilized facilities) and before deduction of credit risk as the result of certain activities (e.g. use of guarantees).

(2) The deduction of credit risk expresses classification of the final risk weighting between the various rates.

The above comments relate to the tables below.

Amount of exposure after expenses in respect of credit losses, and before deduction of credit risk (2)

	31 December 2012											
	0%	20%	35%	40%	50%	75%	100%	150%	225%	650%	Deduction from equity	Gross credit exposures (1)
	NIS millions											
Sovereign debts	**69,263**	**2,623**	**-**	**-**	**507**	**-**	**276**	**-**	**-**	**-**	**-**	**72,669**
Debts of public-sector entities	**-**	**3,378**	**-**	**-**	**3,489**	**-**	**2**	**1**	**-**	**-**	**-**	**6,870**
Debts of banking corporations	**20**	**14,610**	**-**	**-**	**3,009**	**-**	**839**	**-**	**-**	**-**	**-**	**18,478**
Debts of corporations	**-**	**498**	**-**	**-**	**1,261**	**-**	**190,209**	**4,474**	**-**	**-**	**-**	**196,442**
Debts collateralized by commercial real estate	**-**	**-**	**-**	**-**	**-**	**-**	**19,363**	**726**	**-**	**-**	**-**	**20,089**
Retail exposures to individuals	**-**	**-**	**-**	**-**	**-**	**57,333**	**116**	**182**	**-**	**-**	**-**	**57,631**
Loans to small businesses	**-**	**-**	**-**	**-**	**-**	**17,475**	**55**	**181**	**-**	**-**	**-**	**17,711**
Housing mortgages	**-**	**-**	**43,235**	**-**	**-**	**18,256**	**6,473**	**201**	**-**	**-**	**-**	**68,165**
Securitization	**-**	**727**	**-**	**390**	**169**	**-**	**370**	**-**	**42**	**2**	**21**	**1,721**
Other assets	**2,190**	**-**	**-**	**-**	**-**	**-**	**12,899**	**441**	**-**	**-**	**-**	**15,530**
Total	**71,473**	**21,836**	**43,235**	**390**	**8,435**	**93,064**	**230,602**	**6,206**	**42**	**2**	**21**	**475,306**

Amount of exposure after expenses in respect of credit losses, and after deduction of credit risk(2)

	31 December 2012											
	0%	20%	35%	40%	50%	75%	100%	150%	225%	650%	Deduction from equity	Net credit exposures (1)
	NIS millions											
Sovereign debts	73,194	2,623	-	-	506	-	230	-	-	-	-	76,553
Debts of public-sector entities	499	1,386	-	-	3,482	-	2	1	-	-	-	5,370
Debts of banking corporations	20	13,649	-	-	3,077	-	773	-	-	-	-	17,519
Debts of corporations	-	498	-	-	1,261	-	176,851	4,362	-	-	-	182,972
Debts collateralized by commercial real estate	-	-	-	-	-	-	18,367	726	-	-	-	19,093
Retail exposures to individuals	-	-	-	-	-	55,026	107	179	-	-	-	55,312
Loans to small businesses	-	-	-	-	-	15,146	53	172	-	-	-	15,371
Housing mortgages	-	-	43,232	-	-	18,160	6,470	201	-	-	-	68,063
Securitization	-	727	-	390	169	-	370	-	42	2	21	1,721
Other assets	2,190	-	-	-	-	-	12,899	441	-	-	-	15,530
Total	75,903	18,883	43,232	390	8,495	88,332	216,122	6,082	42	2	21	457,504

Amount of exposure before expenses in respect of credit losses, and before deduction of credit risk(2)

	31 December 2011									
	0%	20%	35%	50%	75%	100%	150%	350%	Deduction from equity	Gross credit exposures (1)
	NIS millions									
Sovereign debts	63,065	2,480	-	315	-	303	-	-	-	66,163
Debts of public-sector entities	-	1,374	-	3,499	-	-	4	-	-	4,877
Debts of banking corporations	36	16,442	-	3,095	-	563	-	-	-	20,136
Debts of corporations	-	642	-	2,093	-	201,640	3,559	-	-	207,934
Debts collateralized by commercial real estate	-	-	-	-	-	20,243	426	-	-	20,669
Retail exposures to individuals	-	-	-	-	54,170	123	141	-	-	54,434
Loans to small businesses	-	-	-	-	17,443	259	135	-	-	17,837
Housing mortgages	-	-	38,837	-	17,741	4,600	197	-	-	61,375
Securitization	-	1,001	-	100	-	21	-	-	29	1,151
Other assets	2,380	-	-	-	-	11,397	422	-	-	14,199
Total	65,481	21,939	38,837	9,102	89,354	239,149	4,884	-	29	468,775

(1) Before conversion to credit of off balance sheet components as required by the Basel II directives (e.g. weighting of unutilized facilities) and before deduction of credit risk as the result of certain activities (e.g. use of guarantees).

(2) The deduction of credit risk expresses classification of the final risk weighting between the various rates.

The above comments relate to the tables below.

Amount of exposure after expenses in respect of credit losses, and before deduction of credit risk (2)

	31 December 2011									
	0%	20%	35%	50%	75%	100%	150%	350%	Deduction from equity	Gross credit exposures (1)
	NIS millions									
Sovereign debts	63,064	2,480	-	315	-	303	-	-	-	66,162
Debts of public-sector entities	-	1,373	-	3,497	-	-	4	-	-	4,874
Debts of banking corporations	35	16,437	-	3,095	-	563	-	-	-	20,130
Debts of corporations	-	642	-	2,093	-	199,230	3,461	-	-	205,426
Debts collateralized by commercial real estate	-	-	-	-	-	20,056	391	-	-	20,447
Retail exposures to individuals	-	-	-	-	53,773	82	139	-	-	53,994
Loans to small businesses	-	-	-	-	17,273	113	134	-	-	17,520
Housing mortgages	-	-	38,753	-	17,687	4,229	185	-	-	60,584
Securitization	-	1,001	-	100	-	21	-	-	29	1,151
Other assets	2,381	-	-	-	-	11,396	422	-	-	14,199
Total	65,480	21,933	38,753	9,100	88,733	235,993	4,736	-	29	464,757

Amount of exposure after expenses in respect of credit losses, and after deduction of credit risk (2)

	31 December 2011									
	0%	20%	35%	50%	75%	100%	150%	350%	Deduction from equity	Net credit exposures (1)
	NIS millions									
Sovereign debts	63,563	2,452	-	315	-	303	-	-	-	66,633
Debts of public-sector entities	350	876	-	3,495	-	-	4	-	-	4,725
Debts of banking corporations	35	16,273	-	3,356	-	511	-	-	-	20,175
Debts of corporations	-	642	-	2,093	-	189,146	3,286	-	-	195,167
Debts collateralized by commercial real estate	-	-	-	-	-	19,208	391	-	-	19,599
Retail exposures to individuals	-	-	-	-	51,323	82	133	-	-	51,538
Loans to small businesses	-	-	-	-	15,234	112	127	-	-	15,473
Housing mortgages	-	-	38,747	-	17,587	4,220	185	-	-	60,739
Securitization	-	1,001	-	100	-	21	-	-	29	1,151
Other assets	2,381	-	-	-	-	11,396	422	-	-	14,199
Total	66,329	21,244	38,747	9,359	84,144	224,999	4,548	-	29	449,399

Credit risk reduction

Policy and processes regarding collateral valuation and management

As a policy, the Bank aims to give credit against collateral. The amount of collateral required from a borrower derives, *inter alia*, from the level of risk in the credit. Collateral 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 sectors of the economy, the Bank has set principles and rules concerning types and amounts of collateral. Requirements and rates of collateral derive from the level of risk that the Bank is willing to assume when providing credit, but special attention is given to risk ratings of the borrower' themselves which is determined, taking into account a large number of parameters, the main ones being, financial strength, repayment ability, the sector of industry in which the activity is concentrated

Furthermore, business criteria have been determined 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 their value and means of follow up and control, and these are distributed through working procedures, circulars, and operating instructions.

Collateral is matched to the kind of credit that it secures, taking into account the length of the period, 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 Credit Risk Management Unit in the area of real-estate in the Corporate Division is responsible for the operation of the Appraisal Section whose function, *inter alia,* is appraisals of real estate assets pledged to the Bank.

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, this requires an updated appraisal and an examination of the ability of the corporation as a source of debt repayment. The appraisal is carried out by one of several generally accepted methods in the Bank, taking into account the circumstances of the matter, such as the description of the corporation, and the economic sector and economic environment in which the acquired corporation operates. Appraisals can be carried out by an expert unit in the Bank or by an external appraiser from the list of appraisers authorized from time to time by the Bank. If the appraisal is carried out by an external appraiser, an audit review will be carried out on it by the business personnel and expert units in the Bank.

The Bank has a computerized system enabling information to be produced about types of collateral. Instructions have been issued concerning the various types of collateral, managing them, determining their value (using external appraisers, financial data, etc.), handling the receipt of collateral, and monitoring changes in collateral and in its value. Officers authorized to approve the credit operate in accordance with prescribed policy. Rates of collateral are calculated automatically by the computerized system according to prescribed policy.

The Bank’s collateral procedures contain the business and legal principles on the basis of which the various types of collateral are to be received. These guidelines also include operational aspects regarding the procedure for receiving collateral (for example: requisite forms, registration with registrars - if needed), collateral reliance rates in respect of each type of collateral, control processes to be performed, etc.

The principles on which collateral reliance rates are determined derive 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 condition of the client.

Special emphases regarding specific collaterals also appear in the Bank's Credit and Credit Risks Policy document.

Common types of collateral accepted by the Bank for the purpose of reducing risks deriving from the grant of credit

- Pledge/offset of monies in accounts held at the Bank or with external entities (shekel/foreign currency deposits, savings, securities, provident funds);
- Pledge of sources for repayment 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/retention of inter-branch collateral;
- Third-party guarantees;
- Foreign trade risk insurance policies;
- Real estate;
- Floating liens;
- Movable property (vehicles, equipment);
- Pledge and assignment of rights by way of charge (pledges of contract/factoring).

Reduction of credit risk (Table 7– Basel II):

	31 December 2012					
	Gross credit exposure before allowance for credit losses	Gross credit exposure after allowance for credit losses	Total exposure covered by guarantees deducted	Total amounts added	Total exposure covered by eligible financial collateral	Net credit exposure
	NIS millions					
Sovereign debts	**72,670**	**72,699**	**(45)**	**3,929**	**-**	**76,553**
Debts of public-sector entities	**6,872**	**6,870**	**(1,992)**	**499**	**(7)**	**5,370**
Debts of banking corporations	**18,481**	**18,478**	**(927)**	**495**	**(528)**	**17,519**
Debts of corporations	**199,376**	**196,442**	**(1,901)**	**-**	**(11,569)**	**182,972**
Debts collateralized by commercial real estate	**20,188**	**20,089**	**(30)**	**-**	**(966)**	**19,093**
Retail exposures to individuals	**58,023**	**57,631**	**(5)**	**-**	**(2,314)**	**55,312**
Loans to small businesses	**17,962**	**17,711**	**(24)**	**-**	**(2,316)**	**15,371**
Housing mortgages	**68,617**	**68,165**	**-**	**-**	**(102)**	**68,063**
Securitization	**1,721**	**1,721**	**-**	**-**	**-**	**1,721**
Other assets	**15,530**	**15,530**	**-**	**-**	**-**	**15,530**
Total	**479,440**	**475,306**	**(4,924)**	**4,924**	**(17,802)**	**457,504**

	31 December 2011					
	Gross credit exposure before allowance for credit losses	Gross credit exposure after allowance for credit losses	Total exposure covered by guarantees deducted	Total amounts added	Total exposure covered by eligible financial collateral	Net credit exposure
	NIS millions					
Sovereign debts	66,163	66,162	(28)	499	-	66,633
Debts of public-sector entities	4,877	4,874	(497)	349	(1)	4,725
Debts of banking corporations	20,136	20,130	(287)	376	(44)	20,175
Debts of corporations	207,934	205,426	(365)	-	(9,894)	195,167
Debts collateralized by commercial real estate	20,669	20,447	(29)	-	(819)	19,599
Retail exposures to individuals	54,434	53,994	(4)	-	(2,452)	51,538
Loans to small businesses	17,837	17,520	(11)	-	(2,036)	15,473
Housing mortgages	61,375	60,854	(3)	-	(112)	60,739
Securitization	1,151	1,151	-	-	-	1,151
Other assets	14,199	14,199	-	-	-	14,199
Total	468,775	464,757	(1,224)	1,224	(15,358)	449,399

Activity in Derivative Instruments for the purpose of reducing credit risks

Hedging and/or Risk Reduction Policy and Strategies and Processes for Monitoring the Continuing Efficacy of Risk-Reducing Hedging Activities

Developments in international foreign currency markets and the volatility of exchange rates of the various currencies, with their implications on those borrowers active in foreign currency, make it necessary to increase activity in monitoring, supervising and controlling customers' exposures to fluctuations in market prices (exchange rate, inflation, etc.). To this end, the Bank has updated instructions addressing the matching required between the currency basis of the credit and the currency of the cash flow that constitutes the source of repayment of the credit. Awareness of the subject of exposure to currency risks has been increased and special attention has been drawn to borrowers with the potential for a high degree of exposure. When necessary, the borrower’s risk rating is revised and a requirement issued to strengthen shareholders' equity and collateral. This area was also tightened up in the Bank's credit policy.

If it appears that a borrower faces exposure/sensitivity to changes in exchange rates, the relevant corporate officer must examine the degree of the borrower’s sensitivity from an overall perspective. This examination takes into account all the criteria that require the borrower to be included in the list of sensitive customers, and consideration and quantification of the borrower's sensitivity to changes in the relevant exchange rates and commodity prices.

For the purpose of hedging various credit risks, the Bank recommends its customers make use of defensive mechanisms against macro-economic variables, such as the Consumer Price Index, exchange rates and commodity prices. In order to reduce the level of credit risk, the Bank suggests the borrower protect himself against sharp changes in exchange rates, *inter alia*, by the use of financial instruments. By means of these instruments, it is possible to "hedge" financial exposure and, to a certain extent, real exposure, thus, keeping risk to a minimum.

When a solution is not found to fully cover exposure to changes in exchange rates, the Bank examines the need for taking other measures to reduce exposure, such as changing the terms of the loan, increasing collateral requirements, and reducing the borrower's *obligo*, as well as cancelling facilities that have not yet been utilized.

Various exit 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 shekels.

Due to the high volatility of worldwide prices of commodities, special attention is also paid to sectors that are likely to be adversely affected by this trend.

Below are credit risk balances to counterparties in derivatives (Table 8 – Basel II):

	31 December 2012		31 December 2011	
	Par value balance	Net credit exposure of derivatives	Par value balance	Net credit exposure of derivatives
	NIS millions			
Interest contracts	**290,808**	**10,363**	230,713	8,308
Foreign currency contracts	**180,438**	**5,501**	206,179	7,236
Contracts in respect of shares	**38,415**	**2,163**	18,423	1,653
Commodities and other contracts	**1,535**	**109**	1,547	219
Credit derivative transactions (1)	**187**	**3**	-	-
Offset benefits (2)	**-**	**(11,743)**	-	(9,824)
Eligible collateral	**-**	**(1,297)**	-	(44)
Total	**511,383**	**5,099**	456,862	7,548

(1) At the date of this report, there are no credit risk exposures in respect of hedging, sold or purchased.

(2) From 31 December 2011 credit risk in respect of derivatives is calculated in accordance with Proper Conduct of Banking Business Regulation no. 313, and is offset against transactions for derivatives with offset agreements.

The par value of a transaction in derivatives does not reflect the credit risk of the transaction. 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.

Customer 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 which 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 Law (Netting) enables all future 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 most of the customers have signed the forms.

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 counterparty credit risk, in NIS millions:

	31 December 2012	31 December 2011
Derivatives hedging a positive gross fair value	**31**	9
ALM derivatives with a positive gross fair value	**11,405**	11,564
Other derivatives with a positive gross fair value	**-**	-
Credit derivatives with a positive gross fair value	**2**	-
Total fair value	**11,438**	11,573

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 2012, in NIS millions:

	AAA to AA-	A+	A	A-	BBB to BBB-	BB+ to B-	Unrated	Total
Foreign banks	NIS millions							
Euro zone[(1)]	**2,172**	**-**	**-**	**25**	**152**	**1,995**	**-**	**-**
United Kingdom [(2)]	**1,941**	**311**	**-**	**376**	**300**	**465**	**57**	**432**
United States	**2,144**	**1**	**-**	**2**	**637**	**-**	**-**	**1,504**
Other	**334**	**3**	**-**	**-**	**-**	**291**	**25**	**15**
Total foreign banks	**6,591**	**315**	**-**	**403**	**1,089**	**2,751**	**82**	**1,951**
Israeli banks [(3)]	**2,031**	**21**	**-**	**-**	**798**	**1,212**	**-**	**-**

Corporate customers, according to sectors of the economy	
Financial services[(4)]	**1,785**
Industry[(5)]	**698**
Construction and real estate	**105**
Transportation and storage	**22**
Trade	**95**
Electricity and water	**11**
Business services	**21**
Private individuals	**14**
Communications and computer services	**40**
Others	**25**
Total corporate customers	**2,816**
Others*	**-**
Total exposure	**11,438**

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 2011, in NIS millions:

	AAA to AA-	A+	A	A-	BBB to BBB-	BB+ to B-	Unrated	Total
Foreign banks	NIS millions							
Euro zone[1]	1,119	781	135	-	-	-	2	2,037
United Kingdom [2]	771	14	448	-	7	-	3	1,243
United States	1,145	399	6	-	-	-	220	1,770
Other	337	-	15	-	-	-	5	357
Total foreign banks	3,372	1,194	604	-	7	-	230	5,407
Israeli banks [3]	-	-	1,223	613	-	-	15	1,851

Corporate customers, according to sectors of the economy	
Financial services[4]	2,230
Industry[5]	1,580
Construction and real estate	138
Transportation and storage	82
Trade	123
Electricity and water	6
Business services	9
Private individuals	26
Communications and computer services	103
Others	18
Total corporate customers	4,315
Others	-
Total exposure	11,573

(1) This amount includes transactions in 4 countries (2011 – includes transactions in 5 countries).
(2) This amount includes transactions with 11 banks (2011 – includes transactions in 10 countries).
(3) This amount includes transactions with 9 banks (2011 – includes transactions in 10 countries).
(4) This amount includes transactions with 373 customers, where the highest amount for a single customer is NIS 580 million (in 2011 – includes transactions with 466 customers, with the customer with the highest amount being NIS 349 million).
(5) This amount includes transactions with 260 customers, where the highest amount for a single customer is NIS 453 million (in 2011 – includes transactions with 286 customers, with the customer with the highest amount being NIS 1,078 million).

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Credit concentration

Concentration risk is defined as a single exposure or group of exposures with a common denominator and a potential for causing significant losses. Concentration risk management is conducted by determining restrictions and monitoring and controlling compliance therewith. The aspect of concentration is also reflected in the pricing of credit which reflects the risk.

Dispersal of the credit portfolio among the various sectors of the economy:

The Bank's credit portfolio is split among the various sectors of the economy with the aim of dispersing the risk inherent in the high state of concentration in one sector. In sectors of the economy characterized by a relatively low level of risk, we endeavor to reach a high state of financing from our share in the system.

In addition to the sector dispersal limitation, decided by the Bank of Israel with regard to the 20 most important sectors of the market, the Bank defines internal restrictions as a part of its risk policy to disperse the credit portfolio on the basis of the sectors of the economy and the sub-sectors, both as a percentage of the regulatory capital and as a percentage of the credit risk.

Activity and risk restrictions in the construction and real estate sector

This involves the area of activity with the largest exposure of all sectors of the economy. As with other sectors of the economy, restrictions at sector level and sub-sector level are defined for the real estate sector as part of the credit and credit risk policy, and the methodology and parameters for financing transactions are also defined.

In addition, the emphasis given by Leumi to financing real estate is reflected in the fact that a significant part of the Bank's activity in the sector is concentrated in a separate system within the framework of the activity of the Corporate Division. In this context, the examination of credit frameworks of the large borrowers in the area of construction and real estate, the approval of transactions or their transfer for discussion in the appropriate credit committee, are examined by the credit risk management (real estate) unit.

The Bank has a special 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 sets up the financing package, including possible cooperation with capital market entities in financing the transaction.

The financing of the real estate sector is carried out ensuring a diversification of the credit portfolio, distinguishing between the various segments – initiation of housing construction, building contracting including performance contracting, infrastructure works, activities in non-housing real estate – income-yielding assets, building products industry, trade in building products, and geographical areas in which the projects are located according to the relevant demand.

A significant part of the financing of the construction is carried out in the "closed project" (construction loan) format, which is characterized by periodic examination and close monitoring, on the reliance and with the assistance of external building supervisors.

As a part of the Bank's strategy to finance its customers in all the places in which they operate, and with a tendency to disperse risks, the Bank also regularly participates in the financing of real estate abroad. The financing is effected for selective customers, in a controlled fashion and after examining all their activity in Israel and abroad, in preferred countries and taking into consideration the country's political and economic risk, with a meticulous examination of the projects, and the Bank's overseas subsidiaries or local bank oversee the projects.

Group of borrowers[1]

The Bank monitors the exposure of groups of borrowers in all their components, using the mechanized system that serves the Bank for the purposes of regular reporting to the Bank of Israel and for internal monitoring and examination of compliance of the scope of obligation of groups of borrowers with the regulatory limitations. In addition, there is an internal process, in the framework of which a central official ("the Group head") is appointed for each of the large groups and there is coordination and information flow regarding the group components with the objective of reinforcing, as much as possible, the control on credit exposure and concentration risk deriving therefrom. This process occurs between the various units in Leumi and also includes the subsidiaries, and obliges the business entities involved with management of groups of borrowers to provide constant flow of information relating to the requests made for credit and the ratio of risk to Group items, exercising discretion regarding the scope of information and entities to whom it is transferred.

Moreover, regarding the largest 10 groups of borrowers, the head of the sector dealing with these groups, is required, once a year, to provide the Board of Directors of the Bank with a comprehensive review of the group.

With regard to the management of the credit portfolio of the Bank as a whole, the Bank implements an internal process of estimating concentration risk inherent in the exposure to all the large groups of borrowers, and the effect of that risk on the overall risk level of the portfolio. The above process enables both the quantification of the allocation of adequate equity according to the Proper Conduct of Banking Business Directive, and the performance of follow-up and ongoing monitoring of trends within the concentration component as part of the development trends of the entire portfolio.

With effect from 31 December 2011 updated provisions of Proper Conduct of Banking Business Regulations No. 313 came into effect, bringing a number of changes into force:

1. The restriction on the six largest groups of borrowers was canceled. In place of this restriction, a limitation of 120% of the Bank's equity was integrated into the restriction on a scheme of debts of large borrowers, groups of borrowers, and groups of bank borrowers, whose indebtedness is more than 10% of the Bank's equity. The total indebtedness of the above groups amounts to 18.0% of the Bank's equity.

2 With regard to the above, the definition "group of bank borrowers" has been added for the first time.

3. The restriction on indebtedness of groups of borrowers – remains at the rate of 25% of the equity of the Bank and the restriction on indebtedness of the borrower – in the amount of 15% of the equity of the Bank. In addition, the restriction of indebtedness of a controlled group of borrowers remains at 50% of the Bank' capital.

For information regarding credit to groups of borrowers whose indebtedness exceeds 15% of the equity of the Bank, see page 97.

Exposure restrictions in transactions for financing the purchase of the means of control

Proper Conduct of Banking Business Directive 323 defines credit for the purchase of the means of control as credit extended to a borrower when the main source of repayment to it is the corporation whose purchase the Bank financed.

[1] A group of borrowers is defined as all the following together: the borrower, a person controlling it or anyone controlled thereby. When a corporation is controlled by more than one individual, it is required to include in one group of borrowers those controllers for which the controlled corporation is material (e.g., from a capital perspective), including the controlled corporation and anyone controlled thereby.

The directive applies to transactions which fulfill the following conditions:

- The amount of the financing for the purchase is higher than 0.5% of the Bank's capital.
- Repayment of the credit is based on the corporation purchased.

The regulation prescribes quantitative restrictions on the credit for financing the transactions for purchasing the means of control in corporations, and the Bank is in compliance. One of these restrictions is that the total credit for all of the transactions to purchase the means of control in banking corporations which comply with the aforesaid conditions, with the rate of financing higher than 50% of the corporation's cost of purchase must not exceed 70% of the Bank's capital.

A further restriction on financing the purchase of the means of control in a banking corporation is that the amount of the credit for a financing transaction for purchasing the means of control in a banking corporation, when the rate of bank financing for this purchase exceeds 30% of the cost of purchase, must not exceed the lower of: 5% of the capital of the bank extending the capital or 5% of the capital of the bank being purchased.

The Bank augments the aforesaid restrictions, with internal limits relating both to transactions for purchasing the means of control according to the regulation and to financing transactions for any purpose against the means of control (without the right of recourse) on a quantitative and qualitative plain, and the Bank complies with them.

1. A quantitative limit on the number of transactions for purchasing the means of control, together with the transactions for any purpose against the means of control.

2. Exposure limits for a single transaction according to ranges of risk-rating.

3. An overall exposure limit on transactions according to ranges of risk-rating.

4. Exposure limit for economy sectors.

5. An overall exposure limit on transactions that are not on the "green channel" and are not in full compliance with the Bank's credit policy.

6. An aggregative "prominent" limit on each credit portfolio for financing the means of control.

As part of the Bank's credit policy, the Bank's requirements have been determined when financing the purchase of the means of control or in the financing against the means of control (without the right of recourse) with regard to the necessary shareholders' equity, collateral, etc., and the other additional conditions required for extending credit of this type.

There is a designated unit in the Corporate Division – Mergers, Acquisitions and Leveraged Transactions, which examines the transactions and designs the financing packages, including the possible inclusion of other financing entities.

Transactions to finance the purchase of the means of control according to the definition in Proper Conduct of Banking Business Directive 323

Below are the principal balances of credit provided in this area by sector of the economy, as of 31 December 2012 (in NIS millions):

Economic sector	Balance sheet and off-balance sheet credit*
	NIS millions
Industry	**1,901**
Trade	**717**
Real estate	**511**
Communications	**547**
Finance and holding companies	**-**
Total	**3,676**

* Less allowances for credit losses and deductible collateral.

Geographic dispersal

Mapping of exposure data of the activity of borrowers to countries/regions:

Geographic dispersal is defined as one of the three main credit concentration risks in a portfolio (in addition to sector dispersal and exposure to groups of borrowers). Geographic dispersal means: Economic/political/security deterioration in countries to which the borrower is exposed is likely to lead to impairment in the financial position of the company and its ability to meet its liabilities.

In 2009, questions relating to geographic exposure were added in the system of borrower rating questionnaires. The reference is in the aspect of the mix of revenues and/or the mix of the firm's cash flows, the location of the material assets used and creating its activity (assets used for generating revenue, such as plant / logistical center / warehouse / head offices / rental property, etc.), as well as assets used as collateral for the company's debts.

These data enable the Bank to conduct an examination from the perspective of the entire portfolio of the exposure of the borrowers to the various countries, for the purposes of monitoring and risk management.

Credit exposure to foreign financial institutions

The following table sets out the credit exposure to overseas financial institutions [(1)]:

	As at 31 December 2012			
	Balance sheet credit risk [(2)]	Securities [(3)]	Current off-balance sheet credit risk [(4)]	Current credit exposure [(6)]
	NIS millions			
External credit rating[(5)]				
AAA to AA-	**5,847**	**762**	**291**	**6,900**
A+ to A-	**8,102**	**1,866**	**751**	**10,719**
BBB+ to BBB-	**1,119**	**1,881**	**150**	**3,150**
BB+ to B-	**17**	**387**	**26**	**430**
Below B-	**-**	**-**	**-**	**-**
Unrated	**778**	**473**	**147**	**1,398**
Total current credit exposure to overseas financial institutions	**15,863**	**5,369**	**1,365**	**22,597**
Problem debt balances	**5**	**-**	**-**	**5**

	As at 31 December 2011			
	Balance sheet credit risk [(2)]	Securities [(3)]	Current off-balance sheet credit risk [(4)]	Current credit exposure [(6)]
	NIS millions			
External credit rating [(5)]				
AAA to AA–	8,989	2,354	649	11,992
A+ to A–	4,300	4,290	123	8,713
BBB+ to BBB-	209	1,130	-	1,339
BB+ to B–	54	-	7	61
Below B-	-	-	53	53
Unrated	1,564	446	123	2,133
Total current credit exposure to foreign financial institutions	15,116	8,220	955	24,291
Problem debt balances	7	316	-	323

(1) Overseas financial institutions include banks, investment banks, insurance companies and institutional bodies.
(2) Deposits in banks, credit to the public, securities that were borrowed or purchased in the context of buy-back agreements and other assets in respect of derivatives (fair value of derivatives).
(3) Including subordinated bank debentures amounting to NIS 1,272 million as at 31 December 2012 and NIS 1,605 million as at 31 December 2011.
(4) Mainly guarantees and undertakings for the provision of credit (excluding off-balance sheet derivatives.)
(5) The bank only uses the rating of Moody's and S&P credit rating agencies to rate the foreign financial institutions to which there is a credit exposure.
(6) Credit exposure is presented after deduction of the specific allowances for doubtful debts.

Notes:

a. Credit exposures do not include investments in asset-backed securities (see the details in the note on securities).
b. Some of the banks have received government support of various types, including direct investment in the Bank's capital, government guarantees of certain asset portfolios of the banks, guarantees enabling the banks to raise sources of financing, etc.
c. For further information regarding the composition of the credit exposure in respect of derivatives *vis-à-vis* banks and broker/dealers (local and overseas), see Note 18 to the Financial Statements.

Credit exposure to overseas financial institutions refers to commercial banks, bank holding companies, investment banks, insurance companies and institutional bodies.

The exposure by country is divided as follows: United States 45%, Europe (Germany, France, Italy, Spain and the Benelux countries) 26%, United Kingdom 19%, and other countries 10%.

The exposure includes mainly deposits in overseas banks, some 98.4% of which are short-term deposits of up to one week, and debentures, usually for a period of up to five years. The Bank closely monitors the condition of banks worldwide, and makes frequent analyses of their financial stability. The Bank maintains a shortlist of quality banks with which the Bank and its overseas subsidiaries make deposits.

Additional details regarding investments in securities, mainly debentures of foreign banks, are presented on page 110.

Management of exposure to and credit lines of foreign financial institutions takes into consideration, *inter alia*, the following:

- Their size as reflected, *inter alia*, in the size of their shareholders' equity.
- Their strength, as reflected in capital adequacy ratios (especially Tier 1 capital), analysis of the quality of their assets, and the stability of their profitability.
- The market's valuation, as reflected in the market value of their shares and their risk, as estimated with the help of their credit derivatives (CDS).
- The ratings assigned to them by the international rating agencies.
- The financial strength of the country where the Bank's center of activity is located.
- Additional considerations, such as the level of support, including direct investment in the banks' capital by governments, for the purpose of insuring the stability of these banks and of other banks in their countries.
- The policy for managing the exposure to overseas financial institutions includes, *inter alia*, limits on the amounts of exposure at bank and country level per risk.

Exposure to foreign countries [1]:

The exposure to foreign countries according to final risk is distributed among geographical regions and countries, the main exposure being to countries in Western Europe and in North America. The exposure to country risk is the exposure to customers who operate in these countries (Table 4(c) – Basel II):

	31 December 2012		
	Balance sheet credit risk	Off-balance sheet credit risk (2)	Total credit risk
	NIS millions		
USA	**25,916**	**5,972**	**31,888**
UK	**11,756**	**2,903**	**14,659**
France	**2,904**	**265**	**3,169**
Germany	**4,066**	**214**	**4,280**
Switzerland	**3,553**	**720**	**4,273**
Belgium	**303**	**71**	**374**
Italy	**348**	**35**	**383**
The Netherlands	**3,063**	**161**	**3,224**
Denmark	**736**	**16**	**752**
Norway	**245**	**-**	**245**
Austria	**72**	**35**	**107**
Sweden	**141**	**2**	**143**
China	**411**	**202**	**613**
Others	**5,380**	**1,090**	**6,470**
Total	**58,894**	**11,686**	**70,580**

	31 December 2011		
	Balance sheet credit risk	Off-balance sheet credit risk (1)	Total credit risk
	NIS millions		
USA	24,762	6,282	31,044
UK	10,330	3,004	13,334
France	2,935	322	3,257
Germany	3,930	304	4,234
Switzerland	2,659	770	3,429
The Netherlands	2,607	176	2,783
Belgium	554	32	586
Italy	457	15	472
Denmark	150	11	161
China	400	154	554
Sweden	346	2	348
Norway	169	-	169
Austria	104	33	137
Others	5,747	969	6,716
Total	55,150	12,074	67,224

(1) In connection with exposure to foreign countries, see also Exhibit E.

(2) Effective 31 December 2011, credit risk in respect of derivatives is calculated according to Proper Conduct of Banking Business Regulations no. 313 with offset agreements.

The following table presents the exposure to countries according to the countries' credit rating as rated by the World Bank, in NIS millions, as at 31 December 2012:

Rating	Balance sheet exposure	Off-balance-sheet exposure	Total exposure	Percentage of exposure in relation to total	Of which, classified as problematic
OECD countries with high income	**54,949**	**10,799**	**65,748**	**93.2**	**1,254**
Countries with high income	**986**	**107**	**1,093**	**1.6**	**2**
Countries with mid-high income	**2,619**	**520**	**3,139**	**4.4**	**556**
Countries with mid-low income	**334**	**260**	**594**	**0.8**	**3**
Countries with low income	**6**	**-**	**6**	**-**	**-**
Total	**58,894**	**11,686**	**70,580**	**100**	**1,815**

The amount of exposure to countries with liquidity problems as defined by the Fitch liquidity index and by the Bank of Israel (a country receiving monetary assistance from the IMF or whose liabilities are rated with a credit rating of CCC or lower) totals NIS 1,317 million and relates to 14 countries.

The countries are rated according to national income per capita as follows:
High income - exceeding US$ 12,476 per capita.
Mid-high income - from US$ 4,036 to US$ 12,475 per capita.
Mid-low income - from US$ 1,026 to US$ 4,035 per capita.
Low income – up to US$ 1,025 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, Israel, Hungary, France, United Kingdom, Japan, Spain, Switzerland, Luxembourg, Slovenia, the Netherlands, Sweden, Poland, Germany and South Korea

b. Countries with high income:

Cyprus, Hong Kong, Monaco, Singapore, Cayman Islands and Croatia

c. Countries with mid-high income:

Argentina, Brazil, Bulgaria, Chile, Mexico, Panama, Romania, Russia, South Africa, Turkey, Venezuela, Uruguay, Columbia, Peru

d. Countries with mid-low income:

China, Ecuador, Egypt, India, Jordan, Paraguay, the Philippines, Thailand, the Ukraine

e. Countries with low income:

A large number of the African countries, Haiti, Nepal

Overall exposure to certain foreign countries:

Country	31 December 2012				
	Credit to the public	Bonds	Bank deposits	Other	Total
	NIS million				
Italy (1)	**93**	**252**	**3**	**36**	**384**
Ireland	**5**	**1**	**-**	**-**	**6**
Greece	**2**	**-**	**-**	**-**	**2**
Spain (2)	**6**	**198**	**1**	**4**	**209**
Total (3)	**106**	**451**	**4**	**40**	**601**

(1) Of which NIS 256 million in Bank Intessa.
(2) Most of the exposure to Spain is to Santander Bank most of whose revenues come from outside Spain.
(3) The Group has no exposure in respect of Portugal.

Problem debts – disclosure, assessment, classification and rules for credit loss allowance

The Bank follows the instructions of the Supervisor of Banks, dated 1 January 2011, in respect of expenses in credit losses and problem debts.

For more information, see page 55.

Market and Liquidity Risks

Market risk and other financial risks policy

Market risk is defined as risk of a loss in off-balance sheet positions arising from changes in the fair value of a financial instrument as a result of a change in market conditions (a change in price levels in various markets, fluctuations in interest rates, exchange rate, inflation, the prices of shares and commodities and other economic indices). Exposure to market risks is reflected in the business results, the fair value of assets and liabilities, shareholders' equity, cash flows and the value of the Bank.

The policy for managing market risks is intended on the one hand, to support the achievement of business goals by assessing the risks and the damage that can result from exposure to risks, in comparison with the forecast profit from them, and on the other hand, to reduce the level of risk deriving from the Bank's ongoing activity, including maintaining a high liquidity level. All this is after taking into account the volume of activity, limitations, and the costs of hedging activity, the changes occurring in the business environment in Israel and throughout the world, directives and requirements of the Bank of Israel, and developments occurring worldwide with regard to measurements and methods of managing risks and adapting them to the needs of the Group and the Bank.

Exposure to credit risk is routinely managed at the Group level. The overseas subsidiaries determine policy for the management of market risk corresponding to the Group policy and the risk framework approved therein. Information on the actual state of exposure according to the frameworks so determined is received from the subsidiaries and taken into account in the overall management of the Group exposure.

Management of market risks is handled by two main risk centers – the banking portfolio and the trading portfolio. Definition of the trading portfolio is derived from the Basel directives and includes the securities trading portfolio of the Bank and transactions deriving from trading activity. The banking portfolio includes transactions that are not included in the trading portfolio.

Policy for the management of market risk includes restrictions on financial exposure in accordance with the risk appetite (the economic value and the accounting profit). These restrictions are aimed at limiting the damage likely to be caused as a result of unexpected changes in the markets. The system of limits demarcates 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, inflation, exchange rates, etc. The restrictions prescribed at the Group level include all subsidiaries in Israel and overseas.

In December 2012, the Board of Directors approved the risk appetite and investment strategy in a general overview of activity in the *nostro* portfolio and non-bank investments. The strategy includes the classification of the products and activities by risk type and determines risk restrictions according to various cutoffs, including a minimum limit on exposure to low-risk products, a maximum limit on exposure to high yield-to-risk products and restrictions on the maximum exposure to specific products. The set of restrictions guarantee a wide distribution from various aspects – the geographical aspect, the aspect of products and specific counterparties. The Risk Management Division and the Capital Market Division regularly examines the classification of products according to the risk levels and updates them as necessary, in order to prevent exceeding the risk limits that have been set.

Structure and functions of market risk management

The Bank implements Proper Conduct of Banking Business Directive No. 339 of the Supervisor of Banks, in the matter of the management of the market risks of the Group. The directive sets out basic principles for the manner of managing and controlling risks, including the responsibility of Management and the Board of Directors, the definition of means of control and tools for measuring risk, and the means of control and supervision of these risks.

The Risk Management Division, headed by the Chief Risk Officer, independently examines and monitors the extent of the risk and the procedure for managing the risks and prescribes the risk management policy. A chief market risk manager, who reports to the Chief Risk Officer, is appointed with the rank of section head.

The Capital Markets Division deals with the Bank's management of nostro and the operation of all the dealing rooms in the Bank for the purpose of trading and brokering in currencies, interest, derivatives and in securities. In addition, the Division is engaged in the overall financial management of financial product development and investment products and the management of the Group's assets and liabilities. Further, the Division is responsible for maintaining the relationship with overseas financial institutions and for providing service to customers operating on financial and money markets, including institutional customers and in the day-to-day management of control of risks of all the abovementioned activities.

Market risk management is discussed in the following committees:

- Risk Management Committee of the Board of Directors – Once every quarter, the Risk Management Committee of the Board of Directors conduct a discussion place on exposures to market risks and the change in risk focus points. The committee reports the position regarding compliance with the limits at Group level, and the damage that the Bank might incur from stress scenarios. In addition, any new activity in financial instruments that is significantly different from the current activity in financial instruments is presented for discussion and the approval of the committee within the context of a "new product" procedure. The results of the Board of Directors Risk Management Committee are reported and approved by the Board of Directors in plenum.
- The Upper Risk Management Committee headed by the President and CEO of the Bank – The policies crystallized in the Market Risk Management Committee (below) are presented and approved to the Upper Risk Management Committee headed by the President and CEO, the Chief Risk Manager and all members of the Bank's management. In addition, subjects on market risks that are on the agenda are discussed.
- The Management Committee for Current Matters headed by the President and CEO, which meets every week, reports on the financial exposure position to market and liquidity risks and compliance with the limits determined by the Board of Directors. Periodically (every four to six weeks), the President and Chief Executive Officer reports in the context of the CEO's Report to the Board of Directors on exposure to market risks.
- The Risk Management Division's quarterly exposure document is presented to the Board of Directors and the Board's Risk Management Committee each quarter. If necessary, a report on material changes in exposure is transferred more frequently as part of the CEO's report, which is circulated to the Board of Directors once every six weeks.
- The Market Risks Management Committee, headed by the Chief Risk Officer, examines events and market trends which could have repercussions for the Bank, and it is its responsibility to discuss and approve risk policy and restrictions - prior to their being brought for discussion and the approval of the Board of Directors, to monitor compliance with the aforementioned restrictions, to approve the methodology for measuring exposure and, periodically, and to check and discuss market risks in the subsidiaries.
- The Assets, Liabilities and Financial Investments Committee (ALCO), headed by the Capital Markets Division, is responsible for managing the assets and liabilities and financial investments, giving emphasis to the structure of the balance sheet, transfer prices, the required liquidity and liquid reserve investments, capital structure and capital-raising policy.

Quantitative tools for risk management

Market risks are assessed using a wide array of tools, which complement each other and match the Bank's various exposures in the trading rooms, the nostro investment activity and the activity of managing assets and liabilities.

Sensitivity analysis and stress scenarios

Global and domestic markets are sometimes subjected to shocks which are reflected in particularly wild fluctuations of the parameters, deviating from normal historical behavior. Quantitative models, such as the VAR or other models, do not provide information on losses that may be incurred under extreme market conditions, or beyond an established level of significance. Accordingly, a risk measurement is taken under a range of stress market scenarios, and sensitivity analysis for changes in one of the risk factors. These include all of the risk factors to which the Bank is exposed and constitute a part of the decision-making process in determining an overall investment strategy and the desired portfolio composition under the restrictions of the risk appetite established.

Value at Risk (VaR)

The risk managed using the VaR, a probability model, refers to the potential loss from holding all positions in currencies, in an index, in interest rates, and in balance sheet and off-balance sheet shares, including the positions of the trading portfolio, which are exposed to changes in market prices. VaR actually measures the expected fall in the present value of the assets, less the liabilities in the given mix of the capital structure, with a 99% confidence level, and for a position-holding period of two weeks, according to a given statistical breakdown. The calculation is based on the economic value of the capital by discounting assets and liabilities at risk-free interest rates prevailing in the market. The VaR calculation is made once a month at Group level and more frequently at Bank level and on the shekel trading portfolio.

The measurement of the VaR is carried out on the overall risk and risk divided into segments (exposure risk on a basis according to currency, exposure on interest according to segments and according to various time periods, shares risk), with, as a result of the coefficients (the dispersal effect) between the various factors, the general VaR is lower than the VaR according to segments.

Model for estimating the (marketable) credit risk in the nostro foreign currency portfolio

The model calculates the expected loss in the foreign currency nostro portfolio in scenarios of varying degrees of severity, based on specific characteristics of the portfolio, taking into account the probability of a failure and change in the ratings of issuers. The measurement of the risk in the entire portfolio is performed taking into account the dispersal and concentrations in the portfolio. The model calculates the expected shortfall, which reflects the potential average loss within a timeframe of a year and a probability of 1%.

Capital requirement in respect of market risk

The capital requirements in respect of market risks (Table 10 – Basel II), as required pursuant to the standard approach, *inter alia*, is as follows. These requirements reflect only a small part of the capital held by Leumi against market risks (First Pillar of the Basel II framework). In addition to this capital, the Group holds additional equity against market risks and nostro activity, in the framework of the Second Pillar of Basel II.

The following table sets forth the capital requirements in respect of market risks (Table 10 – Basel II):

	31 December 2012	31 December 2011
	NIS millions	
Capital requirement in respect of:		
Interest risks	**673**	583
Share price risk	**14**	1
Exchange rate risk	**117**	170
Options	**70**	57
Total capital requirement in respect of market risks	**874**	811

Main focus points in market risks

1. Exposure to interest rates

Risk of a loss as a result of changes in risk-free interest rates of credit in the various currencies, due to differences between the repayment date of the assets and liabilities in each of the linkage segments.

The interest exposure policy restricts the extent of exposure to possible changes in interest on the Bank's profits and on shareholders' equity. Accordingly, in each sector, the exposure to an unexpected change of 1% in interest in all the periods is measured, relating to the potential erosion of economic value[1] and of the accounting profit for the year resulting from a shift in the yield curves in each of the segments and also for all segments together. Exposure of the profit to interest is heavily influenced by the activity remeasured at market prices (derivative transactions and commercial portfolios).

There are structured interest risks arising from the uncertainty in the market factors that may be hedged, but are structured in the banking activity. The risk includes gross behavioral options in loans and deposits that may not be hedged (early repayment options, for example).

The interest risk is actually measured and managed on the basis of various behavioral assumptions with regard to the repayment times of the assets and liabilities. The principal assumptions are:

- In the index-linked sector, an estimate is taken into account with regard to breakages and withdrawals at exit points in savings plans. The estimate is derived from past customer behavior.
- In accordance with accumulated experience, there is a long-standing stable credit balance in non-interest bearing current accounts. Accordingly, for purposes of measuring and managing interest rate exposure, Bank policy is to regard part of the non-interest bearing current account balances as a long-term liability. Periodically, the change in the non-interest bearing current account balances is examined in order to decide how it should be spread. In view of the low interest rates, the current account spread was changed, with effect from June 2012.
- Leumi Mortgage Bank – The management of exposures takes account of assumptions with regard to early repayment of loans. Assumptions regarding CPI-linked loans at fixed rates of interest rely on a statistical model for predicting early repayments. This statistical model is checked regularly. At the same time, Leumi Mortgage Bank has developed a repayment model including all linkage segments to be assimilated in the management of activity.

The summary of exposures to unexpected changes in interest at Group level (before tax and NIS millions)* is as follows:

	Potential erosion in economic value		Potential erosion in annual profit	
Effect of immediate parallel change of 1% on the yield curve	**31 December 2012**	31 December 2011	**31 December 2012**	31 December 2011
Actual	**742**	676	**182**	**271**
Limit	**1,100**	1,100	**500**	**500**

* In the direction that is damaging to the Bank.

In 2012, the potential erosion in economic value ranged from NIS 495 million to NIS 742 million, and in annual profit, from NIS 176 million to NIS 236 million.

[1] The economic value of the capital is defined as the difference between the current value of assets and liabilities. In calculating present value, cash flows are deducted from the risk-free credit yield curve and the foreign currency LIBOR flows.

In 2012, the Group complied with all of the exposure restrictions for interest prescribed by the Board of Directors.

Sensitivity of the fair value of assets and liabilities to interest

The effect of potential changes in interest rates on the fair value of the financial instruments of the Bank and its consolidated subsidiaries, except for non-monetary items, according to accounting principles, is as follows:

The net fair value of financial instruments, before the effect of changes in interest rates.

	31 December 2012				
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency		
	Unlinked	CPI-linked	Dollar	Euro	Others
	NIS millions				
Financial assets	**204,561**	**62,635**	**59,575**	**12,066**	**14,814**
Amounts receivable in respect of derivative financial and off-balance sheet instruments	**280,774**	**5,874**	**119,103**	**28,982**	**26,075**
Financial liabilities	**168,101**	**54,421**	**82,296**	**17,808**	**11,425**
Amounts payable in respect of derivative financial and off-balance sheet instruments	**300,234**	**12,632**	**96,660**	**22,990**	**29,799**
Net fair value of financial instruments	**17,000**	**1,456**	**(278)**	**250**	**(335)**

	31 December 2011				
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency		
	Unlinked	CPI-linked	Dollar	Euro	Others
	NIS millions				
Financial assets	191,767	62,776	61,472	12,608	14,032
Amounts receivable in respect of derivative financial and off-balance sheet instruments	227,619	5,641	161,654	37,432	41,543
Financial liabilities	159,044	54,294	82,937	18,298	10,830
Amounts payable in respect of derivative financial and off-balance sheet instruments	242,830	10,709	143,466	31,945	45,619
Net fair value of financial instruments	17,512	3,414	(3,277)	(203)	(874)

The effect of changes in interest rates on the net fair value* of financial instruments (Table 14 – Basel II):

	31 December 2012						
	Fair value, net, of financial instruments after the effect of changes in interest rates					Change in fair value	
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency				
	Unlinked	CPI-linked	Dollar	Euro	Others	Total	Total
	NIS millions					NIS millions	%
Immediate corresponding increase of 1%	**16,561**	**1,546**	**(387)**	**239**	**(346)**	**(479)**	**(2.65)**
Immediate corresponding increase of 0.1%	**16,956**	**1,465**	**(290)**	**249**	**(336)**	**(48)**	**(0.27)**
Immediate corresponding decrease of 1%	**17,485**	**1,275**	**(179)**	**260**	**(320)**	**429**	**2.37**

	31 December 2011						
	Fair value, net, of financial instruments after the effect of changes in interest rates					Change in fair value	
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency				
	Unlinked	Index linked	Dollar	Euro	Others	Total	Total
	NIS millions					NIS millions	%
Immediate corresponding increase of 1%	17,160	3,523	(3,279)	(191)	(887)	(246)	(1.48)
Immediate corresponding increase of 0.1%	17,477	3,425	(3,277)	(202)	(875)	(24)	(0.14)
Immediate corresponding decrease of 1%	17,869	3,282	(3,276)	(215)	(870)	218	1.32

* Not including estimate of the value of revenues in respect of commission for early repayment.

1.1 Exposure to interest rates and compliance with restrictions

The status of exposure to interest changes at the Group level, which is calculated according to accounting principles, is set forth below. During 2012, the Group complied with all the exposure restrictions for interest set by the Board of Directors. For detailed data on exposure to interest, see below Exhibit D in the Management Review.

	31 December 2012			31 December 2011		
	Unlinked	Index linked	Foreign currency and linked thereto	Unlinked	Index linked	Foreign currency and linked thereto
Average duration of assets (1)	**1.04**	**2.81**	**0.78**	0.91	2.85	0.72
Average duration of liabilities (1)	**0.98**	**3.26**	**0.70**	0.87	3.25	0.71
Duration gap in years	**0.06**	**(0.45)**	**0.08**	0.04	(0.40)	0.01
Internal rate of return (IRR) (%)	**1.30**	**0.86**	**0.81**	0.42	0.56	2.45

(1) Including future transactions and options, and based on fair value data of financial instruments.

From December 2009, there was a change in the method of calculating and presenting the report of exposure to changes in interest rates, following new regulations of the Bank of Israel on this subject. Instead of data aggregating to balance sheet balances, the data in Exhibit D present the fair value of the financial instruments which are stated in Note 18c regarding "balances and estimates of fair value of financial instruments". The internal rate of return was also changed accordingly. Instead of an internal rate of return discounting the expected cash flows to the balance sheet balance, an internal rate of return discounting the expected cash flows to the fair value, is presented.

In addition, instead of presenting the average duration based on the forecast data of assets and liability, with effect from December 2010, an effective average duration is presented, based on a change in the fair value as a result of a change of 0.1% in the internal rate of return of the assets and liabilities.

In calculating the average duration of the liabilities in the index-linked segment, an estimate regarding early repayments and withdrawals at exit points in the savings programs is taken into account, in accordance with a model which estimates the expected early repayments on the basis of the savers' behavior. An average duration of the total liabilities according to the original cash flow of the savings programs is higher, reaching 3.29 years, and the internal rate of return gap (hereinafter "IRR") amounts to 0.52%.

Early repayments of index-linked mortgage loans are taken into account in the figures set forth above, in accordance with a statistical model, which estimates the expected repayments on the basis of the borrowers' behavior in the past. The average duration of the assets at the end of 2012, according to the original cash flow which does not take into account early repayments, is longer, reaching 3.19 years, and the IRR gap amounts to 0.52%.

Exhibit D in the Management Review presents current account balances according to the Bank of Israel directives on deposits with demand of up to a month. On the other hand, for the purpose of exposure to interest, a certain rate from the current account balances in shekels and foreign currency was spread for repayment periods up to 10 years. This is in accordance with the model of behavior where its basic assumptions are regularly updated. Taking these assumptions into account, the average duration of the liability is higher, reaching in unlinked shekels, 1.04 years, and in foreign currency, 0.76 years, and the difference in the IRR amounts to 1.29% and 0.75%, respectively.

2. Basis exposure

The exposure to basis risk is reflected in the loss which is likely to occur as a result of changes in the consumer price index and in exchange rates, as a result of the difference between the value of assets and liabilities, including the effect of futures transactions, in each of the linkage sectors.

According to accounting principles, capital is defined as an unlinked shekel source. Thus, an investment of capital in a segment other than the unlinked shekel segment is defined as basis exposure. Exposure to basis risk is measured as a percentage of the Group's exposed capital.

The exposed capital, at the Bank level, includes shareholders' equity and certain reserves, less fixed assets and investments in investee companies, excluding investments in subsidiaries abroad that are financed from foreign currency sources and are therefore not deducted from capital. At the Group level, the exposed capital includes shareholders' equity and certain reserves, less fixed assets and investments in companies included on equity basis.

Exposure limits approved by the Board of Directors are decided in accordance with considerations of expected return and risk and are allocated among: the trading rooms, ALM and subsidiary companies.

The subsidiaries abroad and in Israel generally maintain low levels of basis exposures, on the basis of policies which are anchored in resolutions of the Board of Directors, and in coordination with the Bank in Israel.

Changes in the exchange rate affect the effective tax rate, because exchange rate differentials in respect of investments abroad are not taken into account in the income basis for calculating the provision for tax, unlike exchange rate differences in respect of sources of financing, and thus, there is an asymmetry with respect to exchange rate differences. In the past, the Bank has carried out hedging transactions against tax exposure. From 2012, the accounting policy for investments in the United States and Switzerland, such that they were defined as units whose functional currency was changed from the shekel, and exchange rate differences in respect of the investments and those in respect of the defining sources are carried to a capital reserve. The Bank decided not to renew the hedging transactions in respect of these companies.

Changes in exchange rates have an effect on current income in foreign currency. Hedging activity was carried out at the beginning of 2012 against the expected net income.

The following table sets out the actual economic exposure at Group level, compared with the limits stipulated by the Board of Directors. The data is presented in terms of percentages of the exposed capital:

	Approved limits	Actual position	
	Maximum excess (or deficit)	**31 December 2012**	31 December 2011
		%	
Unlinked	65% - (65)%	**(5.2)**	(17.9)
CPI-linked	50% - (50)%	**3.9**	22.4
Foreign currency	15% - (15)%	**1.3**	(4.5)

In 2012, the percentage of capital invested on average over the year in the linked segment was 15%. During the year, the percentage ranged from a surplus of 30% to a deficit of 1% of the exposed capital. Capital was channeled to the foreign currency-linked sector at a relatively low rate, and therefore, the effect of the change in exchange rate on pre-tax profit was not material.

In the third quarter of the year, an expansion was approved for the base exposure limit in the index-linked segment to a maximum surplus or deficit of 50% - (50)%.

In 2012, the Group complied with all the basis exposure restrictions approved by the Board of Directors.

The following table presents sensitivity to changes in the exchange rate of the main foreign currencies as of 31 December 2012. The measurement relates to the effect of the changes in the Bank's capital and includes activity in balance sheet and off-balance sheet instruments:

	Dollar	Euro	Pound sterling	Swiss franc	Yen
	NIS millions				
Increase of 5% in exchange rate	**(23)**	**41**	**4**	**-**	**1**
Increase of 10% in exchange rate	**(37)**	**96**	**12**	**4**	**(3)**
Decrease of 5% in exchange rate	**21**	**(21)**	**(2)**	**12**	**(1)**
Decrease of 10% in exchange rate	**39**	**(24)**	**(2)**	**26**	**(1)**

These data do not take into account the effect of a change in the exchange rate on the flow of income and expenses in foreign currency in respect of which full hedging was made in 2012.

3. Exposure in the trading rooms

The market risks in the trading portfolio arise as a result of the Bank's activity as a market-maker and as a manager of nostro positions:

- Market-making activity – The Bank is a leader in the scope of activity in the area of derivatives and provides immediate services to customers active in the instruments. In the foreign currency and derivatives dealing room, market-making activity is carried out at the spot desk (in shekels and in foreign currency), at the options desk (in shekels and foreign currency) and at the interest desk (in shekels and foreign currency). This activity exposes the Bank to market risk (exchange rate risk and interest risk) and accordingly, the activity is managed and monitored in accordance with the restrictions approved by the Market Risk Management Committee. Due to the dynamic nature of the activity, these restrictions are regularly monitored at least once a day by the Middle Office.

- *Nostro* trading activity – In the trading room, there is initiated activity whereby initiated exposures are taken for bonds in shekels. This activity is routinely managed and monitored at least once a week, in accordance with the restrictions approved and validated by the Risk Management Division.

Risk management framework and methodology

As stated, tradable market risks are routinely monitored, with the frequency being determined in accordance with the nature of the activity being conducted. An estimate of the risks is made using a known and recognized methodology. The main points are as follows:

1. Interest exposures are measured and managed in terms of a change in the market value of the instruments as a result of corresponding changes in the interest curves in which exposures are taken.

2. The exposures at the option desk are measured and managed on the basis of generally accepted sensitivity ("Greeks") indices.

3. Stress scenarios:

3.1 Analysis of the sensitivity of the portfolio to the various risk factors (each risk factor separately) and an examination of the change in the value of the portfolio as a consequence.

3.2 Stress scenario – macroeconomic scenarios based on history (for example, a scenario based on the 2008 crisis), as well as scenarios developed in collaboration between the Risk Management Division and the Economics Branch.

The table below shows the open transactions as at 31 December 2012 compared to the previous year (amounts in NIS millions):

	31 December 2012	31 December 2011
Full hedging transactions	**4,184**	3,241
ALM and other transactions:		
Interest contracts	**308,208**	246,974
Currency contracts	**203,033**	244,878
Contracts in respect of shares, share indices and commodities	**52,389**	51,757
Total	**566,814**	546,850

For details regarding the accounting policy for recording the balances, income and expenses of these types of instrument, see Note 1m –Significant Accounting Policies in the financial statements.

For further details, see Exhibit C to the Management Review and Note 20 to the financial statements.

4. Aggregate exposure to market risk – interest, basis, shares as reflected in the Value at Risk model

The VaR limits are determined, both on the economic value of the Group including overseas subsidiaries and the effects of the exposure in VaR terms, and on the components remeasured at market value (MtM) which affect the profit and loss of the Bank (including the Bank's commercial portfolios).

Below is the estimated VaR at Group level in NIS millions:

	VaR of economic value		VaR of mark-to-market portfolios	
	31 December 2012	31 December 2011	**31 December 2012**	31 December 2011
Actual	**142**	161	**41**	79
Limit	**500**	500	**400**	400

In 2012, VaR on the economic value ranged from a maximum of NIS 212 million and a minimum of NIS 142 million.

In 2012, the Group complied with the VaR restriction prescribed by the Board of Directors.

Marketable credit nostro risks

Leumi is exposed to credit and market risks of countries, banks and financial institutions in Israel and abroad. In addition, the Bank invests to a limited extent in asset-backed instruments (CLO, MBS and ABS).

The Group exposure policy for foreign financial institutions is a part of the policy for managing market risks and marketable credit risks. This policy defines guidelines, risk limits on credit/counterparty exposures and authorities. The policy prescribes that most exposures will be to large banks that are systemically important to their country and to banks with a relatively high credit quality with an emphasis on dispersal of the portfolio.

Risk management in the exposure to financial institutions and to countries is effected through two credit committees headed by the Capital Market Division and in collaboration with the Risk Management Division.

- Limits Committee for activity *vis-à-vis* countries – this determines exposure limits for countries on the basis of economic analysis.

- Marketable Credit Risk Committee – this determines the exposure limits for financial institutions in accordance with the prescribed policy and market conditions.

The quality of the portfolio is monitored by the Risk Management Division and risk analyses and scenarios for the examination of risk focal points which are discussed in the Upper Market Risk Committee and in the Risk Management Committee of the Board of Directors.

Exposures to liquidity risk

Liquidity risk

Liquidity risk is the risk created due to the uncertainty relating to the possibility of raising funds and/or realizing assets unexpectedly within a short period, without incurring any material loss.

Liquidity risk management policy

In accordance with Bank of Israel directives, the Bank implements an overall policy for managing liquidity risk, the purpose of which is to support the achievement of business goals, while evaluating and limiting losses that may arise from exposure to liquidity risks. The liquidity risk management policy is aimed at maintaining a high level of liquidity through investment in quality assets at a high level of liquidity and via policy directs the raising of stable and varied sources, with an emphasis on raising deposits from a large number of customers for various terms, including long terms.

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 the obligatory directives of the relevant regulatory authorities.
- The subsidiaries may rely on, amongst other sources, the use of credit lines from Leumi, subject to prior arrangement, and subject to regulatory limits.

In accordance with the abovementioned, the principles of the Bank's policy in the area of liquidity management were adopted by the overseas subsidiaries, subject to the local regulatory provisions in each subsidiary. In each of the Bank's overseas subsidiaries, the liquidity management policy is approved by the board of directors of the subsidiary. In the context of this policy, restrictions are prescribed, and compliance with the restrictions is examined with the Market and Liquidity Risk Management Committee both in the subsidiaries, and in Israel.

As part of the day-to-day management, liquidity risk is measured using an internal model whose purpose is to examine and monitor the liquid resources at the Bank's disposal under various scenarios, including stress scenarios. In addition to the model outlined above, the Bank operates an additional system of indices for early warning of unusual and unexpected developments in the liquidity position.

As part of assessments for the crisis positions, a system of qualitative and quantitative indicators has been defined, indicating an unusual development or deterioration in the liquidity position and an updated contingency plan has been drawn up including 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.

Sources of financing

The composition of the Bank's assets and liabilities continues to point to high liquidity, as a result of a policy of raising stable and varied sources and a policy of investing surplus liquid means in quality assets.

Surplus liquid means in Israeli currency are invested primarily in deposits in the Bank of Israel amounting to some NIS 36.4 billion and in securities, some NIS 31.9 billion, principally in government debentures. Surplus liquid means in foreign currency are invested primarily in debentures amounting to some NIS 22.1 billion, and in bank deposits, some NIS 14.4 billion.

The balance of public deposits in the Bank, not including subordinated notes, increased during 2012 by NIS 7.4 billion, 2.7%, and after canceling the effect of exchange rate differentials, the increase was NIS 9.3 billion, 3.3%.

Most of the increase was in the unlinked shekel segment amounting to NIS 6.2 billion, 3.6%, while. in the foreign currency and foreign currency linked segment, there was an increase of NIS 1.2 billion, 1.1%, after canceling the effect of exchange rate differentials, the increase was NIS 3.1 billion, 2.8%.

Monitoring liquidity risk

The Bank routinely monitors the liquidity position and the liquidity risk indices. Liquidity risk is measured and managed using an internal model, the purpose of which is to examine and monitor the liquid resources at the Bank's disposal under various scenarios. The scenarios relate to various market situations: normal course of business and extreme situations relating to the Bank and the entire banking system.

In each of the scenarios, the liquidity position is examined on the basis of two quantitative indices: the liquidity gap and the liquidity ratio. The model places the balance of the liquid assets (for example, cash, Bank of Israel deposits, realizable portfolio of bonds and credit forecast to be repaid) as a ratio of liabilities expected to materialize in the short term, in a way that examines the Bank's ability to meet all liquidity requirements.

The rate of change in the balance of deposits and credit for the whole payment period, under different scenarios, is determined in accordance with various parameters, depending on the level of severity of the scenario. Behavioral functions which have been defined on the basis on the judgment of officers, assisted by historical data, take into consideration parameters such as the size and nature of the deposit for which expected cash flows are calculated.

It should be pointed out that the stress scenarios are more severe than anything the Bank has experienced in the past and the assumptions of these scenarios are therefore necessarily based more on the judgment of senior professional functions at the Bank than on any historical data.

In addition to the model outlined above, other indices are measured to complement the liquidity position:

- In the foreign currency sector, the rate of long-term assets being financed by short-term liabilities, the "long/short" ratio, is also monitored.

- 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 gap distribution is used for updating the model and improving the quality of forecasting of the liquidity position.
- In the Israeli currency and foreign currency sectors, trends in the liquidity position are examined (daily, monthly, etc.) over a protracted period, in order to monitor developments in deposits of the public, credit to the public, and liquidity in general, as well as for measuring margin risk.

Publication of the Bank of Israel Directive No. 342 regarding Management of Liquidity Risks and Preparation for Basel III.

As noted in the above section dealing with the Bank's preparations for implementing the Basel III directives above, the Bank is positioned to implement the directive published by the Banking Supervision Department regarding liquidity management.

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 shown 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 cash flows, as specified in Note 18D.

Fair-value estimates are based on the conditions existing on the date of the Financial Statements and do not necessarily represent future fair values.

The Board of Directors of the Bank has prescribed a limit of US$ 600 million for the total of 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 the criteria prescribed by the Bank Management.

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, nor can it be used for comparisons between different banks.

It should be noted that data relating to fair value do not take into account the effect of taxes in the event of a positive or negative gap between the fair value and the book value of assets and/or liabilities shown on an accrual basis.

The data appearing in Note 18D to the financial statements show that the fair value of financial assets at the end of 2012 was NIS 1,234 million higher than the balance sheet value (in 2011, higher by NIS 555 million), while the fair value of financial liabilities was NIS 4,645 million higher than the balance-sheet value (in 2011, higher by NIS 2,873 million). The majority of the gap derives from the fact that the decrease in interest on liabilities was greater than the decrease in interest on loans, due to an increase in the risk margin.

The change in the fair value of monetary assets and liabilities beyond that recorded in the financial statements in 2012 derives mainly from the decrease in interest rates in the economy, and particularly, in the unlinked shekel segment, similar to the decrease in 2011.

Operational risks

Leumi Group operates in a wide range of financial activities, and, accordingly, is exposed to operational risk, including, *inter alia*, risk of embezzlement and fraud, legal risks, compliance risk, data technology risk, business continuity and data protection.

An operational risk is defined as the risk of a loss resulting from inadequate or failed internal processes, people, systems, or external events. This definition includes legal risk, but not strategic risk and image risk.

A significant pillar in the range of operational risks is data technology risks, which are liable to expose the banking corporation to goodwill and impairment in business activity due to system failure.

Operational risks in Leumi Group are managed with systemic vision, using a consistent and systematic group methodology which delineates the Operational Risk Management Branch in the Risk Management Division, adapting to the nature, size and complexity of each organizational unit in the Group. Operational risk management relies on a proactive process of identifying, evaluating, measuring, monitoring, reporting and controlling/reducing material risks, which is carried out in all divisions of the Bank.

Operational risk management in Leumi Group relies on three lines of defense, similar to the other risks. Responsibility for operational risk management falls upon the managements of the divisions and subsidiaries (first line of defense) and includes: a decision between alternatives of accepting the risk, a change in controls, a change in the scope of activity or a transfer of risk. The Operational Risk Management Department and the Compliance and the Prohibition of Money Laundering and SOX Department in the Accounting Division represent a second line of defense. The third line of defense is the Audit Division. The latter two lines of defense have an independent hierarchical reporting structure in the lines of business in which risk exists.

Operational risk management policy is on a group basis and is intended to minimize losses, taking into account risk tolerance and maintain long-term operating stability. Operational risk management is an integral part of the organizational culture and business and operational activity in the Group.

Risk appetite/tolerance in the Bank is defined for operational risks. In risk tolerance, loss restrictions, the Bank determines limits on loss are determined that the Group will be prepared to absorb in various scenarios, and in a number of significant products/activities.

Corporate governance

Monitoring and supervision of operational risk management in the Group is carried out through the Board of Directors, the operational risk management function in the Risk Management Division, and the Operational Risk Committees and Controller system (coordinators of the sub in the first line of defense units) and officers in charge in the divisions are responsible for actual risk management.

The Upper Committee for Operational Risk Management, headed by the Chief Risk Manager, and in collaboration with the Chief Auditor, Operational; Risk Manager and representatives of the business divisions and main subsidiaries, monitors the implementation of the existing operational risk management policies and assessments, and those required for reducing material risks.

In addition, various forums convene to discuss operational risk management, led by the Operational Risk Manager, attended by representatives of all the business entities and subsidiaries (the risk controllers), the Legal Division and the Compliance Department. These forums constitute a platform for sharing knowledge, drawing conclusions from failure incidents inside and outside the organization and discussing strategies for reducing risk.

The independent function of operational risk management

The Operational Risk Management Branch in the Risk Management Division is responsible for the Group's policy outline – which is discussed and approved by the Board of Directors – planning and development of methodology and tools, methods and a working framework for operational risk management, real-time partnership in examining risks in material new products, assimilation of an operational risk management culture, reporting to the Board of Directors and senior management, and supporting and professional guidance of the representatives of the first line of defense.

Methodologies, processes, methods and tools for operational risk management

The methods and tools for operational risk management in Leumi are examined and updated from time to time, leveraging professional knowledge from Israel and around the world, and as a result of regulatory directives of the Bank of Israel and other supervisory bodies. Presented below is a description of the range of measures taken by the Bank in order to strengthen the operational risk management at Group level.

In February 2012, the Bank of Israel published Proper Conduct of Banking Business Regulation regarding operational risk management which came into force on 1 January 2013. (In December 2012, the regulation was updated, but without immaterial changes.) The Group conducted an analysis of the gaps and took steps to close them in 2012.

The Group has defined an operational risk management policy document which forms a basis and working framework for risk management, and in the spirit of the document, procedures and methods have been determined. In addition, methodological tools have been assimilated for the management and control of operational risks. During the year, procedures supporting the reporting of loss and near-loss events, the examination of the effectiveness of the control and methodologies for determining and constructing key risk indicators (KRI), were prepared and assimilated in the Group.

Over the second quarter of 2012, a two-year round of a risk assessment survey on central work processes was conducted, in the course of which, prioritized reduction programs were determined. The survey was conducted in two channels – the assessment of risk and the construction of prioritized reduction programs in business processes and supporting processes. A special emphasis was placed on IT procedures.

An ordered risk assessment, on the basis of the survey, enables the Bank to understand its own risk profile, to designate resources and strategies for managing risks more effectively, and to assess the amount of capital required in respect of operational risks. The risk assessment is a self-evaluation by content experts who are acquainted with the business activity in which the risk is inherent, and combines a qualitative and quantitative assessment. The quantitative assessment relates to potential monetary damage, and the qualitative assessment covers all direct and indirect damage that could occur when the risk materializes, with reference to structured risk, to the existing controls, and as a result, to the residual risk.

The Bank is taking steps to establish a robust culture of operational risk management among all employees and managers in the Group. Within this framework, assimilation and training procedures are carried out in designated training sessions for managers and employees, integrating the project in a variety of banking courses and the construction of a designated operational risk management portal.

A further means of risk management is the analysis of stress scenarios, which are assessed and monitored, and for which evaluation and reduction programs are established. Bank Leumi is continuing to strengthen its ability to continue business activity in the event of the materialization of broad operational scenarios, such as war and earthquake. The Bank, however, has computers which are protected against missiles and earthquake, an emergency program for the continuation of the Bank's activity in the event of scenarios of this type. Bank Leumi has examined its preparedness and has drawn conclusions in the "Mifne 6" national emergency drill which took place on October 2012.

The allocation of capital in respect of operational risks is intended to act as an absorption cushion for unexpected risks. The regulatory capital is calculated using the Basel basic indicator approach (total capital allocation in respect of operational risk appears on page 31). At the same time, an assessment is made of the economic capital on the basis of a self-evaluation of operational risks, with the results of the calculation constituting a basis for challenging the regulatory capital. The assessment of the economic capital is made using an internal model of the loss distribution approach (LDA).

Operational risk is managed using a designated system, supporting the documentation of risks, controls and reduction programs. In addition, the system enables the gathering and analysis of internal loss and near-loss events. The stored data supports the decision-making process with regard to the material risks and the prioritization of the reduction operations.

Data technology risk

Data technology is a central component in the proper operation and management of a banking corporation, inasmuch as the data, in all its aspects and implications, has a decisive effect on the Bank's stability and development. Data technology risks apply to the operation of data systems in production, broad data technology processes and new activities (projects and systems).

A policy document has been prepared on information technology risk management, which defines the principles for technological risk management and includes the organizational framework, areas of operation and responsibility of the various functions in the Group and the work processes necessary for managing technological risks.

An assessment of the level of operating risk in the system's ongoing operation is integrated into the risk management process. An analysis of the results of risk assessments facilitates identification of high-risk systems. In accordance with the risk assessment, a multi-year work program is designed to carry out safety surveys and controlled penetration attempts, and a reduction program is determined accordingly.

In addition, a methodology for assessing risks in data systems development projects has been implemented and assimilated, the findings are analyzed, and recommendations for reducing the level of exposure is determined.

Data protection risk

Data protection risk management in Leumi is executed on the basis of Leumi's data protection policy.

The management of data protection risks supports the solution to threats and risks and maintaining Leumi's data assets and data technology systems.

Data protection contends with challenges emanating from threats inherent in developing technologies.

Data protection is made ready, among other things, *vis-à-vis* the increase in threats and attacks, including cyber-attacks, using an international model for mapping and risk management, the implementation of controls and hedging of risks.

For further explanation on the subject of cyber-risks, see below.

Business continuity risks

Bank of Israel directives require banks to take action to ensure business continuity in an emergency. The Bank's computer system relies on two computer centers. The main center is located in Kiryat Hamachshavim in Lod – underground and protected against missiles, earthquakes and biological and chemical attack – and a secondary underground center in Tel Aviv. In addition, Leumi has set up an underground emergency location for the Bank's trading room in the Hamachshavim Compound in Lod.

The Bank prepares itself for disaster recovery and continuity of its business activity. Activity is comprised of three layers:

- Technological infrastructure;
- Action plans and procedures;
- Periodic emergency drills.

The main activities in the area of business continuity carried out during 2012 were as follows:

1. A disaster recovery survey was conducted – a project whose aims are: the charting of the present preparedness for computer failure, finding alternatives for improving/upgrading the disaster recovery plan/business continuity plan, specifying definition of gaps between the existing preparedness and alternatives. This activity will continue in 2013.

2. Leumi exercise as part of the "Mifne 6" national emergency drill, Leumi carried out an extensive exercise for an emergency in the event of an earthquake and tsunami, and even broadened the exercise to a state of war and missile attack. The exercise was carried out successfully, maintaining complete availability and continuity in the provision of service.

3. The establishment of a team to examine Leumi's preparedness for war and update the war scenario.

4. The establishment of a third back-up in Har Hotzvim which contains all of the Bank's data and is updated on a daily basis.

5. Updating policy documents and procedures (business continuity policy, crisis management team procedure, crisis operation team procedure, disaster manager procedure, etc.)

6. Adaptation to the Bank of Israel's Banking Conduct of Business Management regulations for business continuity.

7. Business Impact Analysis (BIA) project – continuation of analysis of business effects in divisions in accordance with the work plan.

8. Technological and unit exercise drills were carried out, in accordance with annual exercise programs.

Reporting as forward-looking information – In recent years, it has been possible to distinguish an increase in the scale of cyber threats worldwide. Attacks have taken place against national infrastructures, government bodies and corporations, both in Israel and around the world.

The attacks have been carried out by various players, from employees in the organizations, through organized crime, to attacks instigated by nations.

As a part of preparations for dealing with cyber-threats, a survey was carried out in order to review Leumi's resistance. As a result of the survey, Leumi began a multi-year process to improve its defensive capability against cyber-threats.

In our opinion, the escalation of cyber-threats will continue in coming years, despite the fact that there has been a restructuring at the sectoral, national and global level in an attempt to create defensive, technological, regulatory and cooperative frameworks.

In 2012, there were no serious cyber or data security events in Leumi.

Data security and cyber-attack risks – Leumi's business activity relies largely on its data systems, the availability of the systems, the reliability of the data and the maintenance of the confidentiality of the information essential for orderly business activity. With the advance of technology, the level of risk to Leumi and its customers increases. In aspiring to progress and excellence, new technologies are integrated into the banking core, as well as in the end-user systems in Leumi and among its customers. These technologies create uncertainty and raise the level of risk from cyber-attacks.

Bank Leumi, as a leading financial organization, is an attractive target for various attackers. The computer systems, communication networks and our customers' devices have come under attack and will continue to be vulnerable to cyber-attack, viruses, malware, phishing, and other exposures intended to cause damage to service, or steal or corrupt data.

Leumi regards the Bank's data as an important asset and invests much effort in applying supervision and control mechanisms and procedures.

Leumi monitors cyber-events that have occurred around the world and updates its preparedness accordingly.

Compliance, Prohibition of Money-Laundering and Prohibition of the Financing of Terrorism

In 2001, at the request of the authorities, the Compliance Department commenced operations in the Group, pursuant to the requirements of the authorities, and a chief compliance officer was appointed to be responsible for complying with the obligations pursuant to the statutory provisions relating to the prohibition of money laundering and the prohibition of the financing of terrorism.

The complexity and development of banking activities require 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, orders, permits and Bank of Israel directives.

Proper Conduct of Banking Business Directive No. 308 obligates banks to enforce consumer directives, i.e. the laws, regulations, and directives governing banking activities regarding the Bank's relations with its customers, including the prohibition of money laundering and the prohibition of financing of terrorism.

In accordance with this Directive, a review of infrastructure is carried out every five years, in which consumer directives and the risks of the occurrence of events deviating from the directives are mapped out, and controls are defined to prevent their occurrence.

A decentralized compliance model and automated tools and systems required for the compliance functions have been implemented in Leumi.

For the effective management of the subject, a compliance community has been set up in Leumi, comprising regional compliance managers in the lines of business, full-time compliance trustees at branch level (58 as at December 2012) and part-time compliance trustees, for focused handling and controlling the areas of compliance, the prohibition on money-laundering, the prohibition on the financing of terrorism, administrative enforcement and American customers.

The Compliance and Enforcement Department is in regular contact with the Bank's subsidiaries in Israel and overseas, for the purpose of monitoring the implementation of compliance in general, and the prohibition of money laundering and the prohibition of financing terrorism, in particular, as expressed in the Group policy document, prepared in accordance with a risk-based approach, and approved by the Board of Directors in January 2013.

In 2012, the Bank continued activities required for the implementation of the statutory provisions pertaining to the prohibition of money laundering and the prohibition of the financing of terrorism, including: steps for improving data, the dissemination of publications and lessons learnt to the various units, developing and improving computer systems, and participation in training activities, to heighten awareness of this subject and the assimilation thereof among employees of the Bank.

On 26 December 2011, the Supervisor of Banks published a circular on the subject of the "Prohibition of Money Laundering and the Financing of Terrorism and the Identification of Customers (Proper Conduct of Banking Business, Regulation no 411"). The circular directs banking corporations and credit card companies to be alert to the risks inherent in entering into contracts with declared parties in international lists published by the United Nations Security Council, the European Union and OFAC, as parties involved in and assisting Iran's nuclear program and plans related thereto.

The Compliance and Enforcement Department has conducted a broad process including charting the type of transactions that may have relevance, directly or indirectly, to activity *vis-à-vis* the declared parties. The products of the charting process were forwarded to the Bank of Israel on 1 April 2012.

Enforcement

On 17 January 2011, the Efficiency of Enforcement Procedures in the Securities Authority Law (Legislative Amendments), 2011 was passed in the Knesset. The object of the law, which is detailed in the explanatory notes, is the improvement of efficiency of enforcement over the legislative provisions in the area of securities laws. In the context of this legislation, it will be possible to impose various sanctions on a corporation, including its violating officers and employees, that breaches the relevant provisions.

On 15 August 2011, the Securities Authority published a document of criteria for recognition of an internal enforcement program in the field of securities and investment management (hereinafter: "document of criteria").

In the document of criteria, the Security Authority instructs the corporation to appoint an officer to be in charge of enforcement. His function, according to the document of criteria, is to be responsible for the implementation of the enforcement program.

The Chief Compliance Officer of the Group was also appointed by the President and Chief Executive Officer to serve as head of Compliance and Enforcement and has the authority and means to implement the legislative provisions relevant to this area.

On 20 January 2013, the Board of Directors was presented with the draft internal enforcement program, which was built according to guidelines determined in the document of criteria, and which is related to a comprehensive process, including, *inter alia*, conducting surveys of compliance with the relevant legislative provisions including mapping of the gaps in this area, and formulating reporting, assimilation and control mechanisms.

Foreign Account Tax Compliance Act– FATCA

In March 2010, the Internal Revenue Code in the United States (the U.S. Income Tax Law) was amended, so as to bring into effect a reporting regime, which aims to compel foreign financial institutions (FFI) to transfer information regarding accounts held by U.S. customers.

As a part of the Bank's preparedness for implementing the law in Leumi Group, the division is acting in conjunction with the Legal Consulting Division in circulating procedures and circulars and in assimilating policy regarding the arrangement of the subject of identifying, detecting and dealing with U.S. customers.

The FATCA regime will come into effect on 1 January 2014.

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. The legal risks are part of the operational risks.

Legal risks derive from the three main areas:

- Risks attributable to the Bank's activity, if it does not comply with a primary or secondary legislative directive, a regulation of the Bank of Israel or a directive of other qualified authorities, and judgments (legislative risks).
- Risks attributable to the Bank's activity with customers, suppliers and other factors with whom the Bank contracts in various agreements, if it is not backed by an agreement fully regulating the Bank's rights, or that the agreement is not fully enforceable (legal commitment risks).
- Risks attributable to legal proceedings conducted against the Bank.

The Group also implements a program for managing legal risks, which aims to detect, prevent, manage and minimize the legal risks. The program includes policy documents and an interface between the Legal Division and units of the Bank, as well as internal procedures applicable to the Legal Division, the purpose of which is to ensure that legal counseling provided in the Bank is professional and up-to-date. The policy document was updated at the end of 2012.

With regard to the Bank’s subsidiaries in Israel and abroad, a general policy has been determined to manage risks in the framework of designated policy documents. Each subsidiary has prepared an internal procedure for managing legal risks that correspond with its activity and the Group policy on the subject. The internal procedures prepared by the subsidiaries as aforesaid, have been approved by the Legal Division and in the boards of the subsidiaries. According to the policy documents, the subsidiaries are required to refer certain subjects for appropriate legal advice. In addition, the companies send six-monthly reports to the Legal Risk Officer at the end of the second and fourth quarters each year, as well as immediate reports, as required in the policy documents. The reports are sent in a consistent format prepared in the Legal Division and updated in 2012.

The program places emphasis on:

- Preventing and minimizing legal risks;
- Identifying sources of material legal risks and how to deal with them;
- Preparing appropriate agreements, guidelines and procedures;
- Examining statutory provisions (including case law) and regulatory directives, and their implications on the work of the Bank.
- Drawing conclusions on various matters and implementing of these conclusions drawn in legal documents used in the Bank, as well as disseminating opinions on these subjects to the relevant units in the Bank.

In order to conduct the legal risk management program, various officials and committees operate in the Legal Division, whose function is to locate and examine new legislation and legal rulings that have repercussions for the work of the Bank and coordinate the way in which they will be dealt with. New regulatory directives (primary legislation, secondary legislation, and directives from authorities) are identified and, if necessary, dealt with, even at the stage of being a proposed law.

The activity of each of the abovementioned officials and committees is organized in an internal work procedure of the Legal Division. The procedures stipulate, *inter alia*, the information flow among each of the abovementioned officials and the management of the division and the legal risk team which operates in the division.

Linkage Status, Repayment Periods and Liquidity Status

A. Linkage Status

In accordance with the policy for the management of assets and liabilities on a linkage basis, the 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 respect thereof.

A summary of the linkage basis position as it appears in Note 16 to the Financial Statements is as follows:

	As of 31 December 2012			As of 31 December 2011		
	Unlinked	CPI-linked	Foreign currency(2)	Unlinked	CPI-linked	Foreign currency(2)
	NIS millions					
Total assets (1)	**216,020**	**60,341**	**120,100**	199,656	61,163	121,590
Total liabilities (1)	**196,437**	**62,127**	**120,924**	180,099	60,966	126,136
Total exposure in the segment	**19,583**	**(1,786)**	**(3) (824)**	19,557	197	(3) (4,546)

(1) Includes future transactions and options.
(2) Includes foreign currency linked.
(3) The short position in foreign currency derives mainly from a hedging transaction in respect of investments in foreign subsidiaries.

Day-to-day management of the exposure of the Bank to basis risks is conducted according to the economic approach including adjustments and additions to the accounting approach shown above. The basis exposure, calculated according to the economic approach, is detailed in the chapter "Exposure to Risks and Methods of Risk Management".

In 2012, there was an increase of some NIS 7.7 billion in total deposits from the public (including subordinated notes and capital notes). In total credit to the public, there was no material change. Investments in securities and debentures increased by some NIS 8.7 billion, and credit to banks, by some NIS 2.6 billion.

The main changes that occurred in 2012 in the principal activity divided into linkage segments were as follows:

The unlinked shekel segment

The ratio of the assets in the unlinked shekel segment to total assets is some 57%.

Most of the activity in the segment is for short periods, up to one year.

Total credit to the public increased by some NIS 4.8 billion, some 3.6%.
Total deposits in banks, net increased by NIS 0.4 billion, and the total investment in securities decreased by some NIS 7.3 billion.

In 2012, total shekel deposits increased by NIS 7.6 billion, 5.0%. This increase includes the issue of capital notes and subordinated notes amounting to NIS 1.3 billion.

Total net balance of derivative transactions in the segment as at 31 December 2012, was NIS 19.0 billion, an increase of NIS 3.7 billion compared to December 2011.

The CPI-linked segment

Total credit to the public increased by some NIS 2.4 billion, some 4.6%.
Total investment in securities increased by NIS (3.2) billion.

Index-linked deposits increased by NIS 2.6 billion. In addition, subordinated notes amounting to NIS 1.0 billion were issued and subordinated notes amounting to NIS 4.7 billion were repaid.

The net balance of derivative transactions in the segment as at 31 December 2012, amounted to some NIS (6.3) billion, an increase of NIS (1.8) billion compared to December 2011.

Foreign currency and foreign currency linked segment

Assets in the foreign currency segment as a percentage of total assets amount to 32%.

Credit to the public, which constitutes only some 45% of the total deposits of the public in the segment, decreased by NIS (7.2) billion, a reduction of (13.0%) and after canceling the effect of exchange rate changes, a reduction of 11.6%.

Investments in securities in foreign currency amounted to NIS 22.1 billion, an increase of NIS 4.6 billion, compared with December 2011.

Deposits in banks, net, rose by some NIS 2 billion.

From the beginning of 2012, there was an increase of some NIS 1.2 billion 1.1% in total deposits of the public in foreign currency. After canceling the effect of changes in exchange rates, the increase was 2.7%.

According to past experience, a large part of deposits in the foreign currency segment, which are deposited for periods shorter than one year, including deposits on demand, are re-deposited in the Bank in a continuous and constant process.

Activity in future transactions has a material impact on liquidity in the foreign currency segment. Total net future transactions in which foreign currency was given against shekels, amounted to some NIS 25.3 billion as of 31 December 2012, an increase of some NIS 5.5 billion, compared with December 2011.

B. Repayment periods

During 2012, as in recent years, the Bank was characterized by a high level of liquidity in shekels. This was partially as the result of a policy directed by the Bank to raise 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.

Some 28% of the Bank's total assets are deposited for short periods in banks and invested in marketable securities, mainly in government debentures.

Total liquid assets in 2012 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.

The following table shows a future cash flow of the assets and liabilities according to repayment periods and according to index base (including derivative instruments and not including non-monetary items) **(For further information, see Note 17 to the Financial Statements).**

Pursuant to directives of the Bank of Israel from 2010, cash flows in respect of liabilities with a number of repayment dates will be classified in accordance with the intention of Management, and in the event that Management has no discretion, the cash flows will be classified in accordance with the earliest forecast repayment date.

	As at 31 December 2012			
Surplus of assets over liabilities*	Unlinked Israeli currency	CPI-Linked	Foreign currency including foreign currency linked	Total
Period remaining to maturity:	NIS millions			
Up to 1 month	**(51,463)**	**(847)**	**(36,118)**	**(88,428)**
From 1 month to 1 year	**10,219**	**(7,571)**	**7,304**	**9,952**
From 1- 5 years	**43,494**	**(6,972)**	**23,264**	**59,786**
From 5 - 10 years	**16,786**	**5,293**	**5,424**	**27,503**
More than 10 years	**20,412**	**13,940**	**2,770**	**37,122**
Without maturity date	**1,177**	**(1,711)**	**283**	**(251)**
Total	**40,625**	**2,132**	**2,927**	**45,684**

	As at 31 December 2011			
Surplus of assets over liabilities*	Unlinked Israeli currency	CPI-Linked	Foreign currency including foreign currency linked	Total
Period remaining to maturity:	NIS millions			
Up to 1 month	(49,417)	(5,285)	(23,955)	(78,657)
From 1 month to 1 year	22,422	(3,486)	(5,619)	13,317
From 1- 5 years	30,962	(2,096)	22,687	51,553
From 5 - 10 years	17,723	4,108	3,542	25,373
More than 10 years	18,545	13,308	2,349	34,202
Without maturity date	1,268	(1,185)	92	175
Total	41,503	5,364	(904)	45,963

* 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 221.

In the unlinked sector, there was an increase in the excess of liabilities over assets for a period of up to a year, mainly as a result of an increase in the balance of deposits. At the same time, there was an increase in the excess of assets over liabilities for a period above one year, arising from an increase in investments in government debentures.

In the index-linked sector, the increase in the excess of liabilities over assets for a period of five years derived from an extension of index-linked sources.

In the foreign currency-linked sector, the excess of liabilities over assets for a period of up to a month derives from an increase in the balance of short deposits and a reduction in the balance of credit for this period. The increase in the excess of assets over liabilities for a period above one month derives from an increase in the balance of the assets and a reduction in the balance of deposits for these periods.

C. Liquidity Position and Funding

Liquidity position in the system

The total balances of the banking system (current accounts and monetary deposits) in the Bank of Israel at the end of December 2012 stood at NIS 126 billion, compared with NIS 130 billion at the end of 2011.

The total of these balances in the fourth quarter of the year stood on average at NIS 121 billion and in 2012 as a whole, at NIS 119 billion.

In 2012, holdings of T-bills by the public fell by NIS 5 billion, while holdings of government debentures rose by NIS 8 billion. During the year, the Bank of Israel did not make any purchases of foreign currency in the system.

Total balances of Leumi (current accounts and monetary deposits) in the Bank of Israel at the end of December 2012 stood at NIS 36 billion, similar to the end of 2011.

The total of these balances in the fourth quarter of the year on average stood at NIS 32 billion, and in 2012 as a whole, at an average of NIS 27 billion.

Liquidity position and raising funds by 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 for the long term.

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 230 of the Report.

At 31 December 2012, the net balance of cash and deposits with banks (excluding Leumi Mortgage) amounted to some NIS 42.5 billion, compared with NIS 41 billion at the end of 2011, an increase of some 3.7%.

In addition, the Bank has a securities portfolio of some NIS 49 billion, invested mainly in Israeli government debentures, foreign government debentures, and debentures of banks overseas. This is in comparison to the balance as at 31 December 2011 amounting to NIS 41 billion.

Approximately 43% of the financial assets of the Bank are deposited in the Bank of Israel and in banks and invested in securities, an increase of 4% compared with 31 December 2011.

The balance of credit to the public as at 31 December 2012 amounted to NIS 145.5 billion, compared with NIS 151.6 billion at the end of 2011, a decrease of some 4.0%. The decrease was mainly in the foreign currency segment. After canceling the effect of exchange rate differentials, the credit fell by NIS 5.8 billion, a decrease of some 3.8%.

At the end of December 2012, the balance of public deposits amounted to some NIS 270.5 billion, compared with NIS 257.5 billion at the end of 2011, an increase of 5.0%. Shekel deposits increased by NIS 11.9 billion, or 6.5%. Foreign currency deposits increased by NIS 0.9 billion, or 1.2%. (In dollar terms, an increase of US$ 0.8 billion was recorded.)

During the period under review, the volume of off-balance sheet monetary assets of customers rose by NIS 61.4 billion to NIS 498 billion. After deducting the effect of the impairment in market value, a positive accumulation of NIS 23 billion was recorded.

Legal Proceedings

1. Civil Proceedings

1.1 The Bank is a party to legal proceedings, including petitions for leave to approve class actions, brought against it by customers and former customers of the Bank, and various third parties considering 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 grounds for claims against the Bank are different and varied, including assertions as to the non-execution of instructions or their late execution, petitions for approval of attachments imposed by third parties on assets of debtors that according to them, are held by the Bank, assertions that interest charged is not in accordance with the interest rates agreed upon between the Bank and the customer, interest rates deviating from those permitted by law, errors in the dates of debiting and crediting accounts in respect of checks drawn on them, assertions in connection with the charging of commissions, assertions relating to securities, labor relations, drawing checks without cover, and failure to honor checks.

For details regarding claims and petitions for leave to approve class actions filed against the Bank, see Note 18 to the Financial Statements.

For claims in an amount exceeding 1% of the shareholders' equity of the Bank on 31 December 2012, of about NIS 250 million, see also additional detail in Note 18 to the Financial Statements.

1.2 As part of measures taken to recover debts during the ordinary course of its business, the Bank, *inter alia,* initiated various legal proceedings against debtors and guarantors, and proceedings to realize collateral. The Financial Statements contain allowances for credit losses 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 taking into account the extent of the information concerning the relevant debtor/guarantor with regard to his financial strength and the collateral given to the Bank to secure repayment of the debt.

1.3 On 19 April 2012, the Jerusalem District Court rejected a claim, submitted on 28 September 2008 for the approval of a class action against the Bank and other banks amounting to NIS 672 million which alleged that the banks were collecting an illegal commission from customers engaged in continuous trading in Tel Aviv-25 index options.

1.4 On 5 December 2012, the Tel Aviv District Court handed down judgment ordering the dismissal of a petition for approval of a class action amounting to NIS 1 billion, pertaining to cross-commissions in credit card clearing agreements, which had been submitted against the Bank and Leumi Card and against other banks and other credit card companies, for want of action.

1.5 On 17 January 2013, a claim and a petition for approval for a class action were dismissed, They had been submitted on 19 January 2012 in the Tel Aviv District Court against Leumi Card, IsraCard Co., and another company, in which it was alleged that they showed negligence in their duty to supervise the data security level of vendors clearing through them and that, as a result of a deficient level of security in certain Internet sites, there had been an information leak of credit card numbers.

1.6 On 19 July 2012, a hearing was held in the Supreme Court on an appeal submitted on the matter of fees to the agent of the petitioner and special compensation to the petitioner which were handed down by the District Court as part of the compromise agreement approved by the District Court in a class action submitted on 2 December 2006, in the amount of NIS 150 million, against Leumi Mortgage Bank and against Migdal Insurance Company Ltd. in connection with the payment of partial life assurance payments. In the appeal, it was decided, with the consent of the parties, that Leumi Mortgage Bank and Migdal would pay (allocated equally between them), in addition to the amounts already paid to date, an additional aggregate amount of NIS 180,000 as professional fees and special compensation.

1.7 On 12 November 2012, the Supreme Court dismissed the appeals against the 1997 decision of the District Court, to reject outright the request for approval of a class action of an amount in excess of NIS 1 billion against Leumi Mortgage Bank together with other mortgage banks in connection with the collection of borrowers' life assurance and building insurance commissions. Following mediation proceedings conducted by the parties, a compromise arrangement between the parties was submitted to the court, whereby all of the respondent banks in the petition would pay an aggregate amount of NIS 17 million as contribution for selected public purposes, and an additional aggregate amount of NIS 3 million as compensation and as professional fees to the petitioners and their agents, and thus, completing all of the legal proceedings in the case. Leumi Mortgage Bank share is 27.16%. The compromise arrangement was approved by the court and Leumi Mortgage Bank paid its share accordingly.

2. Other Proceedings

2.1 On 26 April 2009, a ruling of the Antitrust Commissioner 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 into 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 submitted an appeal against this ruling. On 22 February 2011, the Commissioner's response to the appeal was submitted. Mediation proceedings took place between the parties that were unsuccessful. On 29 July 2012, the Bank received a letter from the Antitrust Authority according to which the Antitrust Commissioner is considering publishing a supplementary ruling in relation to the transfer of information set forth in the response of the Commissioner to the appeal, but that was deleted from it at the request of the banks, according to which the transfer of information were restrictive trade arrangements. The Bank was given the opportunity to present its position to the Commissioner before the Commissioner makes a decision to publish the said supplementary ruling. At this stage, the implications of the ruling cannot be assessed.

2.2 The United States authorities (the "U.S. authorities") are conducting wide-ranging investigations against foreign banks in connection with activities of the banks with customers who are U.S. taxpayers ("U.S. customers"), on suspicion of a breach of U.S. law. In the context of the said investigations, which are also being conducted against the Group, the U.S. authorities have submitted and are continuing to submit various subpoenas for information and documents concerning U.S. customers and have summoned customers and former employees of banks which are part of the Group, to testify and provide documents in connection with U.S. customers and the banking services given to them by the Group. The Group is cooperating with the U.S. authorities, in providing information and in the procedural steps required, as allowed by law. In addition, the Group is conducting an investigation of the subject by means of outside parties hired by it for this purpose. These outside parties are continuing with their investigation. At this stage, the investigation has not been concluded.

Following further examinations conducted at the Bank's initiative, the Bank decided to make a provision of approximately NIS 340 million. The provision was made to cover the expense that might be caused to the Group due to the investigations that are being conducted by the U.S. authorities with regard to the U.S. Customers. This provision also includes expenses for advisors and other external service providers which the Bank hired with respect to the investigations.

In light of the fact that there is no certainty regarding the level of expense that might be caused to the Group in the context of the investigations, it is entirely possible that the related expense will be significantly higher. It should be noted that the provision does not constitute an acknowledgement to any claim that might be raised against the Group by the U.S. Authorities.

2.3 During the reporting year, the Israel Securities Authority has been conducting administrative arbitration procedures pursuant to Section 52QQ(a)(2) to the Securities Law, 1968, in connection with the publication of a profit warning by the Bank on 14 November 2011, and in connection with the issue of deferred notes by Leumi Finance Ltd (a wholly-owned and controlled subsidiary of the Bank) (hereinafter "**Leumi Finance**"), pursuant to the shelf offer published by Leumi Finance on 9 November 2011. On 12 November 2012, an arrangement (as defined in section 54A of the Law) was signed between the Bank and Leumi Finance, on the one part, and the Securities Authority, on the other, in connection with the administrative arbitration procedure. On 12 December 2012, the arrangement was approved by the Administrative Enforcement Committee appointed pursuant to Section 52FF to the Law. As part of the arrangement, whose full wording was attached to the Immediate Report published by the Bank on 13 December 2012 (Ref no. 2012-01-309429), the Bank and Leumi Finance agreed to assume – against the undertaking of the Securities Authority to refrain from initiating enforcement procedures in connection with the facts upon which the arrangement is based, without admitting these facts create any negligent actions or breaches, while maintaining all of their rights and claims in connection with these facts – an agreed sum as a monetary sanction amounting to NIS 2 million each, alongside measures to prevent a repetition of the alleged breaches.

2.4 In March 2012, an indictment was served against Leumi Romania and against members of the credit committee of Leumi Romania, regarding a transaction in the account of a customer, who, according to the General Prosecutor in Romania, was not lawfully carried out. The indictment was submitted as a result of a complaint by the customer who alleged that he incurred damage as the result of the bank's action (the amount of the damage is not material). On 28 November 2012, the court in Romania accepted Bank Leumi Romania's arguments that the General Prosecutor in Romania had no authority to serve an indictment against it and against certain of its employees/managers, and decided to send the file back to the General Prosecutor for rewording and resubmission of the indictment. The General Prosecutor and the complainant have appealed the decision.

2.5 In December 2012, Leumi Romania received an invitation to arbitration (a "pre-trial" is required before submitting a claim) in connection with the sale of Bank Eurom to the Bank. According to the claim, the Bank owes various entities that were involved in the sale various amounts aggregating US$ 228 million and CHF 10 million.

2.6 On 22 May 2012, the Antitrust Commissioner extended the term of the exemption from the necessity of approving a restrictive arrangement (hereinafter "the exemption") for the activities of Bank Leumi, Bank Hapoalim, Discount Bank, First International Bank and Bank Mizrahi-Tefahot (hereinafter, together – "the Banks") for an arrangement with regard to the Banks' joint holdings in Shva – Automatic Bank Services (hereinafter "Shva") and in Masav – Bank Clearing Center (hereinafter "Masav") for a period of four months.

Pursuant to the exemption, if 22 May 2012, most of the conditions stipulated by the previous exemption remained unchanged, but further conditions were imposed on Shva, Masav and the Banks, as applicable. These included, inter alia, a restriction on the ability of Shva and Masav to grant discounts to the Banks and companies under their control, and a prohibition on Shva and Masav from charging the various systems operated by them with joining fees, with the exception of additional costs that may be directly involved in making the required adjustments in the systems for purpose of joining.

The 22 May 2012 exemption was given as aforesaid for a period of four months, in which time the Commissioner announced he would examine the continuation of Shva's activities in the area of automated telling machines (ATMs) and what, if any, is the percentage of costs that Shva and Masav should be allowed to demand from new subscribers.

On 20 September 2012, the Antitrust Commissioner extended the term of the exemption with regard to the joint holdings of the Banks in Shva and Masav. The exemption with regard to Shva was extended for a period of six months, in which time the Commissioner asked to continue comprehensively examining the balance of advantages and disadvantages emanating from Shva's activities in the area of collection and transaction approval services and interface services for clearing and issuing companies; while the exemption with regard to Masav was extended for a period of three months, in which time the Commissioner intends to continue comprehensively examining Masav's activities in the area of debit and credit clearing services. On 20 December 2012, the Commissioner extended the exemption with regard to Masav for an additional three-month period in order to complete the said examination. Furthermore, the Commissioner required Shva to bring its activities in the area of ATMs to an end, by selling the ATMs within eight months, or, alternatively, to discontinue their operation by the end of the said period. Pursuant to exemption, most of the conditions stipulated in the 22 May 2012 exemptions remained unchanged, without any significant changes being made therein. On 20 March 2013, the said period of exemptions regarding Shva and Masav come to an end and by this date, the Commissioner is expected to make further decisions regarding these exemptions.

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 (hereinafter: "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 permit of the Supervisor to hold the means of control in overseas corporations and the Supervisor's approval to hold overseas corporations in sub-subsidiaries were amended in November 2011, enabling the Bank to hold 100% of the means of control of Banque Safdié and its subsidiaries, for the purpose of its merger into Leumi Switzerland (which thereafter changed its name to Leumi Private Bank).

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, a report, or notification to the Supervisor regarding various events, such as: investments in corporations, significant 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 11.

Material Contracts

1. Following publication of the circular by the Supervisor of Banks regarding measurement and disclosure of impaired debts, credit, and the allowance for credit losses, (hereinafter "Directive of the Bank of Israel"), the banks, including the Bank, reached an agreement with the Tax Authority regarding recognition of allowances for credit losses for tax purposes. The agreement was signed on 19 March 2012, and is effective for impaired debts that were recorded from 1 January 2011onwards.

This agreement replaces the earlier agreement which applied to doubtful debts recorded through 31 December 2010.

The main points of the new agreement are as follows:

Large impaired debts on an individual basis:

The allowance is recognized as tax deductible in the same year it is recorded as an expense in the financial statements. In the tax year in which the balance of the allowance for credit losses was reduced (not as a result of an "accounting write-off" or a "waiver"), an "additional tax" will be added to the Bank's tax liability, with the addition of interest and linkage differentials, which will result in a tax charge which would have been collected if the allowance permitted to be deducted had not been recognized at the outset.

For this purpose – a "large debt" is a debt of NIS 1 million or more, or a lower amount as notified by the Bank to the assessing officer and in accordance with the Bank's characteristics.

Impaired debts that are not large:

The expenses in respect of a net "accounting write-off" (after offsetting tax payment for the same year) – half are recognized for tax purposes in the first tax year following the year in which the expense was recorded, and half are recognized in the subsequent tax year in which the expense was recorded.

Collective allowance:

This is not recognized for tax purposes.

Allowances in respect of "retail debts" recorded up to 31 December 2010:

These will be recognized as tax deductible in five annual equal installments, beginning in 2011, providing they were not recognized as an expense for tax purposes in previous years.

Implications of the initial implementation of the Bank of Israel's directive on 1 January 2011:

Differences deducted from shareholders' equity as a result of the initial implementation of the Bank of Israel's directive will be recognized as tax deductible in five annual equal payments, beginning tax year 2011, subject to their being recognized for tax purposes in accordance with the terms of the arrangement, and on condition that they are not collective, general or supplementary provisions.

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 notice of its intention to propose changes to the agreement.

For further details regarding this agreement, see page 251.

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

4. An agreement between the Bank and Union Bank Ltd. ("Union Bank") for providing comprehensive computing and operational services, including development work and new and special projects as well as relevant training, by the Bank to Union Bank and its related entities, signed in September 2001 and effective retroactively from September 1998 for a period of 11 years with an extension option. In December 2007, an addition to the agreement was signed by Leumi and Union Bank, concerning an extension of the relationship, with changes in the business terms. The new relationship term is ten years, starting from 1 January 2007, during which a gradually increasing annual consideration will be paid to the Bank, starting at some NIS 40 million in the first two years and up to some NIS 45 million starting from the sixth year (the sums are linked to the December 2006 CPI, and are contingent upon Union Bank's volume of activity). The addition was approved by the Supervisor of Banks and the Antitrust Commissioner.

5. 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 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 a year or the tax liability in Israel.

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 were made accordingly.

3. 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 company tax rates to 18% for the year 2016 and thereafter. The company tax in Israel was 25% in 2010 and 24% in 2011.

On 5 December 2011, the Change in the Tax Burden Law (Legislative Amendments), 2011 (hereinafter – the Law) was passed in the Knesset. Pursuant to the Law, *inter alia,* the tax reduction provided in the Economic Efficiency Law was canceled. Since 2012, the company tax rate is 25%.

On 30 August 2012, a Value Added Tax Order was published, updating the rate of profit tax and payroll tax for financial institutions to 17% from 1 September 2012. As a result of the abovementioned change, the statutory tax rate applicable to banking corporations rose in 2012 from 35.34% to 35.53%, and from 2013 onwards, it rose to 35.9%. In addition, the rate of payroll tax applicable to financial institutions rose to 17% with respect to salary payable for work from September 2012 and thereafter, instead of the planned rates of 16% for 2012 and 15.5% for 2013 and thereafter.

On 13 August 2012, the Deficit Reduction and Change in Tax Burden Law (Legislative Amendment), 2012 (hereinafter: "the Law") was published. Pursuant to the Law, with effect from January 2013, the rate of National Insurance premiums collected from employers in respect of the part of the salary exceeding 60% of the average salary in the market increased from 5.9% to 6.5%. In addition, this rate will increase in January 2014 and January 2015 to 7% and 7.5%, respectively.

The taxes for the periods reported in these financial statements are calculated at the tax rates as determined in the laws referred to above.

The balance of the deferred taxes to 31 December 2012 were calculated at the tax rate as determined in the laws referred to above, at the tax rates at the expected date of reversal.

The effect of the change in the tax rate on the financial statements as at 31 December 2012 is reflected in an increase in the balance of the asset for deferred taxation amounting to NIS 35 million, against a tax provision.

In addition, the said changes resulted in an increase in the balance of liabilities in respect of employee rights amounting to NIS 77 million, before the related tax effect.

For further details regarding the policy for recording deferred taxes in the Bank, see Note 1T.

4 The Bank has been issued with final assessments for the period up to and including the 2007 tax year. The principal consolidated companies have issued final assessments up to and including the 2008 tax year.

5. 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 2012, the number of positions* in the Group decreased by 284, a fall of some 2.1% in relation to the number of positions in 2011. With regard to the average for the year, the number of positions in the Group fell by 53 a fall of some 0.4% in relation to the average for 2011.

This fall derives from streamlining procedures in the number of positions in the Bank and the consolidated companies in Israel and abroad.

	Positions at year end		Average positions during the year	
	2012	2011	**2012**	2011
The Bank in Israel	**9,639**	9,843	**9,744**	9,782
Leumi Mortgage Bank **	**515**	534	**521**	535
Total	**10,154**	10,377	**10,265**	10,317
Consolidated subsidiaries in Israel *** (excluding Leumi Mortgage Bank)	**2,057**	2,054	**2,053**	2,043
Total of the Group in Israel	**12,211**	12,431	**12,318**	12,360
Overseas: Bank branches and representative offices	**49**	49	**49**	52
Consolidated subsidiaries	**1,147**	1,211	**1,199**	1,207
Group total in Israel and overseas	**13,407**	13,691	**13,566**	13,619

* Position – means a full time position including specific overtime, working hours of employees from temporary employment agencies and employment of external consultants.

** Restatement of the number of positions in Leumi Mortgage Bank beside the number of personnel in the Bank in Israel

*** Restatement of the figures for the consolidated subsidiaries in Israel excluding Leumi Mortgage Bank and the inclusion of the number of personnel of Maalot Insurance Company, a wholly-owned subsidiary of Leumi Mortgage Bank (58 positions at the end of 2011 and 60 positions on average during 2011).

Efficiency program and early retirement

As part of preparations for the 2012 work program, it was decided to embark on an efficiency program affecting 800 employees over a period of three years until 2014.

The program was based mainly on the "Advancing Together" project which advances the transfer of back-office activity from the branches to centers of expertise and a streamlining project in the divisions' staff; levels of expected natural retirement; and a reduction in the level of recruitment, at the same time, utilizing the potential of the existing human capital.

In 2012, with progress in the streamlining process, after further consideration, it was decided to change the quality mix of the workforce in the program and, to this end, directing efforts towards the early retirement of veteran employees. In view of this, a provision of NIS 323 million was made for financing early retirement.

Natural retirement

During 2012, around 70 employees left the Bank by natural retirement.

Over the coming decade, around 2,200 employees are expected to leave by natural retirement.

Remuneration system and salary structure

In general, the salary and remuneration systems for the Bank's employees are based upon a correlation between the level of remuneration and the position of the employee, the contribution of the employee to the Bank and the evaluation of the employee's manager. Consequently, the remuneration granted to the employee is differential.

Collective agreements with the employees

See page 271 for details of remuneration of senior officers.

Labor and Salary Costs (for the Bank)

	2012	2011	2010
	NIS thousands		
Cost per employee position (excluding bonus)*	**330.3**	316.7	300.8
Cost per employee position (including bonus)*	**331.2**	323.3	327.5
Salary per employee position (excluding bonus)*	**219.6**	211.8	202.2
Salary per employee position (including bonus)	**220.2**	217.2	224.1

* Cost per employee position does not include pension expenses, costs of voluntary retirement, retro-severance pay and shares to employees.

Training and Development

The Management of the Bank sets itself the goal of supporting the business units and the attainment of their business goals through study and training procedures, which focus on improving the professional and managerial ability of employees and managers. In this context, Leumi employees participated in 36,562 training days during 2012.

Training activities in 2012 focused on raising the level of professionalism of the employees with emphasis on core banking areas – credit, investment counseling, service and sales and management training, all according to the business objectives of the Bank, including comprehensive training and assimilation with regard to regulations and compliance for all the Bank's employees.

Organizational development and supporting units undergoing change and under construction

In 2012, activity was expanded in the area of organizational development and supporting units undergoing change or in the process of being established. Among the central processes in the area are: "Advancing Together", Leumi Upgrade, the merger of Leumi Mortgage Bank, completion of the change in the Procurement and Real Estate Division, etc.

Digital learning

In 2012, the increase in knowledge management activity in Leumi continued, with the adoption of new remote-learning (LM) technologies, and self-teaching activities at all the Bank’s units, with the object of making wider use of the existing knowledge 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.

Manager development

Implementation of the manager development program at Leumi continued in 2012, and during the year, more than 98% of managers participated in Bank-wide management courses, professional courses, and enrichment and skills development programs. The scope of mentoring for new managers beginning their work at the Bank, for managers taking up new positions and for supporting processes of changing units, was expanded. In addition, development programs were carried out for managers participating in the Bank's management cadres.

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 64.6% of all employees at the end of 2012, compared with 63.5% in 2011, 61.4% in 2010 and 59.6% in 2009. The percentage of graduates among the managerial staff reached 93.4% in 2012, in comparison with 93% in 2011, 92.6% in 2010 and 92.4% in 2009.

This increase in the percentage of university graduates is the result of the recruitment of employees with university education, the resignation of Bank employees who were 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 and collective agreements. The terms of employment of members of the Bank's Management and certain other senior employees are regulated by personal employment contracts. For additional details see note 15 to the financial statements.

Organizational Culture

In 2005, Leumi launched the ethical code "the Leumi Way".

Between 2005 and 2012, comprehensive and varied assimilation procedures of the ethical code took place among Leumi employees with an emphasis on the integration of the subject of ethics as a part of the perception of the manager's role in Leumi. In addition, there are active ethics institutions, an official in charge of ethics, an ethics call-center**,** the inter-divisional ethics committee and a divisional ethics committee.

The ethical code, "the Leumi Way" was reviewed in the framework of the SOX controls and the *Ma'ala* credit rating, and represents a part of the Leumi's Corporate Responsibility Report, which won international recognition from the Global Reporting Initiative organization, the leading world body dealing with the formulation and promotion of social and environmental responsibility reports.

In 2013, a revision of the Code will be examined.

Employee involvement in the community

Leumi management views the involvement of its employees and managers in the community as a central goal in the area of social responsibility. Leumi encourages its employees to take an active part in volunteer projects and to become involved in community life, and provides them with frameworks for volunteering and a variety of opportunities to contribute and volunteer.

During the course of 2012, some 4,276 employees – from various units within the Bank - engaged in volunteering activity. The total hours of volunteer work by employees by which the community benefited in 2012 was 34,626.

The activities of the unit are based on a network of social leaders in all the divisions and functions of the Bank, numbering some 320 employees representing the various units of the Bank. Their purpose is to promote the subject of volunteer work among employees in their unit while building an infrastructure to support the activity.

Leumi has a wide range of community partners, mainly in the area of children and young people. Many thousands of people every year benefit from the direct influence of volunteer work by Leumi employees.

Employees from throughout the country are involved in a range of activities such as assisting children and youth at-risk in residential homes, clubs and community centers; tutoring, assisting with homework, collecting equipment for the needy, visiting hospitals, assisting Holocaust survivors, supporting populations with special needs, etc. . Bank employees participate in the annual traditional Passover food collection, distributing meals to over 2,000 needy families.

Alongside these many activities, Leumi chose to link with Leumi's vision of strengthening the future generation, through a strategic program, such as "Leumi Movement" program in partnership with youth movements, strengthening the connection with associations supported by the "Leumi Tomorrow" organization with various projects, such as "After Youth Leading Change", "Atidim", "Action Center", etc. In the past year Leumi employees have integrated successfully in Project "Taglit", managed by the Jewish Agency, as well as other projects.

Positions according to operational segments:

	Average positions in 2012		Average positions in 2011	
	Managerial Staff	**Clerical Staff**	Managerial Staff	Clerical Staff
Households	**1,471**	**5,703**	1,382	5,829
Small businesses	**482**	**1,364**	466	1,400
Corporate banking	**439**	**663**	451	657
Commercial banking	**778**	**1,120**	787	1,194
Private banking	**454**	**421**	401	417
Financial management – capital markets	**302**	**359**	270	350
Other	**2**	**8**	3	12
Total	**3,928**	**9,638**	3,760	9,859

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 and Retirement

Appointments:

Mr. David Brodet, Chairman of the Board of Directors of Leumi Group, was appointed to the position of chairman of the board of directors of Bank Leumi USA from 26 July 2012.

Ms. Rakefet Russak-Aminoach, was appointed to the position of President and Chief Executive Officer of Leumi Group, with effect from 1 May 2012.
For an update of the terms of employment of Ms. Russak-Aminoach, on her election to serve as President and CEO of the Bank and the Group, see Immediate Report of the Bank dated 1 May 2012 (Ref no. 2012-01-112527).

Professor Daniel Tsiddon, Head of Capital Markets Division, was appointed to the position of chairman of the board of directors of Leumi Partners, with effect from 1 July 2012.

Mr. Yoel Mintz ceased to serve as Head of the Construction and Real Estate Department and was appointed to the position of Head of Structured Finance and Real Estate Division and member of Bank management, with effect from 1 May 2012. In addition, Mr. Mintz was appointed to the position of chairman of the board of directors of Bank Leumi UK with effect from 22 May 2012.

Mr. Ron Fainaro was appointed a member of Bank management on 1 July 2012 and, in addition, he was appointed Head of the Economics and Finance Division, with effect from 1 November 2012.

Mr. Yaakov Haber ceased to serve as Head of Economics and Finance Division and was appointed Head of Corporate Division with effect from 1 January 2013. In addition, Mr. Haber served as chairman of the board of directors of Leumi Partners from 1 April 2012 to 30 June 2012.

Ms. Tamar Yassur ceased to serve as CEO of Leumi Card and was appointed Head of Banking Division and member of Bank management and to the post of chairman of the board of directors of Leumi Card, with effect from 1 January 2013.

Mr. Dan Yerushalmi was appointed to the position of Head of Operations and Information Systems Division and member of Bank management, with effect from 1 March 2013. From 1 January 2013, and until he took up his position, Mr. Moshe Wolf was the acting Head of Operations and Information Systems Division.

Mr. Shlomo Goldfarb left his position as Deputy Head of Accounting Division, and was appointed to the position of Head of Accounting Division, Chief Accounting Officer and member of Bank management, with effect from 1 April 2013.

Ms. Einat Skornik was appointed to the position of Head of the Investment Consulting Department, with effect from 1 January 2012.

Ms. Meira Karni, Head of the Compliance and Enforcement Department, was promoted to the rank of Executive Vice-President with effect from 1 April 2012.

Mr. Malkiel Shachar was appointed to the position of Head of the Credit Unit, with effect from 1 May 2012.

Mr. Yitzhak Naor was appointed to the position of Head of the Corporate Unit and was promoted to the rank of Executive Vice-President, with effect from 1 May 2012.

Mr. Avner Mendelson, Head of the Strategy Department, was given responsibility for International Operations Headquarters, with effect from 1 July 2012.

Ms. Nitza Rousso–Stauber was appointed to the position of Head of the Private Banking Department, with effect from 1 July 2012.

Mr. David Shafner was appointed to the position of Head of the Construction and Real Estate Department, with effect from 1 October 2012.

Ms. Osnat Tennenbaum was appointed to the position of Head of the Special Credit Department, with effect from 1 February 2013.

Mr. Haggai Heller was appointed to the position of General Manager of Leumi Card, with effect from 15 October 2012.

Retirements:

Ms. Galia Maor announced her intention on 1 January 2012 to retire from her position as President and Chief Executive Officer of the Bank. At the request of the Board of Directors, she continued in her employment until 30 April 2012, having completed 21 years of employment with the Bank, of which 17 years were as President and Chief Executive Officer. The period of advance notice which commenced on 1 May 2012 continued for nine months without actual work, and ended on 31 January 2013. Ms. Maor will continue to serve as chairman of the board of directors of Leumi Switzerland.

Mr. Zeev Nahari, Chairman of the Board of Directors of Leumi Partners served in his position until 31 March 2012, and was appointed chairman of the board of directors of Arab-Israel Bank, as of 1 April 2012.

On 30 June 2012, **Mr. Zvi Itskovitch**, Head of International and Private Banking Division and member og Bank management, stepped down from his position and retired from the Bank on 31 January 2013 after 33 years of employment with the Bank. Mr. Itskovitch will continue to serve as chairman of the board of directors of Leumi Luxembourg until 30 April 2013.

Mr. Baruch Lederman left his position as Head of Banking Division, member of Bank management and chairman of the board of directors of Leumi Card on 31 December 2012 and he will retire on 31 July 2013, after 30 years of employment with the Bank.

Mr. Yitzhak Malach left his position as Head of Operations and Information Systems Division and member of Bank management on 31 December 2012, and he will retire on 31 December 2013, after 20 years of employment with the Bank.

Mr. Menachem Schwartz will leave his position as Head of Accounting Division and member of Bank management on 31 March 2013 and he will retire on 31 October 2013, after 43 years employment with the Bank.

Mr. Shmuel Zussman left his position as Chairman of the Board of Directors of Arab Israel Bank, and he will cease to serve in this position on 31 March 2012, after seven years in office.

Mr. Yehoshua Bornstein left his position as General Manager of Leumi Mortgage Bank on 31 December 2012 and he retired on 15 March 2013, after 24 years employment with the Bank.

Mr. Moshe Ingevir left his position as Head of the Special Credits Department on 31 January 2013 and he will retire, after 46 years employment 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 into 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. The **Corporate Division** manages the activity of Israel's large business customers on the basis of sectoral expertise and synergy between the sectors. This line of business also includes the Corporate Department, which manages the activity of the large business corporations, particularly in the area consumption and commerce, industry, transport, communication and high tech. In addition, the Division includes the Credit Department and also operates through the Complex Finance and Real Estate Division, as outlined below.

   The **Complex Finance and Real Estate Division** manages the activity of large construction companies, entrepreneurs and contractors in the economy (including national infrastructure projects), with specific skill and expertise in the field. In addition, the division is responsible for activity planning special transactions, such as the finance of projects, transactions to finance the means of control, the organization of syndicates, the sale of debts, and the examination of investment plans, interest; trade and finance.

2. The **Commercial Banking Division** manages the activity of middle-market commercial companies, through its main Tel Aviv branch and 2 commercial branches - organized on a geographical basis into 4 commercial districts. The Division's organizational structure is unique in the banking system, providing a "one stop shop" for its comprehensive and extensive services, while broadening its services to business customers through digital channels.

   The **Special Loans Unit** deals with corporate customers who are in difficulty, while attempting to assist in the recovery of active customers through business help and support and the collection of business customers' debts whose rehabilitation is not possible. In addition, the unit coordinates the professional assistance required for clarifying demands and claims against the Bank and the consulting for the entire Bank on topics related to its area of expertise. From 1 May 2012, the Special Loans Unit reports to the Commercial Banking Division.

3. The **Banking Division** manages the activity of the private and small business customers, who receive the full range of services through 194 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 segment, the premium segment, and the corporate banking segment. The Division coordinates the retail operations in the Group, including those of the Arab Israel Bank, Leumi Mortgage Bank and Leumi Card.

   The **Mortgage Department –** From 31 December 2012**,** the Mortgage Department constitutes an independent unit within the Banking Division. Its main activity is in the sector for loans to purchase housing and in the sector for any-purpose loans with a housing mortgage, with specific skill and expertise in the area. The unit operates through 106 representative offices, most of which are located in branches of the Banking Division, with a few in independent locations. The representative offices report to five regional areas which are themselves report to the units management. The unit operates a business center which coordinates activity in the area of credit, underwriting and the transfer of loan funds to customers. The unit also operates telephone call-centers which allow the submission of requests for approval in principle of a credit facility via telephone and the Internet, and the provision of a qualitative service to existing borrowers regarding managed loans.

4. The **Private Banking Department** is responsible for the private banking activity in the Group in Israel and worldwide. The department has 7 private banking centers in Israel for residents and non-residents and is also responsible for the activity of Bank Leumi le-Israel Trust Company Ltd. The department's activities also include, *inter alia*, control and co-ordination between the Bank in Israel and the overseas units dealing with private banking and establishing standards at an international level for the provision of service to wealthy customers of the Group.

5. The **Capital Markets Division** is responsible for managing the Group'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 market risks; management the formulation of a price policy and financial margins in the Bank; relations with financial institutions abroad; co-ordination of the Bank's capital market operational 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 the following head office units which provide services to the business units:

The **Finance and Economics Division** is responsible for coordinating and preparing the Bank's work-plan; managing profit centers and financial and managerial measurement; planning and managing the Group's capital; preparing the Bank's expenditure budget and monitoring its application, sharing in the determination of the order of priorities in the investment budget, coordination of commissions policy, managing the Bank's and the Group's tax matters and the Bank's and the Group's insurance, connections with investors and analysts, monitoring economic developments and preparation of sectoral reviews and economic forecasts.

The **Procurement, Construction and Logistics Unit** is a part of the Finance and Economics Division and is responsible for providing services in the area of procurement (general, construction and technological), construction and maintenance, asset management and the provision of various logistical services in the areas of consignment and management of a logistical center, in the Bank and in the subsidiaries in Israel.

The **Accounting Division** is responsible for managing, developing and determining the Bank's accounting guidelines, managing the Bank's books of account, preparing the financial statements of the Bank and the Group, the relationship with the Bank of Israel in all accounting matters and the related reports, and the monitoring of regulatory changes related to accounting and their implementation in the Bank and in the Group. In addition, the Accounting Division 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. From 1 April 2013, the Accounting Division reports to the Finance and Economics Division.

The **Human Resources Division** 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, salary structure, labor relations, development and advancement of employees, banking training – managerial and general, assimilation of the "Leumi Way" code of ethics, intra-organizational communications, internal information, care of the individual, organizational counseling and development, employee involvement in the community and employee welfare.

The **Investment Counseling Unit**, which reports to the Human Resources Division, is responsible for Bank's policy regarding counseling in investments in securities, in financial instruments and in pension products, conducting research into capital market and finance matters, professional development for investment and pension consultants, the characterization of systems in the area of consulting and the development of management-supporting models, dealing with aspects of regulation in the area of investment and pension consulting and the adaptation of work procedures and rules in these areas to the directives of the regulator.

The **Operations, Information Systems and Administration Division (*Chatam*)** is responsible for the computerized and operational deployment of the Bank and the Group. As part of its task, the Division co-ordinates the formulation and determination of the strategy, policy and activity regarding technological development, computers, operations, data technology, communications, information security, operations of subsidiaries in Israel, security and extending automated solutions required for achieving Leumi's business goals.

The **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. It is also responsible for expressing an opinion on various legal matters and for the infrastructure of legal forms and opinions, following legislative and regulatory proceedings and representation of the Group with the various legislative and regulatory bodies, legal advice for new products developed or integrated in the activity of the Bank and Group, and is responsible for dealing with claims against the Bank, the employment of outside attorneys and their supervision.

The **Internal Audit Division** is responsible for the internal auditing of the Leumi Group.
The Audit Division operates by virtue of the Internal Audit Law – 1992, Proper Conduct of Banking Business Directives of the Bank of Israel and directives of the Board of Directors. In addition, the Division acts in accordance with professional standards of the Institute of Internal Auditors.

The division 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 processes, examination of the method of managing various risks in the Group, maintenance of the Bank's implementation of the instructions of the Board of Directors, the Management and the Bank's guidelines, and examination of operational efficiency. In addition, the division conducts an independent review of the internal process for an assessment of capital adequacy of the Group (ICAAP). The Chief Internal Auditor is directly responsible to the Chairman of the Board of Directors.

The **Risk Management Division** coordinates risk management at the Group level in the main risk areas: credit, market and operations. The Division operates with an emphasis on independence in risk-taking. The object of the Division is the creation of a strong infrastructure for managing and controlling risks that will support the achievement of business targets, in accordance with the defined risk appetite.

In addition, the Division is responsible for assisting the Board of Directors in defining the risk appetite, leading risk policy, developing and defining tools for measuring and pricing risks in the various activities; identifying, measuring and controlling the major risk focal points in the Group, and the changes occurring in them, and examining the risks inherent in new activities.

The **Compliance and Enforcement Unit** is responsible for implementing compliance in the Bank and Group in relation to consumer regulations, including the prohibition on money laundering, the prohibition of the financing of terrorism, administrative enforcement and American customers (in conjunction with the Finance and Economics Division and the Legal Division). From 1 January 2013, the Compliance and Enforcement Unit reports to the Risk Management Division.

The **Marketing Department** is responsible for Bank and Group marketing and marketing communications, the spokesperson's office, regulation and public relations, conventions and events, marketing research, corporate responsibility, charitable donations, sponsorships and community relations. Among other things, the Department is responsible for delineating Leumi's marketing strategy to advertise through the various media outlets, to create ties with the varied types of communication and media, and to manage government and regulation connections with the legislature and representatives of the State authorities. The Department administers the Group's sponsorship and donation activity and is responsible for organizing conferences and events, for the Bank's employees and customers. It is also responsible for initiating and managing projects in the community and monitoring the area of corporate responsibility in Leumi.

The **Strategy Department** and the **International Activity Department** are responsible for assisting Group Management and the Board of Directors in defining and planning Bank and Group strategy and its validation, examining and analyzing subjects with strategic implications, and providing support and leadership of main projects in cooperation with the lines of business. In addition, the department is responsible for the Group's control and review of international activity, data concentration, processes and broad issue in all matters connected with international activity vis-à-vis the official responsible in the overseas branches, the Bank management, the Board of Directors and the Bank of Israel and support in the overseas branches in all matters connected with computers and operations and in receiving the necessary assistance from Bank Leumi in Israel.

During 2012, a number of significant organizational changes were made in Leumi:

Corporate Division

The organizational structure of the Corporate Division was updated, and the following units report thereto:

- The Structured Finance and Real Estate Division, which is responsible for the Construction and Real Estate Unit, the Structured Finance Unit, international trade activity and diamond trade activity. In addition, the division serves as a professional authority for real estate financing activity in the Bank's offices abroad.

- The Corporate Unit, which includes four business sectors: technology; energy and chemicals and holding companies; consumption and trade; and industry, transport and institutions.

- The Credit Unit, which is responsible for credit risk management and regulatory matters.

Until Mr. Yaakov Haber took up the position of Head of Corporate Division on 1 January 2013, the Head of Structured Finance and Real Estate Division and the heads of the abovementioned units reported directly to the President and CEO.

The Special Credit Unit, which until 1 May 2012 reported to the Head of the Corporate Division, from that date, reports to the Commercial Banking Division.

Private and International Banking

In order to address the current challenges in the field of private banking and international activity, and with a view to increasing management focus and strengthening control and review procedures, it was decided to make a structural change, in the framework of which the Private and International Banking Division was split as follows:

- The Private Banking Unit in Israel and abroad temporarily reports to the Human Resources Division.

- International Operations Headquarters will be joined with the Strategy Department.

In addition, it was decided that a division head or a unit head will be appointed for every overseas office to be directly responsible for business development and support in that office, in order to improve and reinforce the interface between business activity in Israel and abroad:

- The Head of the Structured Finance and Real Estate Division is responsible for the Bank's offices in the United Kingdom and Romania.

- The Head of the Strategy Department and International Operations Headquarters is responsible for the Bank's branches in the United States, Panama and the office being established in China.

- The Head of the Private Banking Division is responsible for the Bank's branches in Switzerland, Luxembourg and Uruguay and all the Bank's other offices which are engaged in private banking overseas.

Risk Management Division

As part of the overall process of coordinating the treatment of risk management in the Group, streamlining of internal controls and the handling of the implementation of various regulatory rules, the Compliance and Enforcement Unit will report to the Risk Management Division, with effect from the beginning of 2013.

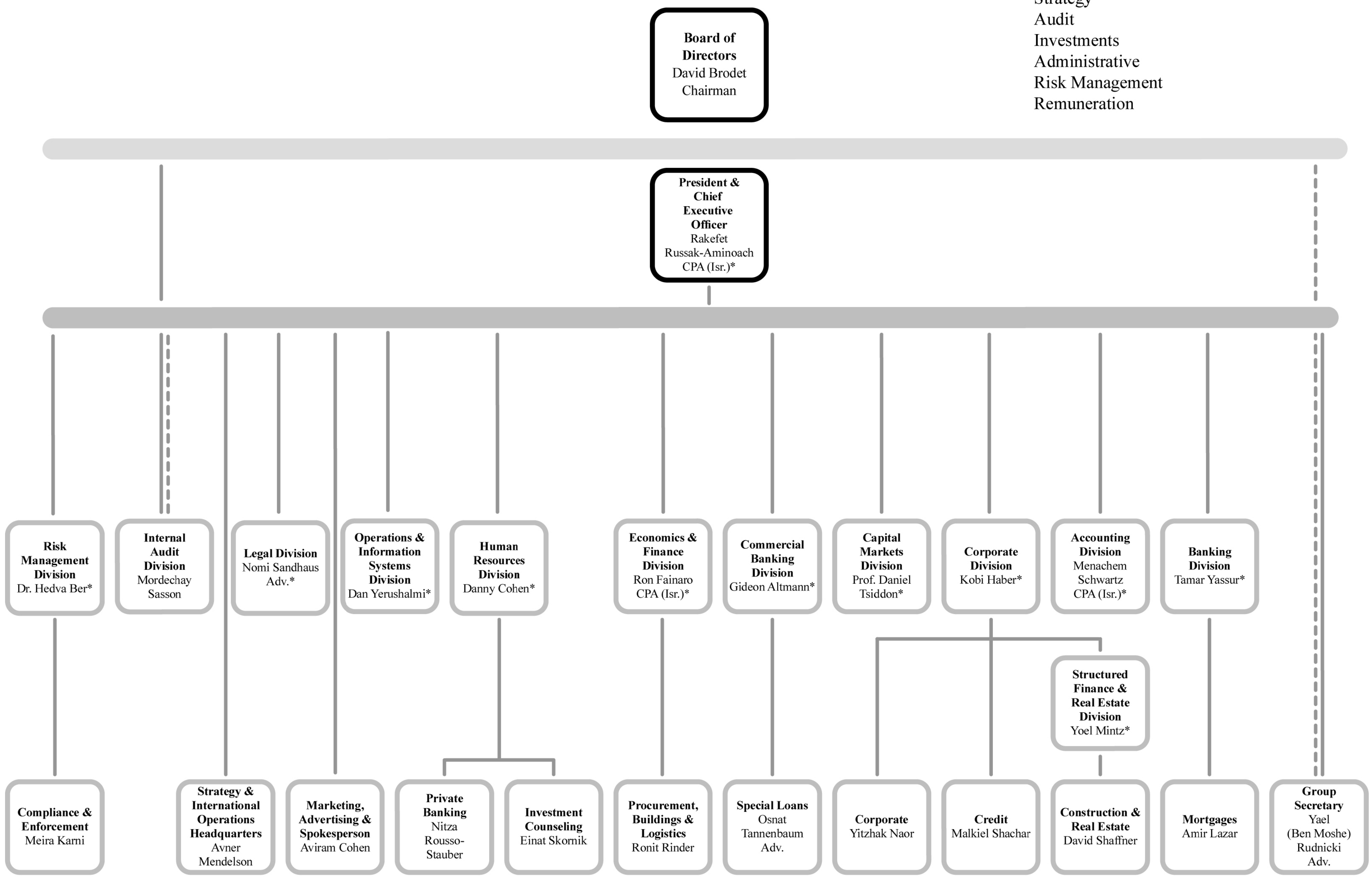
Leumi Mortgage Bank

As part of discussions on the work-plan for 2012-2014, the Board of Directors of Leumi approved the recommendation of the Bank management to merge Leumi Mortgage Bank with Bank Leumi. The merger enables the whole Group to go up a stage in synergy level and level of product offered to the customer and is expected to lead to a reduction in expenses and a more efficient use of the sales floor, while maintaining the level of professionalism and top quality service.

On 31 December 2012, Leumi Mortgage Bank merged with Bank Leumi and was defined as an independent unit within the Banking Division. The department operates through 106 representative offices, specializes in the granting of loans for the purpose of acquiring and renovating properties and offers a range of attractive exclusive plans and tracks.

Bank Leumi le-Israel B.M.
Organizational Structure

Committees of the Board of Directors
Credit
Strategy
Audit
Investments
Administrative
Risk Management
Remuneration



* Member of Management

Leumi for the Community – Social Involvement

Corporate responsibility management

The area of corporate responsibility in Leumi is managed on a basis of overall perception, strategy and policy led by the Board of Directors, and through various committees operating to advance the various subjects: ethics, the environment, accessibility and community ties.

In March 2011, Leumi joined the Global FTSE4Good Index, which examines the performance of companies in comparison to the global benchmarks in the realm of corporate responsibility. The index, which assesses companies traded on the FTSE All World Index, is intended to assist ethical investments according to criteria in the area of society, the environment and corporate governance. Leumi gained a rating according to the FTSE4Good Index rating of 96 (out of 100).

The *Ma'ala* rating of corporate responsibility for 2012 was published in June and Leumi was again placed in the highest group (Platinum).

Management of community ties

Leumi's social commitment is reflected in its constant investment in tomorrow's generation and the provision of opportunities and tools for its success. Leumi has chosen to focus on advancing education, culture and the arts, as well as activities to help close the gaps between the center of the country and the periphery. Leumi's social involvement is implemented via three main channels: "Leumi Tomorrow - The Centennial Fund for Endowing Israel's Future Generation" (R.A), donations and financial sponsorships of social causes and employees' volunteering activities.

"Leumi Tomorrow - The Centennial Fund for Endowing Israel's Future Generation"

The association invests in the advancement of youth by supporting various educational programs, operated by 12 social bodies and associations, among a range of population sectors throughout Israel. In 2012, the association donated NIS 12 million to various educational programs throughout Israel, in which more than 20,000 youth participated.

Alongside the monetary support, the social bodies and associations are able to participate in organizational workshops and financial conduct workshops given by Leumi employees on a voluntary basis, to enjoy an inter-segmental tutoring program by managers in the Bank, to assist in the Bank's infrastructures and to take part in a forum of social partners, intended to develop the organizations' professional abilities.

In 2012, the "Leumi Tomorrow" Association signed an agreement for cooperation and a donation to the "Hotem program, with an undertaking for support for two years in the amount of NIS 1,000,000 per year. Hotem is a joint initiative from 2010 of the Joint Israel, the Ministry of Education, the Naomi Fund and the "Hakol Hinuch" Movement. The object of the Hotem program is to reduce the social and educational gaps between the center of the country and outlying communities and to assist in improving the quality of education received by pupils outside of the center, through recruiting quality youngsters and training them in the teaching profession.

Other programs to which Leumi contributes

"Young Israeli Entrepreneurs" organization

Leumi is an involved partner in the "Young Israeli Entrepreneurs" organization, in which youth experience setting up a start-up company which advances a business idea of product development. 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.

The "Turning-Point" Program in cooperation with the Buchmann-Mehta School of Music at Tel Aviv University, and the Israel Philharmonic Orchestra.

In 2012, Leumi continued its support of the program, together with the Arab Israeli Bank of the Leumi Group. The program promotes artistic musical activity within Arab society, as well as joint activities with students on the campus of the Buchmann-Mehta School of Music**.** Reciprocal 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 Leumi Center for Robotics

In order to encourage and promote excellence in science, and as part of its support of the future generation, Leumi contributed to the establishment of the Center for Robotics, and has sponsored the center's activities since 2009. The center's aim is to nurture motivation among the youth to engage in the fields of science, mathematics and technology.

Promotion of Israeli Creativity

As part of its responsibility for promoting and cultivating tomorrow's generation, Leumi initiates and supports ventures which allow young artists to exhibit their creations to the wider public. In addition, Leumi sponsors various exhibitions and cultural events.
In 2012, Mani House, Leumi's Visitors and Arts Center, which is open to the public, hosted four exhibitions displaying works by a number of Israeli artists.

Summary of Leumi's Donations and Sponsorships in 2012

In 2012, the Leumi Group made donations and provided sponsorships for social and community purposes in the amount of some NIS 32.6 million, of which donations amounted to some NIS 24.0 million.

Set out below is a breakdown by category of total donations and sponsorships in 2012:

Education, children and youth	- NIS 15.6 million
Culture and art	- NIS 4.0 million
Community and society	- NIS 10.7 million
Health	- NIS 2.3 million

Decisions regarding the designation and amount of donations are made, as appropriate, by the Bank's Donations Committee, the members of which are appointed by the President and Chief Executive Officer, and the "Leumi Tomorrow" voluntary association. Applications for donations are given careful and thorough consideration in accordance with criteria determined in the Bank's donation guidelines and approved by the Board of Directors. Large donations (exceeding NIS 250,000) are referred to the Board of Directors for approval.

Internal Auditor

The Chief Internal Auditor, Sasson Mordechay has served as the Chief Internal Auditor since 1 March 2011. His appointment was approved by the Bank's Audit Committee on 13 December 2010 and by the Board of Directors on 14 December 2010.

The Chief 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 (hereinafter "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") until their cancelation in October 2012, and the provisions of paragraphs 11 and 12 of the Proper Conduct of Banking Regulations no. 307 regarding the internal audit function, with effect therefrom.

The Chief Internal Auditor is a full-time employee of the Bank, with the status of a member of management. This is his sole activity and he is responsible within the organization to the Chairman of the 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 which are audited 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, until their cancelation in 2012, and in the corresponding paragraphs of Regulation 307 as of this date. 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 once a 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, the Audit Committee and the plenum 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, "transactions" 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 set forth in Note 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, the financial statements of the companies included on equity basis include reference to the work plans of their internal auditors.

At the material foreign subsidiaries, local internal auditors are appointed. The Internal Audit Division supervises the work of the local auditor, as provided in paragraph 1(a)(3) of the Banking Regulations until their cancelation in October 2012, and in paragraph 21(l) of Regulation 307, from this date. This is, inter alia, through an examination of the local internal audit working program abroad before it is presented for approval to the audit committee and the board of directors abroad. The division of work between the internal auditors in Israel and abroad is carried out through coordination of the audited subjects by each one. The internal auditor of the overseas subsidiary reports to the local audit committee or board of directors.

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 the board of directors of their local audit committee.

The Chief Internal Auditor and his team of employees in the Leumi Group in Israel comprise, on average, 113.3 positions for 2012, as described below:

	Average positions of auditors in the Leumi Group in Israel
The Bank	96.1
Subsidiaries in Israel	12.3
Overseas subsidiaries	4.9
Total	113.3

In addition, 2.1 positions were invested on an outsourcing basis.

Furthermore, local auditors are employed in overseas subsidiaries in 23.8 positions.

The number of positions was approved by the Audit Committee in Israel, 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.

The table below shows details of the benefits and amounts which were paid or for which provisions were made for 2012 to the Chief Internal Auditor: (NIS thousands)

2012										
Holding in the capital of the Bank	Compensation for services				Other remuner-ation		Loans given on beneficial terms			
	Salary	Bonuses**	Social benefit provisions	Share-based payments	Value of the benefit	Total *	Balance as at 31 December 2012	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
	NIS thousands									
0.003	**1,033**	**-**	**800**	**-**	**114**	**1,947**	**49**	**2.42**	**2**	**-**

* Excluding salary tax.
** Estimate – see Note 15H of the financial statements.

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 in accordance with 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, including Proper Conduct of Banking Business Regulation no. 307 regarding the internal audit function.

The Audit Committee and the Board of Directors have noted that in the Chief Internal Auditor's written declaration he complies with the requirements laid down in the abovementioned generally accepted professional standards, and he operates in accordance with the directives and instructions of the Supervisor of Banks. On the basis of this declaration, and on the basis of his role as expressed at the meeting of the audit committee of the Board of Directors, 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 and records of the findings of the examination 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 records, 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 and records of the findings of the examination will be presented in their entirety for discussion at the Audit Committee. Furthermore, lists of all the audit reports and records 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 for them to be presented in their entirety for discussion by the Audit Committee.

Material audit reports records of the findings of the examination are discussed at the Audit Committee each month, and on occasion several times a month.

At the end of the first and second halves of the year, the Internal Auditor 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 for the relevant periods.

In addition, the Chief Internal Auditor 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 the performance of the annual work plan, and an effective assessment of the Bank's internal control framework.

The work program of the Internal Audit Division for 2012 was submitted to the Audit Committee on 19 January 2012 and discussed in committee on 22 January 2012.

The annual report of the Internal Auditor for 2011 was submitted to the Audit Committee on 19 April 2012 and discussed in the Committee on 24 April 2012.
Annual reports of the Israeli and overseas subsidiaries were submitted to the Audit Committee on 10 May 2012 and discussed in the Committee on 13 May 2012.
The Internal Auditor's report for the first half of 2012 was submitted to the Audit Committee on 13 September 2012 and was discussed by the Committee on 19 September 2012.
The Chief Internal Auditor's report for the second half of 2012 was submitted to the Audit Committee on 25 February 2013 and was discussed by the Committee on 28 February 2013.
The annual report of the Internal Auditor for 2012 was submitted to the Audit Committee on 14 March 2013 and was discussed by the Committee on 17 March 2013.

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. 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. They have continuous and direct access to the information systems of the subsidiaries in Israel and abroad, including financial data.

The Board of Directors and the Audit Committee believe that the scope, nature and continuity of operations and the work plan of the Chief Internal Auditor are reasonable under the circumstances, and that they enable the Internal Audit in the Group to achieve its goals.

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 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 as 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 examining 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.

Since 2009, the Bank has been taking steps to implement the directives 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 Chief Accounting Officer, 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 Chief Accounting Officer 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 of the Supervisor of Banks on reporting to the public and at the time required in these Directives.

During the quarter ended 31 December 2012, 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 Officers

For the year ended 31 December 2012

Below are details of the benefits and amounts paid or in respect of which provisions were recorded in the years 2012 and 2011 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, interest benefits in respect of mortgages, discounts or exemptions from commissions for banking services provided by the Bank. The amounts of the benefits in respect of the banking services mentioned, regarding each recipient, are not material. Certain private banking customers, including customers who are included in arrangements between the Bank and employee groups, are occasionally given benefits that are similar to those granted to Bank employees and in some cases, even exceed them.

2012												
Details of party receiving compensation (1)			Compensation for services			Other compensation (2)			Loans given on beneficial terms (5)			
Name	Position	Holding in the capital of the Bank	Salary	Bonuses (9)	Social benefit provisions (3)	Share-based payment	Value of the benefit (4)	Total *	Balance as at 31 December 2012	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
		%	NIS thousands									
Mr. David Brodet (5)(13)	Chairman of the Board of Directors	**0.001**	**2,119**	**-**	**1,029**	**-**	**154**	**3,302**	**-**	**-**	**-**	**-**
Ms. Rakefet Russak-Aminoach (6)(13)	President and Chief Executive Officer	**0.003**	**2,063**	**(353)**	**3,308**	**-**	**140**	**5,158**	**88**	**2.42**	**3**	**103**
Ms. Galia Maor (7)(13)	(Formerly) President and Chief Executive Officer	**0.021**	**2,891**	**(727)**	**(91)**	**-**	**133**	**2,206**	**180**	**2.42**	**11**	**22**
Mr. Baruch Lederman (13)	Executive Vice President, Head of Banking Division	**-**	**1,493**	**(242)**	**5,883**	**-**	**110**	**7,244**	**301**	**5.98**	**16**	**233**
Mr. Yehoshua Borstein (12)	General Manager, Leumi Mortgage Bank	**-**	**1,012**	**161**	**5,473**	**-**	**88**	**6,734**	**67**	**1.81**	**5**	**-**
Mr. Amnon Zaidenberg (10)	Chief Executive Officer, Bank Leumi (Switzerland)	**-**	**1,919**	**2,038**	**733**	**-**	**367**	**5,057**	**-**	**-**	**-**	**-**
Mr. Itzhak Eyal (11)	Chief Executive Officer, Bank Leumi USA	**0.002**	**1,976**	**1,120**	**843**	**-**	**785**	**4,724**	**116**	**2.14**	**7**	**-**
Mr.Yitzhak Malach (13)	Head of Operations and Information Systems Division	**0.008**	**1,479**	**(239)**	**2,083**	**-**	**147**	**3,470**	**244**	**3.41**	**12**	**175**
Ms. Tamar Yassur ** (14)	Vice President Head of Banking Division	**-**	**1,030**	**1,500**	**777**	**-**	**72**	**3,379**	**-**	**-**	**-**	**-**
Mr. Zvi Itzkovitch (13)	(Formerly) Senior Vice President and Head of International and Private Banking Division	**-**	**1,480**	**(203)**	**1,953**	**-**	**120**	**3,350**	**240**	**4.07**	**13**	**20**

* Excluding salary tax.
** The bonus relates to 2011-2012.

1. Those receiving the compensation hold full-time positions.

2. Pursuant to agreements on the matter of the privatization of the Bank and pursuant to agreements with Accountant-General in the Finance Ministry and the Bank's employees, in the context of an outline prospectus dated 6 April 2011, the shares of the Bank were offered by the State of Israel to the Bank's employees (and other employees in the Group). The purchase of the shares by the participants was completed on 17 May 2011 (with regard to the Chairman of the Board of Directors, the purchase was completed on 29 May 2011), pursuant to and subject to the arrangements and conditions set forth in the outline prospectus. The shares are blocked for a period of four years and are deposited with a trustee. In addition, the Bank has extended loans to the participants (who have requested the same) for purchasing the shares offered in the outline prospectus.

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. The value of the benefit includes, *inter alia*, car and telephone expenses.

5. On 14 September 2010, the Audit Committee of the Board of Directors, the Board of Directors on 15 September 2010, and the General Meeting of the Bank on 4 November 2010, approved the terms of engagement between the Bank and the Chairman of the Board of Directors, Mr. David Brodet. The Chairman is employed on a full-time basis as an Executive Chairman. For details of the terms of employment of the Chairman, see Note 15(B)(4) to the Financial Statements. The monthly salary of the Chairman of the Board of Directors was increased by 3.7%, effective 1 January 2012. For further details, see para.13 below. On 1 August 2012, the General Meeting approved an increase in salary for the Chairman of the Board of Directors, as aforesaid.

6. Ms. Rakefet Russak-Aminoach serves as President and Chief Executive Officer of the Bank and the Group from 1 May 2012. For further details regarding the terms of office of the President and Chief Executive Officer, see Note 15(B)(3)(a). The monthly salary of the President and Chief Executive Officer, with effect from May 2012, is NIS 180,000 (linked to the increase in the consumer price index).

7. On 30 April 2012, Ms. Galia Maor ceased to serve as President and Chief Executive Officer of the Bank, and the period of early notice came to effect in May 2012 for 9 months without actually working. On 31 January 2013, the early period notice came to an end and employee-employer relations between her and the Bank were terminated. For further details regarding the terms of the personal employment agreement with Ms. Maor, see Note 15(B)(3)(b). The monthly salary of Ms. Maor was raised by 3.7% with effect from 1 Jan 2012- see further details in paragraph 13 below.
Ms. Maor continues to serve as a director and as chairman of the board of directors in Leumi Private Bank S.A. (Leumi Switzerland), and with effect from 1 February 2013, Ms. Maor is entitled to remuneration in respect of this office amounting to CHF 8,333 per monthly and CHF 1,500 per meeting, plus a refund of expenses as is customary in Leumi Switzerland.

8. Senior employees of the Bank have special personal employment contracts with the Bank. For further details regarding the retirement conditions of senior officers, and entitlement to notice on terminating employment, see Note 15(B)(3)(c) to the Financial Statements. For explanations regarding the annual bonus to senior employees pursuant to the Bank's bonus plan to 2012 (inclusive), see Note 9 below.
The amount of the maximum additional expense to the Bank, if the employment of all of the above employees were immediately terminated, would amount to NIS 364 million (in 2011 – NIS 355 million). These amounts are before tax and include salary tax on the pension obligation. Since it is unlikely that all the said employees will be dismissed immediately, a global provision of 25% of the above sum has been made, in the amount of NIS 110 million (in 2011 - NIS 90 million). These sums also relate to members of Management (with a full provision existing in regard to the CEO).

Following the amendment of the personal contracts of the members of Management, as set forth in Note 15(B)(3)(c) to the Financial Statements, a specific attribution out of the said provision was made for members of management, the balance of which amounted to NIS 12 million as of 31 December 2012; in 2011 – NIS 14 million.

9. The bonus plan for the Bank's senior officers (the Chairman of the Board of Directors, the President and Chief Executive Officer and the other members of Bank management) as detailed in Note 15G to the financial statements ended on 31 December 2012. In respect of 2012, negative bonuses were recorded to the debit of the senior officers in the Bank, and pursuant to the provisions of the bonus plan, the negative bonuses is offset against the balance of the deferred positive bonus payment to which the senior officers are entitled in respect of previous years. The remuneration of senior officers in the Bank in respect of 2013 and thereafter will be effected in accordance with remuneration policies and a remuneration plan which will be presented for discussion and for the approval of the authorized entities in the Bank, pursuant to provisions of Amendment 20 to the Companies Law.

The Chairman of the Board of Directors, the President and CEO, and the members of the Bank management were not awarded bonuses for 2011. The data in this section refer to adjustments of the bonuses for 2010.

10. Mr. Amnon Zaidenberg serves as CEO of Bank Leumi (Switzerland) Ltd. ("**Leumi Switzerland**"), a wholly-owned subsidiary of the Bank, with effect from January 2008. According to the contract of employment between the parties, each party is entitled to terminate this agreement at any time with six months notice. On the termination of employment of Mr. Zaidenberg, due to resignation or dismissal, he will be entitled to all of the monies accrued in the pension fund being maintained for him.

The decision to grant a bonus to Mr. Zaidenberg, as stated in the table above, was approved in the Board of Directors of Leumi Switzerland on 20 February 2013, after receiving the recommendation of the company's salary and remuneration committee. Leumi Switzerland's decision to grant Mr. Zaidenberg a bonus was made further to and in accordance with the remuneration policy of the Leumi Group to Chief Executive Officers in Overseas Subsidiaries and this was accepted, *inter alia*, in light of his central role in leading and managing the merger and acquisition of Banque Safdié with Leumi Switzerland.

11. Mr. Itzhak Eyal serves as Chief Executive Officer of Bank Leumi (USA) ("**Leumi USA**"), a fully owned and controlled subsidiary of the Bank, since 1 October 2010. Mr. Eyal's salary, as set forth in the table above, was determined in accordance with generally accepted practice for the salary of chief executive officers in banks of similar size and activity in the United States. Mr. Eyal's salary also includes additional expenses of the Chief Executive Officer's rent in the United States. The decision to grant Mr. Eyal a bonus as stated in the table above was approved by the Board of Directors of Leumi USA on 28 February 2013. Leumi's decision to grant Mr. Eyal a bonus was made further to and in accordance with the remuneration policy of the Leumi Group to Chief Executive Officers in Overseas Subsidiaries and this was accepted, *inter alia*, against the background of the substantial improvement in the operating results achieved by Leumi USA in 2012 and in light of the improvement in the credit portfolio of Leumi USA, and as a result of implementing the strategic program approved by the Bank.

For details regarding the terms of retirement of the senior officers in the Bank, including Mr. Eyal and his entitlement to advance notice on terminating his employment, see Note 15(B)(3)(c) to the financial statements.

12. Mr. Yehoshua Borstein acted as chief executive officer of Leumi Mortgage Bank, a subsidiary of the Bank, which was merged with the Bank on 31 December 2012. Mr. Borstein acted as CEO from19 March 2008 to 31 December 2012. Mr. Borstein's salary as set forth in the above table was as is customary with chief executive officers of the Bank's subsidiaries. On 15 March 2013, Mr. Borstein retired from the Bank and the employee-employer relations between him and the Bank was terminated. On the termination of his employment with the Bank, Mr. Borstein was entitled to a payment in respect of six months' early notice and in respect of immediate departure from the Bank

13. On 28 March 2012, after receiving the approval of the Audit Committee and after accepting the recommendation of the Executive Committee of the Board of Directors, the Board of Directors approved raising the monthly salary of the Chairman of the Board of Directors (the General Meeting of the Bank gave its approval on 1 August 2012), President and CEO, and Ms. Maor by 3.7%, with effect from 1 January 2012. In addition, after the approval of the Audit Committee and accepting the recommendation of the Executive Committee, the Board of Directors approved various increases in the salary of members of Bank management. Background information relating to the salary of senior officers in the Bank from 2005 until that date, were presented to the Board, showing the amount of change in salaries in the Bank, by group of employees, from 2005 until that date, costs to the Bank in respect of salary adjustments, and data relating to the costs of the five highest paid employees of other banks.\

14. Ms. Tamar Yassur serves as Head of Banking with effect from 1 January 2013. Until 15 October 2012, Ms. Yassur acted as chief executive officer of Leumi Card Ltd., a subsidiary of the Bank. Ms. Yassur's salary, as set forth in the table above, was determined as is customary for the salary of chief executive officers in the Bank's subsidiaries. For details regarding the retirement conditions of senior officers in the Bank, including Ms. Yassur and her entitlement to early notice on leaving, see Note 15(B)(3)(c) to the financial statements.
The decision to grant Ms. Yassur a bonus as stated in the table above, in respect of her term of office as chief executive officer of Leumi Card Ltd., in respect of 2011 and 2012 was approved in the audit committee of Leumi Card on 20 February 2013 and in the board of directors of Leumi Card on February 2013. In addition, the bonus was approved in the Remuneration Committee and in the Board of Directors of Leumi. The bonus was granted to Ms. Yassur against the backdrop of an improvement of Leumi Card's results, an expansion of products offered to customers, in a period of increasing competition and a lowering of cross-commissions.

15. Loans granted under usual conditions to all employees of the Bank, and their amounts were determined according to uniform criteria.

16. Directors and other officers have been insured by the Bank under directors' and other officers' liability insurance policies covering the Bank and its investee companies. The relative insurance premium paid is not included in the above tables, as it is insignificant. The total premium amounted to NIS 2,901 thousand and relates to all officers in the insured group.

17. The Board of Directors believes, having held discussions, received explanations and appropriate and relevant background material, and having examined the remuneration, taking into account the activities of the Bank and the Group and their results in 2011, and after noting the performance and activity of each senior officer mentioned above, that the payments to senior officers, as set out in the table and the explanations above, represent fair and reasonable compensation under the circumstances.

For further details see Note 15 to the Financial Statements.

2011

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	Share-based payment	Value of the benefit	Total *	Balance as at 31 December 2011	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
		%	NIS thousands									
Mr. David Brodet	Chairman of the Board of Directors	**0.001**	**2,007**	**-**	**929**	**20**	**160**	**3,116**	**-**	**-**	**-**	**-**
Ms. Galia Maor	President and Chief Executive Officer	**0.021**	**2,922**	**(26)**	**2,975**	**27**	**138**	**6,036**	**175**	**3.42**	**5**	**-**
Mr. Itzhak Eyal	Chief Executive Officer, Bank Leumi USA	**0.002**	**1,528**	**1,204**	**143**	**10**	**753**	**3,638**	**151**	**2.48**	**4**	**-**
Mr. Amnon Zaidenberg	Chief Executive Officer, Bank Leumi (Switzerland)	**-**	**1,795**	**914**	**207**	**-**	**374**	**3,290**	**-**	**-**	**-**	**-**
Mr. Ofer Grinbaum	Chief Executive Officer, Leumi Partners Underwriting	**-**	**556**	**2,092**	**175**	**-**	**28**	**2,851**	**-**	**-**	**-**	**-**
Mr. Gideon Altman	First Executive Vice President, Head of Commercial Banking Division	**0.001**	**1,185**	**(6)**	**1,410**	**11**	**120**	**2,720**	**39**	**1.80**	**1**	**327**
Mr. Menachem Schwartz	First Executive Vice President, Chief Accounting Officer, Head of Accounting Division	**0.006**	**1,165**	**(6)**	**1,445**	**11**	**101**	**2,716**	**128**	**4.73**	**4**	**-**
Mr. Zvi Itskovitch	First Executive Vice President, Head of International and Private Banking Division	**0.000**	**1,391**	**(6)**	**1,125**	**13**	**127**	**2,650**	**276**	**5.29**	**8**	**128**

* Excluding salary tax.

Auditors' Fees (1)(2)(3)

	Consolidated		Bank	
	2012	2011	**2012**	2011
	NIS thousands			
For auditing activity: (4)				
Joint auditors	**30,742**	29,315	**12,898**	12,646
Other auditors	**4,499**	3,080	**254**	294
Total	**35,241**	32,395	**13,152**	12,940
For audit related services: (6)				
Joint auditors	**355**	450	**27**	23
Other auditors	**406**	727	**-**	-
For tax services: (5)				
Joint auditors	**1,836**	1,977	**504**	510
Other auditors	**502**	600	**-**	-
For other services:				
Joint auditors	**3,860**	4,011	**3,054**	2,394
Other auditors	**474**	6,528	**-**	5,771
Total	**7,433**	14,293	**3,585**	8,698
Total auditors' fees	**42,674**	46,688	**16,737**	21,638
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 continuous tax auditing.

(6) Audit related fees, mainly include: prospectuses, special certificates, comfort letters, tax consultancy, 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

Pursuant to Proper Conduct of Banking Business Directive No. 301 of the Supervisor of Banks, at least one-third of the members of the Board of Directors shall be external directors who meet the eligibility requirements of an external director as defined in Proper Conduct of Banking Business Regulation 301.

Accordingly, eight directors who are classified as external directors serve on the Board of Directors, three of whom are external directors pursuant to the provisions of the Companies Law, 1999 ("external directors pursuant to the provisions of the Companies Law").

In addition, in light of the definition of an "independent director" in the Companies Law, the Audit Committee of the Board of Directors confirmed that the external directors pursuant to Proper Conduct of Banking Business Directive No. 301 of the Banking Supervision Department and the external directors pursuant to the provisions of the Companies Law are independent directors.

Pursuant to the provisions of the Companies Law and its Regulations, the Board of Directors of the Bank has resolved that, a minimum number of three directors with "accounting and financial expertise", will serve on the Board of Directors of the Bank at all times, so as to allow the Board of Directors to comply with the requirements imposed upon it by law and the documents of incorporation, 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 law.

At least three 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. Until 31 December 2012, prior to discussion and approval of the financial statements in the plenum of the Board of Directors, the draft financial statements and matters relating to them are discussed in the Financial Statements Review Committee. From 1 January 2013, and pursuant to Proper Conduct of Banking Business Regulation no. 301 of the Supervisor of Banks, the Financial Statements Review Committee ceased to function, and discussions held in the Financial Statements Review Committee are now held in the Audit Committee of the Board of Directors.

There are currently 15 directors serving on the Board of Directors, the legal quorum for its discussions being eight directors, one-third of whom are external directors.

In addition, pursuant to the directives of the Bank of Israel, the Board of Directors has determined that at least two "directors with accounting and financial expertise" will serve on the Audit Committee of the Board of Directors at all times.

The legal quorum for discussion and the approval of resolutions in the Audit Committee will be a majority of the members of the committee, providing that a majority of those present are external directors who are also independent, and at least one of them is an external director pursuant to the provisions of the Companies Law. Seven directors currently serve on the Audit Committee - five members of the Audit Committee are external directors, of which three directors are external directors pursuant to the provisions of the Companies Law.

Most of the directors serving on the Board of Directors comply with the definition of a director with accounting and financial expertise. All the directors serving on the Audit Committee comply with the aforementioned definition.

See the Bank's website (www.leumi.co.il) for further details about the committees of the Board of Directors and their composition.

Name of Director	Main employment and positions in the Leumi Group and other entities	Additional facts that qualify the Director as having accounting and financial expertise
David Brodet – Jerusalem	Chairman of the Board of Directors – Bank Leumi Le-Israel B.M. and Bank Leumi USA. Owner of David Brodet Ltd. (in suspension), Chairman of the Executive Committee of the Jerusalem Foundation and the Hadassah Academic College Member of the Managing Committee of the Jerusalem Institute for Israel Studies and of the Cameri Theater. Chairman of the Board of Trustees of the Fund for Treatment of Sheltered Persons. Lecturer at the National Security College (Haifa University) and President of the Union of Banks in Israel (R.A.)	Chairman of the Board of Directors of the Bank since August 2010. B.A. in Economics and Political Science and M.A. in Economics, The Hebrew University of Jerusalem. VP Finance of Israel Aircraft Industries 1987-1991 Budgets Director in the Ministry of Finance 1991-1994 Director-General, Ministry of Finance 1995-1997 Served as Chairman of the Board of Directors of Mizrahi Bank and Tefahot Bank, and as Chairman of Karnit Government Insurance Corporation. Served as Director of Public Companies and as a Member of Finance and Financial Statements Committees of various Boards of Directors.
David Avner (1) - Nofit	Chief Executive Officer and Owner of N.S.Y. Avner Ltd.	B.A. in Mathematics and Philosophy, Haifa University, and M.B.A, Haifa Technion, CEO and Deputy CFO in Partner Communication Ltd., a public company traded on the Tel Aviv Stock Exchange, 2005-2010. As part of his function as CEO of the company, he was heavily involved in the process of preparing financial statements.
Rami Avraham Guzman * – Tel Aviv	Director in organizations and associations, Consultant to veteran and start-up companies. Owner, CEO and director and shareholder of Rami Guzman Initiatives and Consulting Ltd. Director in the academic stream of the College for Management founded by the Tel Aviv Clerks Organization Public Benefit Company Ltd., and Ampa Capital Ltd., Tower Semiconductor Ltd., and Gmul Investment Company. Member of Investment Committee, Israel Infrastructure Fund 1-A, L.P., Israel Infrastructure Fund 1-B, L.P. and Israel Infrastructure Fund 1-C, L.P. President of the Association of Beit Zvi – School for Performing Arts. Member of Exposure Committee, B.S.S.CH. – The Israeli Credit Insurance Company Ltd. Chairman of the Executive Committee of the Zeev Gorodetsky Scholarship Fund and Member of the Executive Committee and Chairman of the Finance Committee in the Israel-America Chamber of Commerce	B.A. in Economics and Politics and M.B.A in Public Administration and Philosophy, The Hebrew University of Jerusalem. Member of Research Team, Computer Systems Management, Stanford University and Stanford Research Institute. Held various economic positions in the Ministry of Finance, 1962-1969, 1971-1977. CFO in Electrochemical Industries and Frutarom, 1977-1982. CFO of Analyst 1982-1983, CEO of Dikla Holdings, 1983-1985, CFO in Motorola Communications and Motorola Israel, 1985-2004, Vice-President Motorola Income., 2001-2005, Director in Leumi, 2005-2011, Chairman of the board of directors and director in various companies.
Prof. Arieh Gans * (1)(2) - Ramat Gan	Professor of Accounting, Tel Aviv University and Company Director. Director and Member of Finance and Audit Committee, Middle East Tubes Company Ltd. Member of Professional Committee in the Israeli Accounting Standards Board	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 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.

Name of Director	Main employment and positions in the Leumi Group and other entities	Additional facts that qualify the Director as having accounting and financial expertise
Moshe Dovrat – Tel Aviv	Company Director. CEO, Director and Owner of Beit Meniv Funding Ltd. and Dovrat (M.H.) Investments and Business Initiatives Ltd. Director and Shareholder in Beit Meniv Israel Ltd. and Theracoat Ltd. Chairman of the Board of Directors of Kibbutz Kfar Blum Tourism. Member of Management of Kfar Blum Holdings – Agricultural Cooperative Society Ltd. Member of Executive Committee of the Ra'anana Symphonette Orchestra.. Member of the Economic Assembly and one of the founders of the Macro Center for Political Economics and Sustainable Eco-Tourism in Israel, Member of the General Assembly of the Ramat Gan College and the Academic Israel College in Ramat Gan, Member of the Public Council of the Batsheva Dance Company. Member of the Finance Committee for the Council for a Beautiful Israel.	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 positions as an economist 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.
Yehuda Drori – Tel Aviv	Company Director and Consultant on capital market issues to various bodies. Deputy Chairman of the Committee for Members' Investments in Harel Insurance Co. Ltd.	B.A. in Economics and History and M.B.A. (Finance), The Hebrew University of Jerusalem. Held various positions in the Ministry of Finance, 1968-1987, including Commissioner of the Capital Market, Savings and Insurance. Chairman of the Executive Board of Directors of Poalim Capital Markets 1988-1994. Served as Director of U-Bank of the First International Bank Group. In this position served as Chairman of the Financial Statements and Audit Committees, and as a Member of the Credit and Risk Management Committees. Served as Director in several companies, some of which as Member or Chairman of the Audit and Financial Statements Committees. Member and Chairman of investments committees in institutional entities. Consultant to various entities on capital market issues.
Doron Cohen (1) – Re'ut	CEO, Co-Op Blue Square Services Cooperative Ltd .(in liquidation) Owner and Director, Trigger D.C. Ltd. and Trigger D.C. Holdings Ltd. and in Gamma Capital Ltd. Director, Harel Insurance Investments & Financial Services Ltd. and in the Consumer Cooperation Fund Ltd. Observer in the Nostro Investments Committee in Harel Insurance Co. Ltd. Member of the Council of Leumit Health Fund,	B.A. in Economics and Business Administration and M.B.A. (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. CEO of Co-Op Blue Square Services Cooperative Ltd. since 2000 (in liquidation). Director, Harel Insurance Investments & Financial Services Ltd since 2006 and member of the balance sheet committees. Observer in the Nostro Investments Committee of Harel Insurance Co. Ltd in 2010. Director of Mercantile Discount Bank Ltd., 2000-2006. Director of various companies. Economic and Financial Consultant

Name of Director	Main employment and positions in the Leumi Group and other entities	Additional facts that qualify the Director as having accounting and financial expertise
Adv. Miriyam (Miri) Katz (2) – Tel Aviv	Attorney, Management and Company Director. Shareholder and CEO, Miri Katz Projects Ltd. External Director, Itamar Medical Ltd. CEO, Ima fund, (registered association). Member of the Board of Trustees of the Hebrew University in Jerusalem, and the Technion Israel Technological Institute.	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
Yoav Nardi (1) (2) – Ramat Gan	Company Manager and Business Consultant. Director and Owner of Nardi Consultants and Risk Management Ltd. Chairman of Investments Committee of the National Library Ltd. and Yad Sarah (R.A.)	B.A. in Economics and M.B.A. (Finance), The Hebrew University in Jerusalem. Has wealth of diverse banking experience in the fields of credit, financial markets and asset and liability management. Served in a wide range of positions in the Banking Supervision Department of the Bank of Israel, and as a Chief Economist at the First International Bank. Served as Member of Management and Deputy President and Chief Executive Officer of the Jerusalem Bank and involved on an ongoing basis in monitoring the preparation of the Financial Statements of Bank Jerusalem, including the Directors Report.
Haim Samet + * (2) – Ramat Hasharon	Joint Senior Partner in law firm: Schnitzer, Gottlieb Samet & Co., and Director in Teko Mushroom Farm Ltd, T.Y.D. Trustees (1991) Ltd., H./Y.D. Services Ltd., H.Y.D. Properties Ltd., Keren Yaar Investments Ltd., H.Y.D.A. Holdings Ltd. Samet Attorneys, Director and Deputy Chairman in Tel Aviv Museum of the Arts Ltd., Member of trustee body and Chairman of the audit committee in Tel Aviv University	B.A. in Law, The Hebrew University in Jerusalem. Director in Bank Leumi. Served as member of the Credit and Audit Committee of the Bank, 1995-2000. Director in Bank Hapoalim, where he served as a member of various committees, including its credit committee, audit committee, businesses and budget committee, review of expenditure and streamlining committee and remuneration committee, 2000-2008.
Zipporah Samet + * (1) (2) – Jerusalem	Owner, Chairman of the Board of Directors and CEO in Merav Yaniv Financial Consulting Ltd. Chairman and shareholder in Bio-Plasmar Ltd. External Director in Shahar Hadash Group Ltd. in Africa Israel Investments Ltd.	B.A. in Economics and Mathematics and MBA (Economics), Hebrew University in Jerusalem. Senior Economist in the Bank Research Unit in the Bank of Israel, Head of Pricing Monitoring and Control Team, 1983-1995. Senior Deputy to the Supervisor of Capital Markets, Insurance and Saving in the Finance Ministry, 1995-1998 Supervisor of Capital Markets, Insurance and Saving in the Finance Ministry, 1998-2002. External Director in Israel Discount Bank Ltd., including term as Chairman of the Audit Committee, 2003-2009.

Name of Director	Main employment and positions in the Leumi Group and other entities	Additional facts that qualify the Director as having accounting and financial expertise
Amos Sapir * (1) – Tel Aviv	Member of board of directors of companies and non-profit associations. Director and owner in Sixace Management Co. Ltd (1997) Ltd., and Sixace Holdings Ltd. Chairman of the Board of Directors of N. Feldman & Son Ltd., External Director in Hot Communication Systems Ltd, and A. Dori Group Ltd, Director in Log Plastic Products (1993) Ltd. and Mifal HaPayis Pinhas Sapir Fund, in Israel Management 1 Infrastructures Ltd. and Israel Management 2 Infrastructures Ltd., Chairman of the Board of Trustees in the Pinhas Sapir Development Center, Member of Board of Trustees in Tel Aviv University and Bezalel Art and Design Academy, Jerusalem, Member of the Executive Committee in the Academic College of Tel-Aviv-Yafo, and in the Shoshana and Pinhas Sapir Fund, Chairman of the Executive Committee in Leadership Jump-Start and Excellence in Employment for Ethiopian Academics, Member on Public Council – Midot – Reflection and Rating of Non-Profit Associations Ltd. (Halatz), Member of Council in Educational Technology Center.	B.A. in Social Sciences (Economics and International Relations), Hebrew University in Jerusalem. MBA (Finance) and Doctoral Studies (specializing in Banking Finance), University of Columbia, New York. Economist and Investment Company Manager, Israel Industrial Development Bank Ltd. 1967-1968. Economist, Clal (Israel) Ltd. 1968-1969, CEO – Member of Founders' Group and Shareholders in Technologies, Tadeh Technology Development and Automation Ltd, 1969-1973. Assistant to CEO – in charge of establishment team of new investment company owned by European investors, International Israel Development Company Ltd. 1974-1975. Executive Deputy Chairman of the Board of Directors and representative of the shareholders, Israeli Food Produce Ltd., 1975-1978. CEO – in charge of establishment of television plant, Talanit Ltd., 1978-1979. Finance Officer, VP Finance and Administration, Assistant to the CEO and CEO of Clal Real Estate Investments Ltd., Assistant to the CEO, Head of Staff, Chairman of the Board of Directors of A.B.N. Health and Leisure Sites Ltd. (Tourist Division of Clal Group). From 1/96, CEO of Clal Capital Markets and in charge of the Group's capital market activity, Member of many directorial boards of companies in the Clal Israel Ltd., Clal (Israel) Ltd. 4/1980-5/1997 Chairman of the Board of Directors, Maalot, The Israel Securities Rating Company Ltd. 11/1999-1/2008. Chairman of the Board of Directors, Standard and Poor's Maalot Ltd. 1/2008-10/2009. Chairman of the Board of Directors, N. Feldman & Son Ltd. 1/2003-to date. Director (Chairman of the Board of Directors from January 2011), Ishal Amlat Investment (1993) Ltd. 12/2001-to date. External Director, Hot Communication Systems Ltd, 6/2007-to date External Director, Log Plastic Products Ltd, 11/2007-to date. External Director, A. Dori Group Ltd., 12/2010-to date.

Name of Director	Main employment and positions in the Leumi Group and other entities	Additional facts that qualify the Director as having accounting and financial expertise
Prof. Efraim Sadka * (1) (2) – Tel Aviv	Professor of Economics and Holder of the Henry Kaufman Chair of International Capital Markets, Tel Aviv University. Economic Consultant, Company Director, and Executive Member of voluntary associations. Chairman of the Babylonian Jewry Heritage Center. Owner and Director of A.Z. Eretz Ratz Ltd. External Director of Paz Oil Co. Ltd. Chairman of the Executive Board, The Pinhas Sapir Center for Development, Tel Aviv University. Chairman of the Advisory Committee 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 Steering Committee for Establishing a Medical School in Zefat and the Practical Research Institute in the Eastern Galil, Member of the Professional Committee of the Israel Accounting Standards Board. Editor, The Economic Quarterly. periodical of the Israel Economic Association, Sub-editor in international professional periodicals, Chairman of the Committee to Review Parameters for the actuarial reporting of the National Insurance Institute, Director in Atidim Ltd.	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.
Prof. Yedidya Stern * Jerusalem	Professor of Law in Bar-Ilan University, Deputy President for Research in Israeli Democracy Institute.	
Prof. Gavriella Shalev + (2) – Even Yehuda	President of the Senior Academic Council and Senior Lecturer in the Ono Academic College. Shareholder in Din Publishing, Management and Services Ltd.	B.A. in Law, The Hebrew University of Jerusalem, M.A. in Law, The Hebrew University of Jerusalem, Doctor of Law, The Hebrew University of Jerusalem. Served for lengthy periods on Boards of Directors of public companies and banks. In some of these companies, served as external director. Served as Director and Head of Audit Committee in Bank Hapoalim.

* External Director pursuant to Proper Conduct of Banking Business Directive No. 301 of the Banking Supervision Department.

\+ External Director pursuant to the provisions of the Companies Law.

(1) Until 31 December, member of the Financial Statements Review Committee

(2) Member of the Audit Committee

Board of Directors

During 2012 and until the publication of the Report, the following changes took place in the composition of the Board of Directors:

Pursuant to Bank's regulations, at the Annual General Meeting of the Bank, four directors, Mr. Reuven Adler (external director), Ms. Zipora Gal-Yam, Professor Arieh Gans and Professor Efraim Sadka, retired by rotation.

On 1 August 2012, the Annual General Meeting of the Bank was held, at which the incumbent directors, Professor Arieh Gans, Professor Efraim Sadka, Mr./ Rami Avraham Guzman and Professor Yidiya Stern were elected or re-elected for a three-year period, all of them as external directors pursuant to Regulation no. 301 of the Supervisor of Banks.

In addition, Haim Samet, Adv was elected as an external director pursuant to Section 239 of the Companies Law, 1999, for a three-year period.

The Supervisor of Banks confirmed the absence of any objection to the terms of office of the directors elected at the said Annual General Meeting.

The Board of Directors expressed its thanks to Mr. Reuven Adler and Ms. Zipora Gal-Yam who made a significant contribution to promoting and furthering the Bank's business. For further information, see Annual General Meeting and Appointment of Directors, in the Chapter "Control in the Bank" above.

At the Meeting of the Board of Directors that took place on 20 March 2013, it was decided to approve and publish the audited consolidated financial statements of the Group as at 31 December 2011 and for the period ended on that date.

During 2012, the Board of Directors held 44 plenary meetings and 157 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.

David Brodet
Chairman of the Board of Directors

Rakefet Russak-Aminoach
President and Chief Executive Officer

20 March 2013

Below are tables of detailed financial information by subjects, segments and periods:

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Balance Sheets as at end of years 2008-2012

Exhibit A:

	31 December				
	2012	2011	2010	2009	2008
	NIS millions				
Assets					
Cash and deposits with banks	**54,621**	53,044	30,052	42,933	33,130
Securities	**56,408**	47,936	55,791	57,505	44,910
Securities borrowed or purchased under agreements to resell	**1,435**	1,225	1,190	744	201
Credit to the public	**245,378**	245,287	234,255	215,067	222,703
Allowance for credit losses	**(4,114)**	(3,967)	(10,274)	(10,398)	(9,488)
Credit to the public, net	**241,264**	241,320	223,981	204,669	213,215
Credit to governments	**442**	448	379	407	520
Investments in companies included on equity basis	**2,129**	2,270	1,924	2,178	1,842
Buildings and equipment	**3,705**	3,653	3,638	3,553	3,445
Intangible assets and goodwill	**189**	181	45	125	142
Assets in respect of derivative instruments	**11,438**	11,573	8,717	6,440	10,047
Other assets	**4,529**	4,204	2,605	3,356	3,556
Total assets	**376,160**	365,854	328,322	321,910	311,008
Liabilities and equity					
Deposits of the public	**289,538**	279,404	249,584	250,418	244,783
Deposits from banks	**4,073**	5,056	2,691	3,785	3,742
Deposits from governments	**451**	519	660	712	831
Securities lent or sold under repurchase agreements	**1,007**	442	1,006	273	549
Debentures, bonds and subordinated notes	**27,525**	29,999	26,939	25,261	20,636
Liabilities in respect of derivative instruments	**12,762**	12,069	9,985	7,559	10,513
Other liabilities	**15,576**	14,737	13,846	12,088	11,442
Total liabilities	**350,932**	342,226	304,711	300,096	292,496
Non-controlling interests	**307**	254	318	282	245
Equity attributable to shareholders of the banking corporation	**24,921**	23,374	23,293	21,532	18,267
Total equity	**25,228**	23,628	23,611	21,814	18,512
Total liabilities and equity	**376,160**	365,854	328,322	321,910	311,008

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statements of Profit and Loss for the years 2008-2012

Exhibit B:

	For the year ended 31 December				
	2012	2011 (a)	2010 (a)	2009 (a)	2008 (a)
	NIS millions				
Interest income	**13,507**	14,283	12,489	11,788	18,443
Interest expenses	**6,099**	7,176	5,517	5,277	11,077
Net interest income	**7,408**	7,107	6,972	6,511	7,366
Expenses in respect of credit losses	**1,236**	734	584	1,521	2,145
Net interest income after expenses in respect of credit losses	**6,172**	6,373	6,388	4,990	5,221
Non-interest income					
Non-interest financing income	**444**	11	475	867	(2,259)
Commissions	**4,199**	4,116	4,129	3,890	3,881
Other income	**131**	48	163	350	442
Total non-interest income	**4,774**	4,175	4,767	5,107	2,064
Operating and other expenses					
Salaries and related expenses	**5,290**	5,061	4,686	3,896	4,118
Building and equipment maintenance and depreciation	**1,819**	1,704	1,591	1,514	1,397
Amortization of intangible assets	**23**	2	80	21	17
Other expenses	**1,968**	1,574	1,604	1,350	1,471
Total operating and other expenses	**9,100**	8,341	7,961	6,781	7,003
Profit before taxes	**1,846**	2,207	3,194	3,316	282
Provision for taxes on profit	**811**	418	1,241	1,272	421
Profit after taxes	**1,035**	1,789	1,953	2,044	(139)
Banking corporation's share in profits of companies included on equity basis after tax	**(67)**	148	420	81	249
Net profit:	**968**	1,937	2,373	2,125	110
Before attributing to non-controlling interests	**968**	1,937	2,373	2,125	110
Attributable to non-controlling interests	**(37)**	(46)	(39)	(36)	(18)
Attributable to shareholders of the banking corporation	**931**	1,891	2,334	2,089	92

(a) Reclassified

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statements of Profit and Loss for the years 2008-2012 (cont'd)

Exhibit B (cont'd):

	For the year ended 31 December				
	2012	2011(a)	2010(a)	2009 (a)	2008 (a)
Earnings per share					
Basic and diluted earnings per share:	NIS				
Net profit attributable to shareholders of the banking corporation	**0.63**	1.28	1.58	1.42	0.06

(a) Reclassified

Bank Leumi le-Israel B.M. and its Consolidated Companies
Rates of Financing Income and Expenses (on Consolidated Basis) (a)

Exhibit C:

	2012				2011			
			Rate of income (expense)				Rate of income (expense)	
	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)
	NIS millions		(%)		NIS millions		(%)	
Israeli currency - unlinked								
Assets (c) (d)	191,128	7,980	4.18		173,811	8,007	4.61	
Effect of embedded and ALM derivatives (e)	60,863	9			69,873	664		
Total assets	251,991	7,989		3.17	243,684	8,671		3.56
Liabilities (d)	155,955	(2,835)	(1.82)		143,550	(3,050)	(2.12)	
Effect of embedded and ALM derivatives (e)	74,849	(389)			76,226	(790)		
Total liabilities	230,804	(3,224)		(1.40)	219,776	(3,840)		(1.75)
Interest margin			2.36	1.77			2.49	1.81
Israeli currency - linked to the CPI								
Assets (c) (d)	62,038	3,181	5.13		60,571	3,669	6.06	
Effect of embedded and ALM derivatives (e)	4,931	122			3,447	144		
Total assets	66,969	3,303		4.93	64,018	3,813		5.96
Liabilities (d)	49,874	(2,424)	(4.86)		48,101	(2,994)	(6.22)	
Effect of embedded and ALM derivatives (e)	10,449	(206)			11,267	(236)		
Total liabilities	60,323	(2,630)		(4.36)	59,368	(3,230)		(5.44)
Interest margin			0.27	0.57			(0.16)	0.52
Foreign currency:								
(including Israel currency - linked to foreign currency)								
Assets (c) (d)	86,987	1,446	1.66		83,057	8,200	9.87	
Effect of derivatives (e):								
Hedging derivatives	160	(2)			350	(3)		
Embedded and ALM derivatives	143,560	(1,596)			149,312	8,781		
Total assets	230,707	(152)		(0.07)	232,719	16,978		7.30
Liabilities (d)	109,994	659	0.60		101,226	(8,300)	(8.20)	
Effect of derivatives (e):								
Hedging derivatives	373	-			415	1		
Embedded and ALM derivatives	123,582	1,297			136,096	(7,655)		
Total liabilities	233,949	1,956		0.84	237,737	(15,954)		(6.71)
Interest margin			2.26	0.77			1.67	0.59

See notes on page 292 below.
Note - Full details of the rates of 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)

Exhibit C (cont'd):

	2012				2011			
			Rate of income (expense)				Rate of income (expense)	
	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)
	NIS millions		(%)		NIS millions		(%)	
Total:								
Monetary assets generating income (d) (f)	340,153	12,607	3.71		317,439	19,876	6.26	
Effect of derivatives (e):								
Hedging derivatives	160	(2)			350	(3)		
Embedded and ALM derivatives	209,354	(1,465)			222,632	9,589		
Total assets	549,667	11,140		2.03	540,421	29,462		5.45
Monetary liabilities generating financing expenses (d)	315,823	(4,600)	(1.46)		292,877	(14,344)	(4.90)	
Effect of derivatives (e):								
Hedging derivatives	373	-			415	1		
Embedded and ALM derivatives	208,880	702			223,589	(8,681)		
Total liabilities	525,076	(3,898)		(0.74)	516,881	(23,024)		(4.45)
Interest margin			2.25	1.29			1.36	1.00
In respect of options		74				147		
In respect of other derivatives (excluding options, hedging derivative instruments, ALM derivative and embedded derivatives which have been separated (e))		10				7		
Financing commissions and other financing income (g)		425				958		
Net interest income before expenses in respect of credit losses		7,751				7,550		
Expenses in respect of credit losses		(1,236)				(734)		
Net interest income after expenses in respect of credit losses		6,515				6,816		
Total:								
Monetary assets generating interest income (d) (f)	340,153				317,439			
Assets derived from derivative instruments (h)	10,961				8,861			
Other monetary assets (d)	6,319				4,644			
Allowance in respect of credit losses	(4,415)				(4,951)			
Total monetary assets	353,018				325,993			
Total:								
Monetary liabilities generating financing expenses (d)	315,823				292,877			
Liabilities derived from derivative instruments (h)	11,601				10,264			
Other monetary liabilities (d)	9,486				8,616			
Total monetary liabilities	336,910				311,757			
Total excess of monetary assets over monetary liabilities	16,108				14,236			
Non-monetary assets	9,036				9,683			
Non-monetary liabilities	685				1,061			
Total capital resources	24,459				22,858			

See notes on page 292 below.

Note - Full details of the rates of 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)

Exhibit C (cont'd):

Notes:

(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 consolidated companies, 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 107 million (31 December 2011 – NIS (93) million)

In the index-linked Israeli currency sector – the amount of NIS 73 million (31 December 2011 – NIS 103 million)

In the foreign currency sector (including Israeli currency linked to foreign currency) – the amount of NIS (23) million (31 December 2011 – NIS (142) 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) From the average balance of the assets has been deducted (added to) the balance of unrealized profits (losses) from adjustments to fair value of debentures held for trading and available for sale, in the amount of NIS 157 million in the various sectors (31 December 2011 – NIS (132) 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-sheet 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):

	2012				2011			
			Rate of income (expense)				Rate of income (expense)	
	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)
	$ millions		(%)		$ millions		(%)	
Foreign currency: Local activity (including Israel currency linked to foreign currency)								
Assets (c) (d)	12,343	301	2.44		14,049	364	2.59	
Effect of derivatives(e):								
Hedging derivatives	42	(1)			98	(1)		
Embedded and ALM derivatives	37,240	56			41,790	34		
Total assets	49,625	356		0.72	55,937	397		0.71
Liabilities (d)	19,572	(147)	(0.75)		20,134	(200)	(0.99)	
Effect of derivatives(e):								
Hedging derivatives	96	-			116	-		
Embedded and ALM derivatives	31,500	(12)			37,853	(62)		
Total liabilities	51,168	(159)		(0.31)	58,103	(262)		(0.45)
Interest margin			1.69	0.41			1.60	0.26
Foreign currency: Foreign activity (integrated operations)								
Assets (c) (d)	10,249	235	2.29		9,315	224	2.40	
Effect of embedded derivatives and ALM (e)	49	16			62	22		
Total assets	10,298	251		2.44	9,377	246		2.62
Liabilities (d)	9,004	(51)	(0.57)		8,326	(54)	(0.65)	
Effect of embedded derivatives and ALM (e)	609	(9)			304	(13)		
Total liabilities	9,613	(60)		(0.62)	8,630	(67)		(0.78)
Interest margin			1.72	1.82			1.75	1.84
Total:								
Monetary assets in foreign currency generating financing income (c) (d)	22,592	536	2.37		23,364	588	2.52	
Effect of derivatives (e):								
Hedging derivatives	42	(1)			98	(1)		
Embedded and ALM derivatives	37,289	72			41,852	56		
Total assets	59,923	607		1.01	65,314	643		0.98
Monetary liabilities in foreign currency generating financing expense (d)	28,576	(198)	(0.69)		28,460	(254)	(0.89)	
Effect of derivatives (e):								
Hedging derivatives	96	-			116	-		
Embedded and ALM derivatives	32,109	(21)			38,157	(75)		
Total liabilities	60,781	(219)		(0.36)	66,733	(329)		(0.49)
Interest margin			1.68	0.65			1.63	0.49

(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 of the Bank and consolidated companies in Israel and quarterly opening balances in consolidated companies abroad, 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$ (7) million (2011 – US$ (37) 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

Exhibit D:

	31 December 2012												31 December 2011		
	On demand up to one month	Over one month to three months	Over three months to one year	Over one year to three years	Over three years to five years	Over five years to ten years	Over ten years to twenty years	Over twenty years	Without fixed maturity	Total	Internal rate of return	Average duration (b)	Total fair value	Internal rate of return	Average duration (b)
	NIS millions										(%)	(Years)		(%)	(Years)
Israeli currency - unlinked															
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments															
Financial assets (a) (c)	157,067	7,961	21,623	10,560	2,977	2,397	1,104	236	636	204,561	3.95	0.45	191,767	4.12	0.39
Derivative financial instruments (excluding options)	42,316	86,162	56,074	33,999	24,093	26,607	688	-	-	269,939	-	1.53	221,545	-	1.38
Options (in terms of the underlying asset) (e)	2,155	813	4,055	3,602	16	53	141	-	-	10,835	-	-	6,074	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total fair value	201,538	94,936	81,752	48,161	27,086	29,057	1,933	236	636	485,335	3.95	1.04	419,386	4.12	0.91
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments															
Financial liabilities (a)	139,415	8,804	12,219	4,203	3,195	234	14	-	17	168,101	2.65	0.25	159,044	3.70	0.27
Derivative financial instruments (excluding options)	53,120	94,105	56,808	33,946	24,290	26,293	225	20	-	288,807	-	1.44	235,982	-	1.30
Options (in terms of the underlying asset) (e)	4,681	1,172	3,335	1,965	18	46	173	-	-	11,390	-	-	6,805	-	-
Off-balance sheet financial instruments	-	-	34	-	-	-	-	-	-	34	-	0.50	43	-	0.50
Total fair value	197,216	104,081	72,396	40,114	27,503	26,573	412	20	17	468,332	2.65	0.98	401,874	3.70	0.87
Financial instruments, net															
Exposure to interest rate fluctuations	4,322	(9,145)	9,356	8,047	(417)	2,484	1,521	216							
Accumulated exposure in the sector	4,322	(4,823)	4,533	12,580	12,163	14,647	16,168	16,384							
Israeli currency – linked to the CPI															
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments															
Financial assets (a)	2,952	3,029	15,810	17,400	14,841	7,377	1,157	43	26	62,635	2.29	2.84	62,776	3.10	2.78
Derivative financial instruments (excluding options)	214	-	2,735	1,036	773	1,116	-	-	-	5,874	-	2.53	5,641	-	3.61
Options (in terms of the underlying asset) (e)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total fair value	3,166	3,029	18,545	18,436	15,614	8,493	1,157	43	26	68,509	2.29	2.81	68,417	3.10	2.85
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments															
Financial liabilities (a)	1,827	1,455	10,606	15,866	11,561	11,668	1,175	263	-	54,421	1.43	3.57	54,294	2.54	3.60
Derivative financial instruments (excluding options)	745	761	5,416	3,409	813	1,165	222	-	-	12,531	-	1.97	10,604	-	1.46
Options (in terms of the underlying asset) (e)	-	-	-	-	-	-	-	-	-	-	-	-	4	-	-
Off-balance sheet financial instruments	-	-	101	-	-	-	-	-	-	101	-	-	101	-	-
Total fair value	2,572	2,216	16,123	19,275	12,374	12,833	1,397	263	-	67,053	1.43	3.26	65,003	2.54	3.25
Financial instruments, net															
Exposure to interest rate fluctuations	594	813	2,422	(839)	3,240	(4,340)	(240)	(220)							
Accumulated exposure in the sector	594	1,407	3,829	2,990	6,230	1,890	1,650	1,430							

See notes on page 296.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Exposure to Interest Rate Fluctuations - on Consolidated Basis (cont'd)

Exhibit D (cont'd):

	31 December 2012												31 December 2011		
	On demand up to one month	Over one month to three months	Over three months to one year	Over one year to three years	Over three years to five years	Over five years to ten years	Over ten years to twenty years	Over twenty years	Without fixed maturity	Total	Internal rate of return	Average duration (b)	Total fair value (f)	Internal rate of return	Average duration (b)
	NIS millions										(%)	(Years)		(%)	(Years)
Foreign currency and foreign currency linked															
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments															
Financial assets (a) (d)	46,804	15,779	9,004	7,932	3,201	3,127	276	28	304	86,455	1.90	0.80	88,112	4.04	0.58
Derivative financial instruments (excluding options)	59,022	45,196	38,105	7,215	5,842	7,436	551	23	162	163,552	-	0.81	164,408	-	0.14
Options (in terms of the underlying asset) (e)	(1,530)	2,217	2,778	968	3,733	2,205	236	-	-	10,607	-	-	22,041	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total fair value	104,296	63,192	49,887	16,115	12,776	12,768	1,063	51	466	260,614	1.90	0.78	274,561	4.04	0.27
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments															
Financial liabilities (a)	71,770	17,236	18,929	2,430	631	482	36	-	15	111,529	1.09	0.28	112,065	1.59	0.30
Derivative financial instruments (excluding options)	54,627	30,310	27,754	9,660	7,018	9,381	531	22	162	139,465	-	1.08	145,396	-	0.49
Options (in terms of the underlying asset) (e)	(1,796)	1,862	3,072	934	3,603	2,063	236	-	-	9,974	-	-	21,437	-	-
Off-balance sheet financial instruments	-	-	9	-	-	-	-	-	-	9	-	0.50	14	-	0.50
Total fair value	124,601	49,408	49,764	13,024	11,252	11,926	803	22	177	260,977	1.09	0.70	278,912	1.59	0.38
Financial instruments, net															
Exposure to interest rate fluctuations	(20,305)	13,784	123	3,091	1,524	842	260	29							
Accumulated exposure in the sector	(20,305)	(6,521)	(6,398)	(3,307)	(1,783)	(941)	(681)	(652)							
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)	206,823	26,769	46,437	35,892	21,019	12,901	2,537	307	3,963	356,648	2.68	0.96	345,539	3.52	0.88
Derivative financial instruments (excluding options)	101,552	131,358	96,914	42,250	30,708	35,159	1,239	23	462	439,665	-	1.28	391,705	-	0.89
Options (in terms of the underlying asset) (e)	625	3,030	6,833	4,570	3,749	2,258	377	-	-	21,442	-	-	28,115	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total fair value	309,000	161,157	150,184	82,712	55,476	50,318	4,153	330	4,425	817,755	2.68	1.11	765,359	3.52	0.85
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments															
Financial liabilities	213,012	27,495	41,754	22,499	15,387	12,384	1,225	263	672	334,691	1.59	0.80	325,737	2.62	0.84
Derivative financial instruments (excluding options)	108,492	125,176	89,978	47,015	32,121	36,839	978	42	426	441,067	-	1.34	392,067	-	1.00
Options (in terms of the underlying asset) (e)	2,885	3,034	6,407	2,899	3,621	2,109	409	-	-	21,364	-	-	28,246	-	-
Off-balance sheet financial instruments	-	-	144	-	-	-	-	-	139	283	-	0.09	279	-	0.12
Total fair value	324,389	155,705	138,283	72,413	51,129	51,332	2,612	305	1,237	797,405	1.59	1.08	746,329	2.62	0.89
Financial instruments, net															
Exposure to interest rate fluctuations	(15,389)	5,452	11,901	10,299	4,347	(1,014)	1,541	25							
Accumulated exposure in the sector	(15,389)	(9,937)	1,964	12,263	16,610	15,596	17,137	17,162							

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Exposure to Interest Rate Fluctuations - on Consolidated Basis (cont'd)

Exhibit D (cont'd):

Notes:

(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.
(f) Reclassified.

General notes:

(1) Full details of the exposure 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 the fair value of financial instruments, see Note 18.C.
(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 an 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) In calculating the average duration of assets and liabilities in the CPI-linked sector, an estimate is taken into account of early repayments and withdrawals at exit points of savings schemes, in accordance with a model which estimates anticipated early repayments based on the behavior of savers. The average duration of assets according to the original cash flow of the savings schemes is longer, reaching 3.19 years, the average duration of liabilities is 3.29 years, with a gap in the internal rate of return (hereinafter: "IRR") amounting to 0.52%. The change in fair value in assets is NIS 737 million and in liabilities is NIS (8) million.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis
(cont'd)

Exhibit E:

31 December 2012										
	Overall credit risk[1]		Debts[2] and off-balance sheet credit risk (excluding derivatives)[3]							
							Credit losses[4]			
				Of which:						
Activities of borrowers in Israel	Total	Problematic[5]	Total(*)	Debts[2]	Problematic[5]	Impaired	Expenses in respect of credit losses	Net accounting write-offs	Balance of allowance for credit losses
	NIS millions								
Agriculture	2,006	103	2,004	1,700	103	40	(11)	(15)	(43)
Industry	32,285	2,263	30,881	20,325	2,179	805	199	137	(584)
Construction and real estate - construction	40,287	1,371	40,176	14,165	1,371	905	(120)	79	(403)
Construction and real estate - real estate activity	28,110	2,289	28,051	25,427	2,287	1,887	90	173	(495)
Electricity and water	3,309	8	2,424	2,051	8	8	-	1	(3)
Commerce	23,022	1,296	22,531	18,801	1,291	768	194	43	(487)
Hotels, catering services and food	2,987	303	2,962	2,713	303	210	(59)	14	(26)
Transport and storage	5,915	894	5,838	5,005	868	373	53	13	(147)
Communications and computer services	5,715	86	5,528	4,581	86	31	(47)	(15)	(38)
Financial services	26,506	1,191	21,171	13,170	1,156	758	576	263	(519)
Other business services	7,854	202	7,726	6,064	202	159	14	2	(155)
Public and community services	7,529	195	7,490	6,226	195	154	40	60	(25)
Total commercial	185,525	10,201	176,782	120,228	10,049	6,098	929	755	(2,925)
Private individuals - housing loans	64,136	860	64,137	62,101	860	29	(13)	47	(455)
Private individuals - other	57,416	352	57,406	28,941	352	47	91	165	(351)
Total public	307,077	11,413	298,325	211,270	11,261	6,174	1,007	967	(3,731)
Israeli banks	42,122	-	39,295	38,478	-	-	-	-	-
Government of Israel	33,694	-	1,717	1,717	-	-	-	-	-
Total activity in Israel	382,893	11,413	339,337	251,465	11,261	6,174	1,007	967	(3,731)

31 December 2012										
	Overall credit risk[1]		Debts[2] and off-balance sheet credit risk (excluding derivatives)[3]							
							Credit losses[4]			
				Of which:						
Activities of borrowers abroad	Total	Problematic[5]	Total(*)	Debts[2]	Problematic[5]	Impaired	Expenses in respect of credit losses	Net accounting write-offs	Balance of allowance for credit losses
	NIS millions								
Agriculture	80	9	64	50	9	9	1	-	(3)
Industry	11,145	326	10,249	7,025	323	277	98	16	(184)
Construction and real estate	11,410	1,092	10,754	8,375	1,092	878	135	65	(315)
Electricity and water	370	-	164	32	-	-	-	-	-
Commerce	9,102	231	8,933	6,156	231	177	(1)	3	(136)
Hotels, catering services and food	2,296	73	2,295	2,106	73	56	-	18	(11)
Transport and storage	456	49	442	400	49	29	(1)	(2)	(14)
Communications and computer services	644	-	437	260	-	-	(1)	-	(2)
Financial services	12,994	47	4,747	3,619	47	21	(8)	51	(27)
Other business services	3,245	218	3,143	2,349	218	217	2	23	(61)
Public and community services	1,505	13	1,391	1,040	13	7	2	-	(13)
Total commercial	53,247	2,058	42,619	31,412	2,055	1,671	227	174	(766)
Private individuals - housing loans	1,303	47	1,303	1,302	47	43	-	-	(20)
Private individuals - other	1,685	52	1,646	1,394	52	51	2	1	(44)
Total public	56,235	2,157	45,568	34,108	2,154	1,765	229	175	(830)
Foreign banks	28,860	5	18,343	14,008	5	5	-	1	(4)
Foreign governments	7,065	-	300	160	-	-	-	-	-
Total activity abroad	92,160	2,162	64,211	48,276	2,159	1,770	229	176	(834)
Total	475,053	13,575	403,548	299,741	13,420	7,944	1,236	1,143	(4,565)

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis
(cont'd)

Exhibit E (cont'):

31 December 2011

Activities of borrowers in Israel	Overall credit risk[1] Total	Overall credit risk[1] Problematic[5]	Debts[2] and off-balance sheet credit risk (excluding derivatives)[3] Total(*)	Of which: Debts[2]	Of which: Problematic[5]	Of which: Impaired	Credit losses[4] Expenses in respect of credit losses	Credit losses[4] Net accounting write-offs	Credit losses[4] Balance of allowance for credit losses
	(NIS millions)								
Public - commercial									
Agriculture	2,162	109	2,157	1,833	109	53	(41)	(33)	(51)
Industry	38,176	1,362	36,052	24,582	1,362	861	68	599	(563)
Construction and real estate - construction	38,139	1,648	38,084	13,528	1,651	670	250	304	(598)
Construction and real estate - real estate activity	28,805	2,155	28,747	26,236	2,152	1,286	82	567	(570)
Electricity and water	1,357	2	1,132	939	2	-	-	-	(2)
Commerce	22,773	925	22,348	17,907	925	384	60	(179)	(271)
Hotels, catering services and food	3,704	946	3,698	3,434	946	744	(81)	(39)	(148)
Transport and storage	6,036	179	5,803	4,904	162	134	9	40	(77)
Communications and computer services	7,517	160	7,163	4,733	159	122	(19)	61	(60)
Financial services	26,817	1,393	21,942	15,531	1,339	1,053	252	137	(333)
Other business services	7,118	94	7,089	5,337	94	48	(7)	14	(82)
Public and community services	7,271	233	7,228	6,308	233	49	12	(6)	(50)
Total commercial	189,875	9,206	181,443	125,272	9,134	5,404	585	1,465	(2,805)
Private individuals - housing loans	57,895	955	57,895	56,376	955	27	(15)	69	(516)
Private individuals - other	55,038	357	55,000	28,141	357	47	29	113	(424)
Total public	302,808	10,518	294,338	209,789	10,446	5,478	599	1,647	(3,745)
Israeli banks	51,779	-	44,279	43,375	-	-	-	-	-
Government of Israel	28,054	-	1,665	1,665	-	-	-	-	-
Total activity in Israel	382,641	10,518	340,282	254,829	10,446	5,478	599	1,647	(3,745)

31 December 2011

Activities of borrowers abroad	Overall credit risk[1] Total	Overall credit risk[1] Problematic[5]	Debts[2] and off-balance sheet credit risk (excluding derivatives)[3] Total(*)	Of which: Debts[2]	Of which: Problematic[5]	Of which: Impaired	Credit losses[4] Expenses in respect of credit losses	Credit losses[4] Net accounting write-offs	Credit losses[4] Balance of allowance for credit losses
	(NIS millions)								
Agriculture	55	4	53	40	4	4	2	-	(3)
Industry	11,307	259	10,926	7,685	259	83	(4)	19	(86)
Construction and real estate	12,795	1,123	12,163	9,523	1,123	618	104	202	(299)
Electricity and water	393	-	207	65	-	-	-	-	-
Commerce	8,344	342	8,137	5,568	342	171	40	106	(106)
Hotels, catering services and food	1,297	52	1,296	913	52	2	1	-	(6)
Transport and storage	696	44	694	594	44	22	11	45	(18)
Communications and computer services	969	3	818	473	3	-	-	-	(5)
Financial services	10,409	154	4,116	3,009	111	84	(6)	(9)	(70)
Other business services	5,422	276	5,381	3,957	276	145	(4)	13	(38)
Public and community services	962	55	885	833	55	54	-	-	(5)
Total commercial	52,649	2,312	44,676	32,660	2,269	1,183	144	376	(636)
Private individuals - housing loans	1,375	68	1,375	1,375	68	66	6	-	(16)
Private individuals - other	1,799	59	1,764	1,463	59	57	(19)	46	(38)
Total public	55,823	2,439	47,815	35,498	2,396	1,306	131	422	(690)
Foreign banks	17,299	324	12,272	-	7,527	8	8	-	4
Foreign governments	3,292	-	116	-	8	-	-	-	-
Total activity abroad	76,414	2,763	60,203	35,498	9,931	1,314	139	422	(686)
Total	459,055	13,281	400,485	290,327	20,377	6,792	738	2,069	(4,431)

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis (cont'd)

Exhibit E (cont'd):

(1) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts[2], bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments as calculated for single borrower limitations in the sum of NIS 299,743, 54,042, 0, 11,438, 109,832 million (31 December 2011 - NIS 297,863, 42,131, 0, 11,573, 107,488 million , respectively)

(2) Credit risk to the public, credit to governments, deposits with banks and other debts, except for bonds and securities borrowed or purchased under agreements to resell.

(3) Credit risk of off-balance sheet financial instruments as calculated for the purpose of single borrower credit limitations.

(4) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other liabilities").

(5) Impaired, substandard, or special mention, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans for which there is no provision by extent of arrears that are in arrears of 90 days or more.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Country Exposure

Exhibit F:

Part A – Information on total country exposure and on exposure to countries whose total individual exposure exceeds 1% of total assets or exceeds 20% of equity for purposes of calculating capital ratios, whichever is the lower.

	31 December 2012					
	Balance sheet exposure (a)					
	Cross-Border Balance Sheet Exposure			Balance sheet exposure of foreign offices of the banking corporation to local residents		
	To governments (c)	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	**5,472**	**4,161**	**8,519**	**17,965**	**10,201**	**7,764**
United Kingdom	**121**	**4,528**	**2,468**	**6,907**	**2,268**	**4,639**
France	**-**	**2,225**	**679**	**-**	**-**	**-**
Switzerland	**-**	**423**	**1,040**	**2,463**	**373**	**2,090**
Germany	**395**	**1,711**	**1,960**	**-**	**-**	**-**
Belgium	**-**	**172**	**131**	**-**	**-**	**-**
Italy	**-**	**255**	**93**	**-**	**-**	**-**
Netherlands	**-**	**1,425**	**1,638**	**-**	**-**	**-**
Others	**368**	**3,020**	**2,657**	**1,947**	**1,007**	**940**
Total exposure to foreign countries	**6,356**	**17,920**	**19,185**	**29,282**	**13,849**	**15,433**
Total exposure to LDC countries	**187**	**613**	**1,225**	**1,920**	**986**	**934**
Total exposure to GIIPS countries (d)	**-**	**344**	**217**	**-**	**-**	**-**

	31 December 2012						
	Balance sheet exposure			Off-balance sheet exposure (a)(b)			
						Cross-Border Balance Sheet Exposure	
		Credit risk of which:				Repayment period	
	Total balance sheet exposure	Balance sheet problem credit risk	Balance of impaired debts	Total off-balance sheet exposure	Of which: Off-balance sheet problem credit risk	Up to one year	Over one year
	NIS millions						
Country							
United States	**25,916**	**512**	**330**	**5,972**	**16**	**7,813**	**10,339**
United Kingdom	**11,756**	**621**	**484**	**2,903**	**4**	**2,677**	**4,440**
France	**2,904**	**1**	**1**	**265**	**-**	**1,391**	**1,513**
Switzerland	**3,553**	**37**	**37**	**720**	**-**	**1,117**	**346**
Germany	**4,066**	**3**	**3**	**214**	**-**	**2,180**	**1,886**
Belgium	**303**	**-**	**-**	**71**	**-**	**268**	**35**
Italy	**348**	**1**	**1**	**35**	**-**	**96**	**252**
Netherlands	**3,063**	**51**	**34**	**161**	**-**	**2,117**	**946**
Others	**6,985**	**569**	**528**	**1,345**	**-**	**4,779**	**1,266**
Total exposure to foreign countries	**58,894**	**1,795**	**1,418**	**11,686**	**20**	**22,438**	**21,023**
Total exposure to LDC countries	**2,959**	**559**	**518**	**780**	**-**	**1,737**	**288**
Total exposure to GIIPS countries (d)	**561**	**1**	**1**	**40**	**-**	**163**	**398**

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Country Exposure (cont'd)

Exhibit F (cont'd):

	31 December 2011					
	Balance sheet exposure (a)					
	Cross-Border Balance Sheet Exposure			Balance sheet exposure of foreign offices of the banking corporation to local residents		
	To governments (c)	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	2,975	3,850	9,121	19,650 (e)	10,834	8,816 (e)
United Kingdom	-	3,877	2,340	6,237 (e)	2,124	4,113 (e)
France	-	2,155	780	-	-	-
Switzerland	-	380	871	1,897	489	1,408
Germany	35	2,153	1,741	1	-	1
Belgium	-	422	132	-	-	-
Italy	-	378	79	-	-	-
Netherlands	4	1,257	1,346	-	-	-
Others	360	2,768	2,916	1,908 (e)	1,036	872 (e)
Total exposure to foreign countries	3,374	17,240	19,326	29,693	14,483	15,210
Total exposure to LDC countries	166	576	1,307	1,847 (e)	1,036	811 (e)
Total exposure to GIIPS countries (d)	-	735	236	-	-	-

	31 December 2011						
	Balance sheet exposure			Off-balance sheet exposure (a)(b)			
						Cross-Border Balance Sheet Exposure	
		Credit risk of which:				Repayment period	
	Total balance sheet exposure	Balance sheet problem credit risk	Balance of impaired debts	Total off-balance sheet exposure	Of which: Off-balance sheet problem credit risk	Up to one year	Over one year
	NIS millions						
Country							
United States	24,762 (e)	609	346	6,282	19	8,138	7,808
United Kingdom	10,330 (e)	769	286	3,004	4	2,755	3,462
France	2,935	1	1	322	-	1,165	1,770
Switzerland	2,659	80	80	770	-	739	512
Germany	3,930	2	2	304	-	2,807	1,122
Belgium	554	-	-	32	-	492	62
Italy	457	1	1	15	-	72	385
Netherlands	2,607 (e)	57	30	176	-	1,616 (e)	991
Others	6,916 (e)	654	557	1,169	-	3,623	2,421
Total exposure to foreign countries	55,150	2,173	1,303	12,074	23	21,407	18,533
Total exposure to LDC countries	2,860 (e)	649	554	629	-	1,744	305
Total exposure to GIIPS countries (d)	971	5	4	25	-	170	801

(a) Balance sheet credit risk and off-balance sheet credit risk, problematic commercial credit risk and impaired debts are shown before the effect of the allowance for credit losses and before the effect of collateral deductible for purposes of single borrower and group borrower debt limitations. Does not include off-balance sheet risk components.
(b) Credit risk of off-balance sheet financial instruments as calculated for the purpose of single borrower credit limitations.
(c) Including governments, official institutions and central banks.
(d) Exposure to GIIPS countries include: Greece, Ireland, Italy, Portugal and Spain.
(e) Reclassified.

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 bearing 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 – At 31 December 2012 and 31 December 2011, there was no aggregate amount of balance sheet exposure to countries whose total individual exposure was between 0.75% and 1% of the total consolidated assets or 15%-20% of equity, whichever the lower.

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) amounts to NIS 1,317 million and relates to 14 countries (at 31 December 2011, this totaled NIS 1,106 million and related to 13 countries).

Bank Leumi le-Israel B.M. and its Consolidated Companies
Quarterly Consolidated Balance Sheets – Multi-Quarter Data

Exhibit G:

Year	2012				2011			
Quarter	4	3	2	1	4	3	2	1
	NIS millions							
Assets								
Cash and deposits with banks	54,621	48,340	39,166	47,368	53,044	54,662	45,566	36,802
Securities	56,408	56,183	60,348	49,757	47,936	38,356	40,146	47,090
Securities borrowed or purchased under repurchase agreements	1,435	1,946	2,165	1,485	1,225	1,252	1,330	2,068
Credit to the public	245,378	245,407	245,287	244,575	245,287	241,171	232,670	230,017
Allowance for credit losses	(4,114)	(3,943)	(3,860)	(4,075)	(3,967)	(3,856)	(4,322)	(4,946)
Credit to the public, net	241,264	241,464	241,427	240,500	241,320	237,315	228,348	225,071
Credit to governments	442	418	412	425	448	403	352	357
Investments in companies included on equity basis	2,129	2,303	2,129	2,187	2,270	2,350	2,159	2,032
Buildings and equipment	3,705	3,751	3,753	3,715	3,653	3,615	3,627	3,665
Intangible assets and goodwill	189	168	172	176	181	45	45	45
Assets in respect of derivative instruments	11,438	10,494	12,259	9,466	11,573	11,496	7,764	8,419
Other assets	4,529	4,463	4,251	4,189	4,204	3,681	3,719	3,118
Total assets	376,160	369,530	366,082	359,268	365,854	353,175	333,056	328,667
Liabilities and equity								
Deposits of the public	289,538	285,229	280,434	277,642	279,404	267,249	252,704	248,258
Deposits from banks	4,073	2,863	3,981	3,629	5,056	6,327	5,362	3,814
Deposits from governments	451	456	462	436	519	443	443	721
Securities loaned or sold under repurchase agreements	1,007	1,248	1,287	624	442	778	791	1,533
Debentures, bonds and subordinated notes	27,525	28,189	28,223	27,873	29,999	28,573	27,034	26,985
Liabilities in respect of derivative instruments	12,762	11,259	12,575	10,125	12,069	12,636	9,447	10,170
Other liabilities	15,576	14,967	14,587	14,564	14,737	14,055	14,098	14,384
Total liabilities	350,932	344,211	341,549	334,893	342,226	330,061	309,879	305,865
Non-controlling interests	307	301	267	257	254	343	333	314
Equity attributable to shareholders of the banking corporation	24,921	25,018	24,266	24,118	23,374	22,771	22,844	22,488
Total equity	25,228	25,319	24,533	24,375	23,628	23,114	23,177	22,802
Total liabilities and equity	376,160	369,530	366,082	359,268	365,854	353,175	333,056	328,667

Bank Leumi le-Israel B.M. and its Consolidated Companies
Quarterly Consolidated Statements of Profit and Loss – Multi-Quarter Data

Exhibit H:

Year	2012				2011 (a)			
Quarter	4	3	2	1	4	3	2	1
	NIS millions							
Interest income	2,714	3,615	3,914	3,264	3,330	3,801	3,985	3,167
Interest expenses	930	1,743	1,990	1,436	1,651	1,960	2,209	1,356
Interest income, net	1,784	1,872	1,924	1,828	1,679	1,841	1,776	1,811
Expenses in respect of credit losses	386	292	333	225	385	378	73	(102)
Net interest income after expenses in respect of credit losses	1,398	1,580	1,591	1,603	1,294	1,463	1,703	1,913
Non-interest income								
Non-interest financing income	205	119	(25)	145	177	(336)	116	54
Commissions	1,107	1,050	1,022	1,020	1,007	1,005	1,018	1,086
Other income	82	39	(2)	12	19	6	12	11
Total non-interest income	1,394	1,208	995	1,177	1,203	675	1,146	1,151
Operating and other expenses								
Salaries and related expenses	1,314	1,434	1,356	1,186	1,196	1,241	1,273	1,351
Building and equipment maintenance and depreciation	494	452	446	427	442	422	432	408
Amortization of intangible assets	8	4	5	6	2	-	-	-
Other expenses	795	404	393	376	481	392	374	327
Total operating and other expenses	2,611	2,294	2,200	1,995	2,121	2,055	2,079	2,086
Profit before taxes	181	494	386	785	376	83	770	978
Provision for (benefit from) taxes on profit	233	113	159	306	(246)	32	260	372
Profit after taxes	(52)	381	227	479	622	51	510	606
Banking corporation's share in profits of companies included on equity basis, after tax	(199)	108	63	(39)	3	115	72	(42)
Net profit (loss):								
Before attributiing to non-controlling interests	(251)	489	290	440	625	166	582	564
Attributable to non-controlling interests	(8)	(10)	(10)	(9)	(7)	(11)	(18)	(10)
Attributable to shareholders of the banking corporation	(259)	479	280	431	618	155	564	554

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 by Quarter for 2011-2012

Exhibit H (cont'd):

Year	2012				2011 (a)			
Quarter	4	3	2	1	4	3	2	1
	(NIS)							
Basic and diluted earnings per share:								
Net profit (loss) attributable to shareholders of the banking corporation	(0.18)	0.33	0.19	0.29	0.42	0.11	0.38	0.38

(a) Reclassified

Certification

I, Rakefet Russak-Aminoach, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2012 (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;

   (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.

20 March 2013

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Rakefet Russak-Aminoach
President and Chief Executive Officer

Certification

I, Menachem Schwartz, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2012 (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;

   (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.

20 March 2013

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Menachem Schwartz
First Executive Vice President,
Chief Accounting Officer,
Head of Accounting Division

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, maintains 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 2012, 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 2012, 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 2012 was audited by the Bank's Auditors, Kost Forer Gabbay & Kasierer and Somekh Chaikin, as stated in their Report on page 309, which includes an opinion regarding the effectiveness of the Bank's internal control over financial reporting as at 31 December 2012.

20 March 2013

David Brodet
Chairman of the Board of Directors

Rakefet Russak-Aminoach
President and Chief Executive Officer

Menachem Schwartz
First Executive Vice President,
Chief Accounting Officer,
Head of Accounting Division

Report of the Joint Auditors to the Shareholders of Bank Leumi le-Israel B.M. in accordance with Public Reporting Directives of the Supervisor of Banks regarding Internal Control over Financial Reporting

We have audited the internal control of Bank Leumi le-Israel B.M. and subsidiaries (hereinafter together: "the Bank") over financial reporting as of 31 December 2012, 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 (PCAOB) in the United States regarding the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel. 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 transfers of the assets of the company (including dispositions); (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 receipt and payment of funds of the Bank are being made only in accordance with authorizations of the Management and Board of 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 2012, 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, and certain auditing standards, of which implementation in audit of banking institutions was required in directives and guidelines of the Supervisor of Banks, the consolidated balance sheets of the Bank and its subsidiaries as at 31 December 2012 and 2011, and for each of the three years the last of which ended 31 December 2012, and our report of 20 March 2013 included an unqualified opinion on those financial statements, as well as drawing attention to that stated in Notes 18.D paragraphs 2, 18.I, 18.J, and 18.K.

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Somekh Chaikin
Certified Public Accountants (Isr.)

Joint Auditors

20 March 2013

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 consolidated companies ("the Group") as at 31 December 2012 and 2011, 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 2012. 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 consolidated subsidiaries, whose assets constitute approximately 2.2% and 1.4% of the total consolidated assets as at 31 December 2012 and 2011, respectively, and whose net interest income before expenses for credit losses included in the consolidated statements of profit and loss constitutes about 0.7%, 1% and 3% of the total consolidated interest income before expenses for credit losses for the years ended 31 December 2012, 2011, and 2010, 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 directives and 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 appropriateness of 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 consolidated companies as at 31 December 2012 and 2011, and the 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 2012, 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.D paragraph 2, regarding claims against the Bank including petitions for their approval as class actions.
2. that stated in Note 18.I regarding matters concerning a company included on equity basis and its investee companies.
3. that stated in Note 18.J regarding a determination by the Antitrust Commissioner.
4. that stated in Note 18.K regarding investigations carried out against the Group in connection with its activity with US customers.

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 PCAOB (Public Company Accounting Oversight Board) in the United States regarding the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel, internal control over financial reporting of the Bank as of 31 December 2012, 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 20 March, 2013 included an unqualified opinion on the effectiveness of internal control on financial reporting by the Bank.

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Somekh Chaikin
Certified Public Accountants (Isr.)

Joint Auditors

20 March 2013

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Balance Sheet as at 31 December 2012

	Note	31 December 2012	31 December 2011
		(NIS millions)	
Assets			
Cash and deposits with banks	2,14	54,621	53,044
Securities	3,14	56,408	47,936
Securities borrowed or purchased under agreements to resell		1,435	1,225
Credit to the public	4	245,378	245,287
Allowance for credit losses	4	(4,114)	(3,967)
Credit to the public, net		241,264	241,320
Credit to governments	5	442	448
Investments in companies included on equity basis	6	2,129	2,270
Buildings and equipment	7	3,705	3,653
Intangible assets and goodwill	6(e)	189	181
Assets in respect of derivative instruments	18	11,438	11,573
Other assets	8	4,529	4,204
Total assets		376,160	365,854
Liabilities and equity			
Deposits of the public	9	289,538	279,404
Deposits from banks	10	4,073	5,056
Deposits from governments		451	519
Securities lent or sold under agreements to repurchase		1,007	442
Debentures, bonds and subordinated notes	11	27,525	29,999
Liabilities in respect of derivative instruments	18	12,762	12,069
Other liabilities	12	15,576	14,737
Total liabilities		350,932	342,226
Non-controlling interests		307	254
Equity attributable to shareholders of the banking corporation		24,921	23,374
Total equity	13	25,228	23,628
Total liabilities and equity		376,160	365,854

The accompanying notes are an integral part of these condensed financial statements.
For the condensed financial statements of the Bank only – see Note 29.

David Brodet	Prof. Efraim Sadka	Zipporah Samet	Rakefet Russak-Aminoach	Menachem Schwartz
Chairman of the Board of Directors	Director	Director	President and Chief Executive Officer	First Executive Vice President, Chief Accounting Officer, Head of Accounting Division

Date of approval of the financial statements: 20 March 2013

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Profit and Loss
for the year ended 31 December 2012

	Note	2012	2011(a)	2010(a)
		(NIS millions)		
Interest income	20	13,507	14,283	12,489
Interest expenses	20	6,099	7,176	5,517
Interest income, net	20	7,408	7,107	6,972
Expenses in respect of credit losses	4	1,236	734	584
Net interest income after expenses in respect of credit losses		6,172	6,373	6,388
Non-interest income				
Non-interest financing income	21	444	11	475
Commissions	22	4,199	4,116	4,129
Other income	23	131	48	163
Total non-interest income		4,774	4,175	4,767
Operating and other expenses				
Salaries and related expenses	24	5,290	5,061	4,686
Building and equipment maintenance and depreciation	7	1,819	1,704	1,591
Amortization of intangible assets	6e	23	2	80
Other expenses	25	1,968	1,574	1,604
Total operating and other expenses		9,100	8,341	7,961
Profit before taxes		1,846	2,207	3,194
Provision for taxes on profit	26	811	418	1,241
Profit after taxes		1,035	1,789	1,953
Share of the banking corporation share in profits of companies included on equity basis, after tax	6	(67)	148	420
Net profit:				
Before attribution to non-controlling interests		968	1,937	2,373
Attributable to non-controlling interests		(37)	(46)	(39)
Attibutable to shareholders of the banking corporation		931	1,891	2,334
Earnings per share				
Basic and diluted earnings per share:		(NIS)		
Net profit attributable to shareholders of the banking corporation		0.63	1.28	1.58
Weighted average of the number of shares for calculation of basic and diluted earnings		1,473,551	1,473,551	1,473,551

(a) Reclassified pursuant to initial implementation of the directive of the Supervisor of Banks regarding the format of the statement of profit and loss of a banking corporation. See Note 1.D.1.
(b) Comparative figures for credit loss expenses for 2010 have not been restated pursuant to implementation of the new directives and anr not comparable with figures for 2011 and 2012.
(c) Restated - see Note 1.R below.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only – see Note 29.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Statement of Changes in Shareholders' Equity
for the year ended 31 December 2012

		Capital reserves			Accumulated other comprehensive profit (loss)							
	Share capital	Premium	Share-based payment transactions and others (a)	Total share capital and capital reserves	Adjustments in respect of presentation of securities available for sale at fair value	Translation adjustments (b)	Capital reserves in respect of companies included on equity basis	Retained earnings	Loans to employees for purchase of the Bank's shares	Total	Non-controlling interests	Total capital
	(NIS millions)											
Balance as at 1 January 2010	7,059	972	197	8,228	309	(474)	-	13,846	(377)	21,532	282	21,814
Net profit for the accounting year	-	-	-	-	-	-	-	2,334	-	2,334	39	2,373
Expiry of options	-	157	(157)	-	-	-	-	-	-	-	-	-
Benefit to employees - tax effect	-	-	(30)	(30)	-	-	-	-	-	(30)	-	(30)
Dividend paid	-	-	-	-	-	-	-	(500)	-	(500)	-	(500)
Dividend proposed	-	-	-	-	-	-	-	(500)	-	(500)	-	(500)
Adjustments in respect of companies included on equity basis, net	-	-	-	-	-	14	25	(117)	-	(78)	-	(78)
Adjustments in respect of presentation of available-for-sale securities at fair value	-	-	-	-	538	-	-	-	-	538	-	538
Profits in respect of available-for-sale securities that were realized and/or charged to profit and loss (d)	-	-	-	-	(303)	-	-	-	-	(303)	-	(303)
Related tax effect	-	-	-	-	(76)	-	-	-	-	(76)	-	(76)
Loans to employees for purchase of the Bank's shares	-	-	-	-	-	-	-	-	376	376	-	376
Changes in non-controlling interests	-	-	-	-	-	-	-	-	-	-	(3)	(3)
Balance as at 31 December 2010	7,059	1,129	10	8,198	468	(460)	25	15,063(e)	(1)	23,293	318	23,611
Adjustment of opening balances in respect of impaired debts + IFRS (b) (c)	-	-	-	-	-	381	-	(1,090)	-	(709)	(14)	(723)
Net profit for the accounting year	-	-	-	-	-	-	-	1,891	-	1,891	46	1,937
Dividend paid	-	-	-	-	-	-	-	(400)	-	(400)	(15)	(415)
Employee benefit from share-based payment transactions	-	-	13	13	-	-	-	-	-	13	-	13
Adjustments in respect of companies included on equity basis, net	-	-	-	-	-	58	15	(11)	-	62	-	62
Adjustments in respect of presentation of available-for-sale securities at fair value	-	-	-	-	(982)	-	-	-	-	(982)	(2)	(984)
Profits in respect of available-for-sale securities that were realized and/or charged to profit and loss (d)	-	-	-	-	(39)	-	-	-	-	(39)	-	(39)
Related tax effect	-	-	-	-	335	-	-	-	-	335	1	336
Changes in non-controlling interests	-	-	-	-	-	-	-	(47)	-	(47)	(80)	(127)
Loans to employees for purchase of the Bank's shares	-	-	-	-	-	-	-	-	(43)	(43)	-	(43)
Balance as at 31 December 2011	7,059	1,129	23	8,211	(218)	(21)	40	15,406(e)	(44)	23,374	254	23,628
Adjustment of opening balances in respect of initial implementation of International Financial Reporting Standards (IFRS)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(26)**	**-**	**(26)**	**-**	**(26)**
Net profit for the period	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**931**	**-**	**931**	**37**	**968**
Adjustments from translation of foreign operations	**-**	**-**	**-**	**-**	**-**	**(59)**	**-**	**-**	**-**	**(59)**	**-**	**(59)**
Profits in respect of hedging foreign currency investments	**-**	**-**	**-**	**-**	**-**	**4**	**-**	**-**	**-**	**4**	**-**	**4**
Dividend paid by consolidated companies	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(8)**	**(8)**
Tax effect relating to hedging foreign currency investments	**-**	**-**	**-**	**-**	**-**	**(1)**	**-**	**-**	**-**	**(1)**	**-**	**(1)**
Adjustments in respect of companies included on equity basis, net	**-**	**-**	**-**	**-**	**-**	**(8)**	**8**	**(9)**	**-**	**(9)**	**-**	**(9)**
Adjustments in respect of presentation of securities available for sale at fair value	**-**	**-**	**-**	**-**	**1,267**	**-**	**-**	**-**	**-**	**1,267**	**1**	**1,268**
Profits in respect of available-for-sale securities that were realized and charged to profit and loss (d)	**-**	**-**	**-**	**-**	**(201)**	**-**	**-**	**-**	**-**	**(201)**	**-**	**(201)**
Tax effect relating to adjustments in respect of available-for-sale securities	**-**	**-**	**-**	**-**	**(353)**	**-**	**-**	**-**	**-**	**(353)**	**(1)**	**(354)**
Changes in non-controlling interests	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(6)**	**-**	**(6)**	**24**	**18**
Balance as at 31 December 2012	**7,059**	**1,129**	**23**	**8,211**	**495**	**(85)**	**48**	**16,296(e)**	**(44)**	**24,921**	**307**	**25,228**

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Statement of Changes in Shareholders' Equity
for the year ended 31 December 2012 (cont'd)

Notes:

(a) Including NIS 10 million other capital reserves.

(b) In 2012 mainly in respect of implementation of IAS 12, an amount of NIS 42 million, in 2011 adjustments from translation of financial statements of investee companies overseas whose functional currency differs from the functional currency of the Bank (see Note 1.F.3 and F.2), translation differences amounting to NIS 381 million were transferred to accumulated retained earnings following the change to reporting under IAS 21.

(c) Including NIS 721 million in respect of the change to implementation of the Impaired Debts Directives (NIS 1,319 million gross).

(d) Including provisions for impairment.

(e) Including NIS 208 million not available for distribution as a dividend (31 December 2011 – NIS 379 million, 31 December 2010 – NIS 543 million. The balance of the amount for allocation is subject to Bank of Israel directives and the limitations set out 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 2012

	2012	2011 (a)	2010 (a)
	(NIS millions)		
Cash flows from operating activities			
Net profit for the year	**968**	1,937	2,373
Adjustments:			
Group share in undistributed losses (profits) of companies included on equity basis (b)	**181**	(72)	(348)
Expenses deriving from share-based payment transactions	**-**	13	-
Depreciation of buildings and equipment	**775**	707	638
Amortization	**23**	2	80
Expenses in respect of credit losses	**1,236**	734	584
Provision for impairment of assets transferred to group ownership	**9**	11	14
Net profit on sale of available-for-sale securities (including impairment)	**(201)**	(39)	(303)
Realized and unrealized (profit) loss from adjustment to fair value of securities held for trading	**(239)**	(313)	153
Loss (gain) on realization of investments in companies included on equity basis after tax	**(24)**	4	(181)
Loss (gain) on sale of buildings and equipment	**(2)**	2	(2)
Interest received (and not yet received) in respect of debentures available for sale	**(100)**	(822)	1,215
Unpaid interest in respect of debentures and subordinated notes	**356**	602	437
Effect of exchange rate differentials on cash deposits with banks for up to 3 months	**131**	(607)	683
Deferred taxes, net	**(635)**	(308)	(68)
Increase in excess of provisions for severance pay and pensions over amounts funded	**568**	620	234
Other, net	**(2)**	8	1
Net change in current assets:			
Deposits with banks for an original period of over 3 months	**333**	(1,956)	1,330
Credit to the public	**(1,822)**	(19,226)	(19,242)
Credit to governments	**7**	(69)	28
Securities borrowed or purchased under agreements to resell	**(210)**	(35)	(446)
Assets in respect of derivative instruments	**135**	(2,848)	(2,239)
Securities held for trading	**(734)**	(754)	1,054
Other assets	**(31)**	(481)	813
Net change in current liabilities:			
Deposits from banks	**(984)**	2,602	(1,094)
Deposits from the public	**10,459**	27,055	(834)
Deposits from the government	**(62)**	(141)	(52)
Securities lent or sold under agreements to repurchase	**566**	(564)	733
Liabilities in respect of derivative instruments	**657**	1,923	2,440
Other liabilities	**92**	670	815
Net cash from operating activities	**11,450**	8,655	(11,184)

See notes on next page.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only, see Note 29.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows (cont'd)
for the year ended 31 December 2012

	2012	2011 (a)	2010 (a)
	(NIS millions)		
Cash flows from investment activities			
Acquisition of bonds held to maturity	-	-	(77)
Proceeds from redemption of bonds held to maturity	-	-	226
Acquisition of available-for-sale securities	**(50,487)**	(26,345)	(31,726)
Proceeds from sale of available-for-sale securities	**25,727**	28,907	16,038
Proceeds from redemption from available-for-sale securities	**18,911**	6,782	14,668
Acquisition of subsidiary consolidated for the first time (Appendix A)	-	1,848	-
Acquisition of shares in companies included on equity basis	**(66)**	(110)	(14)
Proceeds from realization of investment in companies included on equity basis	**64**	50	765
Repayment of shareholders' loan to company included on equity basis	**4**	2	2
Acquisition of buildings and equipment	**(770)**	(755)	(719)
Proceeds from realization of buildings and equipment	**9**	6	24
Proceeds from realization of assets transferred to group ownership	**14**	7	8
Net cash from investment activities	**(6,594)**	10,392	(805)
Cash flows from financing activities			
Issue of debentures and subordinated notes	**2,420**	3,386	4,075
Redemption of debentures and subordinated notes	**(5,250)**	(928)	(2,834)
Issue of capital in consolidated companies to minority shareholders	**21**	-	-
Additional purchase of shares in consolidated companies	-	(115)	-
Dividend paid to shareholders	-	(900)	(500)
Dividend paid to minority shareholders in consolidated companies	**(8)**	(15)	(3)
Loans to employees for purchase of the Bank's shares	-	(43)	376
Net cash from financing activities	**(2,817)**	1,385	1,114
Increase (decrease) in cash and cash equivalents	**2,039**	20,432	(10,875)
Balance of cash and cash equivalents at beginning of year	**49,736**	28,697	40,255
Effect of exchange rate fluctuations on balances of cash and cash equivalents	**(131)**	607	(683)
Balance of cash at end of year	**51,644**	49,736	28,697

(a) Comparative figures have been reclassified in order to adapt to the current method of presentation.
(b) Less dividend received.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only, see Note 29.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows (cont'd)
for the year ended 31 December 2012

Interest and taxes paid and/or received and dividends received

	For year ended 31 December		
	2012	2011	2010
	(NIS millions)		
Interest received	**13,823**	14,027 (a)	12,462
Interest paid	**(8,395)**	(7,222) (a)	(5,701)
Dividends received	**170**	153	246

(a) Reclassified.

Appendix A - Net cash flow from acquisition of a subsidiary consolidated for the first time:

	For year ended 31 December 2011
	(NIS millions)
Assets and liabilities of a subsidiary that was consolidated and cash flow from acquisition of subsidiary that was consolidated, as at date of acquisition	
Cash acquired	2,426
Assets (excluding cash)	635
Liabilities	(2,621)
Identifiable assets and liabilities	440
Goodwill	138
Total cost of acquisition	578
Less non-cash proceeds for acquisition of consolidated subsidiaries	-
Proceeds paid in cash	(578)
Less cash acquired	2,426
Cash flow from acquisition of subsidiaries consolidated for the first time	1,848

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 (cont'd)
for the year ended 31 December 2012

Appendix B - Transactions not involving cash:

In 2012:

(1) During the year, shares in the amount of NIS 310 million were transferred from credit to the public to the available for sale portfolio, due to the completion of lending of securities.
(2) During the year, assets were transferred from credit to the public to other assets, in the amount of NIS 9 million, in respect of loans that were repaid.
(3) During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 66 million.

In 2011:

(1) During the year, securities were transferred from credit to the public to the available for sale portfolio, in the amount of NIS 562 million, due to the completion of lending of securities.
(2) During the year, assets were transferred from credit to the public to other assets, in the amount of NIS 6 million, in respect of loans that were repaid

In 2010:

(1) Proposed dividend of NIS 500 million (paid on 27 January 2011).
(2) During the year, shares were transferred from the available for sale portfolio to credit to the public, in the amount of NIS 651 million, due to lending of securities.
(3) During the year, assets were transferred from credit to the public to other assets, in the amount of NIS 16 million, in respect of loans that were repaid.
(4) During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 26 million.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only, see Note 29.

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 on a single-entity basis appear in Note 29.

The financial statements were approved for publication by the Board of Directors of the Bank on 20 March 2013.

B. Definitions

In these financial statements -

The Group – the banking corporation and its subsidiaries.

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 proportional 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 proportional 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 generally operates. This is the currency of the environment where the corporation produces and spends most of its cash funds.

Reporting currency - the currency in which the financial statements are reported.

Related parties - as defined in IAS 24 – Related Party Disclosures, except for interested parties.

Interested parties - as defined in the Securities Law Regulations (Annual Financial Statements), 2010.

Index - the Consumer Price Index in Israel published by the Central Bureau of Statistics.

Adjusted amount - historical nominal amount 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 - 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 reporting - financial reporting based on reported amounts.

Note 1 – Significant Accounting Policies (cont'd)

Adjusted financial reporting - financial reporting 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.

Cost – cost in reported amount

Fair value - the amount that would be received from the sale of an asset or that would be paid to transfer a liability in a transaction between a willing seller and a willing buyer at the measurement date.

Recorded debt balance – the recorded debt balance is defined as the outstanding debt after deducting accounting write-offs, but before deducting an allowance for credit losses in respect of that debt.

C. Basis for preparation of the financial statements

(1) Reporting principles

The financial statements of the Bank have been prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and the directives and guidelines of the Supervisor of Banks. In preparing the financial statements, the Bank implements, *inter alia*, certain International Financial Reporting Standards (IFRS) and accounting principles generally accepted by US banks, in the manner explained below:

- On subjects that are a core part of the banking business – the accounting treatment is in accordance with the Public Reporting Directives and instructions of the Supervisor of Banks and in accordance with accounting principles generally accepted by US banks that were adopted within the framework of the Public Reporting Directives of the Supervisor of Banks.

- On subjects that are not a core part of the banking business – the accounting treatment is in accordance with accounting principles generally accepted in Israel and in accordance with certain International Financial Reporting Standards (IFRS), as set out in the directives and instructions of the Supervisor of Banks. International standards are implemented in accordance with the principles detailed below:

  1.1 In cases where a material issue arises that is not addressed in the international standards or the Supervisor's instructions for implementation, the Group treats the issue in accordance with accounting principles generally accepted by US banks that apply specifically to these issues;

  1.2 In cases where there is no specific reference in the standards or interpretations to material issues, or there are a number of alternatives for the treatment of a material issue, the group acts according to specific implementation instructions decided on by the Supervisor;

  1.3 In those places where an international standard that has been adopted contains a reference to another international standard adopted in the Public Reporting Directives, the Group acts in accordance with the provisions of the International Standard;

  1.4 In those places where an international standard that has been adopted contains a reference to another international standard not adopted in the Public Reporting Directives, the Group acts in accordance with the Reporting Directives and with accounting principles generally accepted in Israel;

1.5 In those places where an international standard that has been adopted 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.

For details of the International Financial Reporting Standards implemented for the first time, see paragraph D below.

(2) Functional currency and reporting currency

The financial statements are reported in new shekels rounded to the nearest million, unless stated otherwise.

The shekel is the currency representing the principal economic environment in which the Bank operates.

(3) Basis of measurement

3.1 General

The financial statements are shown in reported amounts in accordance with the accounting standards of the Israeli Accounting Standards Board and the directives of the Supervisor of Banks.

Amounts of non-monetary assets do not necessarily show realizable value or current economic value, but only the amounts reported for those assets.

3.2 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 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 in reported amounts or translated to new Israeli shekels.

3.3 Profit and Loss Statement

- Income and expenses that arise from non-monetary items (for example, depreciation and amortization and prepaid income and expenses) 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 share of external shareholders 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 (for example, net interest income, operating commissions).

3.4 Statement of changes in shareholders' equity

Dividend declared or paid in the year of the report is stated in nominal values.

(4) Use of estimates

When preparing the financial statements, in accordance with generally accepted accounting principles in Israel and directives and guidelines of the Supervisor of Banks, management is required to use estimates, evaluations and their discretion affecting 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.

Changes in estimates

In July 2012, a draft position paper was published by the Capital Market, Insurance and Savings Department in the Ministry of Finance concerning the update of demographic assumptions in pension funds and life insurance, including a possible update of mortality tables. In accordance with instructions of the Banking Supervision Department on the measurement of liabilities in respect of employee rights, assumptions regarding mortality and disability are to be updated according to the best information available to the banking corporation. For this purpose, use is to be made, *inter alia*, of the draft mortality and disability tables published recently by the Ministry of Finance.

In accordance with the aforesaid, the Bank updated its evaluation of demographic variables, based on the updated estimates of life expectancy included in the draft position paper. As a consequence, the Bank increased the liability for pensions by some NIS 25 million before tax. The increase in provision was charged to payroll expenses in the statement of profit and loss. In March 2013, the Capital Market, Insurance and Savings Department in the Ministry of Finance published a final circular on the subject. No further update was required to the amount of liabilities for pension.

D. First-time Implementation of Accounting Standards, Accounting Standard Updates, and Directives of the Banking Supervision Department

As of reporting periods commencing 1 January 2012, the Bank implemented for the first time the accounting standards and directives set out below:

1. Directives on the format of the statement of profit and loss of a banking corporation and adoption of generally accepted accounting principles in US banks on the measurement of interest income.

2. Certain International Financial Reporting Standards (IFRS) and the interpretations of the IFRIC Interpretations Committee relating to the implementation of these standards as set out below:

IAS 7	Statement of Cash Flows
IAS 12	Income Taxes
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures

3. Explanations of the Banking Supervision Department regarding the manner of implementation of certain International Financial Reporting Standards (IFRS) concerning the functional currency of offices operating abroad.

4. Directives of the Banking Supervision Department regarding transactions between a banking corporation and its controlling shareholder and a company under the control of the banking corporation.

5. Accounting Standards Update ASU 2011-03 - "Reconsideration of Effective Control for Repurchase Agreements", which constitutes an update of the principles set out in FAS 166 (ASC 860).

6. Directives of the Banking Supervision Department regarding fair value measurement, which incorporate, in the Public Reporting Directives, Accounting Standard Update ASU 2011-04 - "Fair Value Measurements" (ASC 820): "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRS.

7. Directives of the Banking Supervision Department regarding updating the disclosure of credit quality of debts and the allowance for credit losses, adopting Accounting Standard Update ASU 2010-20.

The effect of implementation of these Standards is shown below as part of the Accounting Policy.

Reclassification

Pursuant to the first-time implementation of certain accounting standards and directives of the Banking Supervision Department as set out above, certain sections in the financial statements and comparative figures have been reclassified:

1. Directives of the Banking Supervision Department regarding the format of the statement of profit and loss for a banking corporation and adoption of generally accepted accounting principles in US banks on the measurement of interest income

Pursuant to the circular of the Banking Supervision Department of 29 December 2011 on the format of the statement of profit and loss of a banking corporation and adoption of generally accepted accounting principles in US banks on the measurement of interest income, the Bank implements those directives relating to the manner of presentation of the statement of profit and loss.

In accordance with the directives, the Bank has adapted its manner of presentation of the components of financing profit in the body of the statement of profit and loss and in the accompanying notes as follows:

The item "Financing profit before expenses in respect of credit losses" was split into three parts: "Interest income", "Interest expenses", and "Non-interest financing income". Accordingly, the gross profit of the Bank now includes only net interest income after deducting credit loss expenses.

The definition of net interest income was changed so as to include interest income and expenses including index-linkage differentials on the principal.

The Bank has applied the directives concerning the format of the statement of profit and loss retroactively from 1 January 2012. Initial implementation had no effect, apart from a change in presentation.

Below are details of the reclassifications made:

a. **The following components of the financing profit have been reclassified under non-interest financing income in respect of activities for purposes other than trading:**

- Profits (losses) from the sale of bonds available for sale.
- Income (expenses), net in respect of derivative instruments used for ALM activity.
- The ineffective part of hedging relationships.
- Exchange-rate differentials in respect of financial assets or liabilities, except for interest-rate differentials included as part of interest income or expenses.
- Profits (losses) from the sale of loans.

b. **The following components of the financing profit have been reclassified under non-interest financing income in respect of activities for trading purposes:**

- Realized and unrealized profits (losses) from fair value adjustments of securities held for trading.
- Dividends from shares held for trading.
- Income (expenses) in respect of other derivative instruments.

c. Fee income from financing business previously included under the item "Profit from financing activity" has been reclassified under the item "Commissions" (previously "Operating commissions").

d. Profits (losses) previously included under the item "Profits (losses) net from investments in shares" have been reclassified and included under the item "Non-interest financing income" as part of activities for trading purposes or as part of activities for purposes other than trading, according to the classification of the shares in the trading portfolio or in the portfolio available for sale.

e. Early repayment commissions and interest on arrears previously included in "Other financing income" have been reclassified and included in "Interest income from credit to the public".

f. The approach used in the US has been adopted regarding the classification of any event or transaction as profit from extraordinary activities, under which special items are defined as items which are “unusual" and “infrequent”. In view of this, a banking corporation is allowed to classify an event or a transaction as an extraordinary item only with the approval of the Supervisor of Banks. Profits (losses) previously included under the item "Profit (loss) from extraordinary activities, after taxes" have been reclassified as follows: Profits (losses) from the sale of shares in companies included on equity basis under the item "Non-interest financing income in respect of activities for purposes other than trading".
Profits (losses) from the realization of buildings and equipment have been reclassified from the item "Profit from extraordinary activities after taxes" to the item "Other income".

Note 1 – Significant Accounting Policies (cont'd)

The effect of the change on the condensed consolidated financial statements (NIS millions):

Name of item	Name of item before change in presentation	Name of item after change in presentation	For the year ended 31 December 2011	For the year ended 31 December 2010
Profits (losses) from the sale of bonds available for sale	Profit from financing income before credit loss expenses - other financing income (expense)	Non-interest financing income in respect of activities for purposes other than trading	**265**	**262**
Income (expenses) net in respect of ALM derivative instruments and non-effective part of hedging relationships	Profit from financing income before credit loss expenses in respect of derivative financial instruments and hedging activities	Non-interest financing income in respect of activities for purposes other than trading	**1,055**	**(1,795)**
Exchange-rate differentials on principal in respect of assets/liabilities	Profit from financing income before credit loss expenses in respect of assets/liabilities	Non-interest financing income in respect of activities for purposes other than trading	**(1,482)**	**1,752**
Profits (losses) from the sale and fair value adjustment of bonds for trading, net	Profit from financing income before credit loss expenses - other financing income (expense)	Non-interest financing income in respect of activities for trading purposes	**78**	**147**
Profits (losses) from the sale and fair value adjustment of shares for trading, net	Operating and other income – profits from investment in shares, net	Non-interest financing income in respect of activities for trading purposes	**140**	**1**
Net income in respect of other derivative instruments	Profit from financing income before credit loss expenses in respect of derivative financial instruments and hedging activities	Non-interest financing income in respect of activities for trading purposes	**7**	**15**
Commissions from financing business	Profit from financing income before credit loss expenses - commissions from financing business	Commissions	**399**	**384**
Early repayment commissions	Profit from financing income before credit loss expenses – other financing income	Interest income	**160**	**103**
Interest on arrears	Profit from financing income before credit loss expenses – other financing income	Interest income	**13**	**15**

Note 1 – Significant Accounting Policies (cont'd)

2. IAS 7 – Statement of Cash Flows

Pursuant to the first-time implementation of IAS 7 – Statement of Cash Flows, the following reclassification was made:

Net changes in cash flows in respect of current assets (such as deposits in banks, securities held for trading, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, credit to the public, credit to the government, and other assets) previously included under activity in assets, an increase of NIS 25,369 million and NIS 18,702 million in the years ended 31 December 2011 and 2010, respectively, were reclassified to current activity.

Net changes in cash flows in respect of liabilities (such as deposits from the public, deposits from banks, deposits from the government, securities lent or sold under agreements to repurchase, liabilities in respect of derivative instruments and other liabilities) previously included under activity in liabilities and equity, an increase of NIS 31,545 million and NIS 2,008 million in the years ended 31 December 2011 and 2010, respectively, were reclassified to current activity.

E. Foreign currency and linkage

Transactions in foreign currency

(1) Assets and liabilities denominated in foreign currency or linked thereto are stated according to the representative rates of exchange published by Bank of Israel at the balance sheet date, or other appropriate date, as follows:

- Assets and liabilities denominated in foreign currency or linked thereto are translated to the functional currency at the rate of exchange prevailing on that date.

- Non-monetary assets and liabilities in foreign currency or linked thereto that are measured at fair value, are translated into the functional currency at the rate of exchange prevailing on the date on which the fair value is determined. Non-monetary items denominated in foreign currency or linked thereto and measured at historical cost, are translated at the rate of exchange prevailing on the date of the transaction.

Income and expenses in foreign currency are included in the statement of profit and loss according to current representative exchange rates at the transaction dates with the addition of exchange rate differentials on the assets and liabilities in respect of which the above income and expenses arose.

Exchange rate differentials are recognized in other comprehensive income result from the translation of:

- Equity financial instruments classified as available for sale (except in the event of impairment when the translation differences recognized in other comprehensive income are reclassified to profit and loss).

- Financial liabilities hedging investments in a foreign operation in respect of the effective part of the hedge.

- Cash flow hedge in respect of the effective part of the hedge.

Note 1 – Significant Accounting Policies (cont'd)

The functional currency of offices operating overseas

The Bank applies IAS 21 – "The Effects of Changes in Foreign Exchange Rates" as of 1 January 2011, except for the provisions of the Standard with regard to the classification of banking offices operating overseas as foreign operations whose functional currency is not the shekel.
Until 1994 certain foreign banking offices were considered as a foreign operation whose functional currency is different from the shekel, and exchange rate differentials were charged directly to equity, as part of the translation reserve. From 1995, pursuant to the directives of the Supervisor of Banks, foreign banking offices were classified as a foreign operation whose functional currency is the same as the functional currency of the Bank.

On 14 February 2012, instructions were published by the Supervisor of Banks as to the manner of determining the functional currency of banking offices operating overseas. When determining the functional currency, the Bank is required to examine the range of criteria listed below, and document the results:

- If the primary environment in which the office generates and expends cash is a foreign currency and the activity of the office in shekels is marginal.

- If recruiting customers for the office is carried out independently, such that the activity of the office vis-à-vis the customers of the banking corporation or related parties is not significant.

- If the activity of the office vis-à-vis the banking corporation and related parties is not significant, and, *inter alia*, the office has no dependence on sources of funding from the banking corporation or its related parties.

- If the activity of the office is essentially independent and stands alone, and is not an extension of or supplementary to the local activity of the banking corporation.

When one of the said criteria is clearly not fulfilled (for example, the transactions of the office carried out with the banking corporation's customers are so significant that they represent most of the office's transactions), this indicates that the office is to be treated as a foreign operation whose functional currency is the shekel. In any other situation, the determination is to be made according to an examination of a range of criteria.

The Bank has reexamined the classification of its overseas banking offices in accordance with the new criteria, and has reclassified the banking offices in the US and Switzerland as foreign operations whose functional currency is other than the shekel.
The change in classification was dealt with prospectively as a change in the functional currency of the offices, so that exchange rate differences from translation are recognized from 1 January 2012 as other comprehensive income, and shown under "Adjustments for translation of foreign operations".

Hedging a net investment in a foreign operation

The Group applies hedge accounting in respect of exchange rate differences between the functional currency of a foreign operation and the functional currency of the Bank (NIS), whether the investment in a foreign operation is held directly by the Bank or through a holding company.
Exchange rate differences arising from translation of a financial liability hedging a net investment in a foreign operation, are charged to other comprehensive income and shown as equity under "Adjustments for translation of foreign operations". The ineffective part is charged to profit and loss. When the investment for which the hedging was made is realized, the relevant amount accrued in "Adjustments for translation of financial statements" is transferred to profit and loss as part of the profit and loss from realization of the investment.

Note 1 – Significant Accounting Policies (cont'd)

Index linked assets and liabilities not measured for fair value

Assets and liabilities linked to the Consumer Price Index are included in accordance with the linkage terms determined for each balance.

Details of representative exchange rates and the CPI and the rate of change therein:

	31 December			Rate of change in		
	2012	2011	2010	**2012**	2011	2010
	NIS			%		
Exchange rate of:						
U.S. dollar	**3.733**	3.821	3.549	**(2.3)**	7.7	(6.0)
Euro	**4.921**	4.938	4.738	**(0.3)**	4.2	(12.9)
Pound Sterling	**6.036**	5.892	5.493	**2.5**	7.3	(10.1)
Swiss franc	**4.077**	4.062	3.788	**0.4**	7.2	3.3
Consumer Price Index:	(Points)					
November – known index	**105.5**	104.0	101.4	**1.4**	2.6	2.3
December – index for the month	**105.7**	104.0	101.8	**1.6**	2.2	2.7

F. Basis of consolidation

(1) Business combinations

The Group applies the acquisition method with regard to all business combinations. The acquisition date is the date when the acquirer achieved control over the acquiree.

For acquisitions occurring after 1 January 2011, the Group recognizes goodwill at the acquisition date at the fair value of the proceeds paid, including amounts recognized in respect of any rights not conferring control over an acquiree, as well as the fair value at the acquisition date of equity rights in the acquiree that were held prior to then by the acquirer, after deducting the net amount attributable on acquisition to identifiable assets that were acquired and liabilities that were assumed.

The Bank recognizes a contingent liability assumed in a business combination at the date of acquisition if there is a liability at the date of acquisition deriving from past events whose fair value can be measured in a reliable manner.

In the event the Group carries out an acquisition at an advantageous price (an acquisition that includes negative goodwill), it recognizes the profit generated as a result in the profit and loss statement at the acquisition date, after carrying out an additional examination of the amounts attributed to the assets and liabilities of the entity acquired and approval of the Supervisor of Banks.

The proceeds transferred include the fair value of the assets transferred to the previous owners of the acquiree, liabilities assumed by the acquirer vis-à-vis the previous owners of the acquiree, and equity rights issued by the Group. In a business combination achieved in stages, the difference between the fair value at the date of acquisition of the equity rights in the acquiree held previously by the Group, and the book value at the same date, is charged to the statement of profit and loss under "Non-interest financing income – profits or losses from investment in shares" as part of activities not for trading purposes. Furthermore, the proceeds transferred include the fair value of the conditional proceeds. Subsequent to the date of acquisition, the Group recognizes changes in the fair value of the conditional proceeds classified as a financial liability in the statement of profit and loss, while the conditional proceeds classified as a capital instrument is not remeasured.

Costs of a transaction resulting from a business combination transaction are charged immediately to profit and loss.

Business combinations occurring prior to 1 January 2011

Pursuant to the instructions of the Supervisor of Banks, the Group adopted the relief provided in IFRS 1 – First-time Implementation of International Financial Reporting Standards. Accordingly, the Group does not implement IFRS 3 (2008) retroactively with regard to business combinations, acquisitions of companies included on equity basis, and acquisitions of non-controlling interests occurring prior to 1 January 2011. Thus, for the said acquisitions, goodwill recognized and surplus costs generated represent the amounts recognized in accordance with the Public Reporting Directives of the Supervisor of Banks.

(2) Subsidiary companies

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 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 otherwise permitted.

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.

Non-controlling interests are the part of the equity of subsidiary companies, directly or indirectly, which are not attributable to the parent company. These rights, which grant the holder part of the net assets of the acquiree, are measured for fair value on the date of acquisition.

Profit or loss and any element of other comprehensive income are attributable to the shareholders of the Bank and to non-controlling interests. The amount of profit, loss, and other comprehensive income attributable to the owners of the Bank and to non-controlling interest even if as a result of this the balance of non-controlling interests would be negative.

Transactions with non-controlling interests, while maintaining control, are treated as equity transactions. Any difference between the proceeds paid or received in the change of non-controlling interests is charged to the owners' share of the Bank, directly to retained earnings. The amount for which non-controlling interests are adjusted is calculated as follows: if the holding percentage increases, according to the relative part acquired from the balance of the non-controlling interests in the consolidated financial statements prior to the transaction. If the holding percentage decreases, it is calculated according to the relative part realized by the owners of the bank in net assets of the subsidiary company including goodwill. Furthermore, when there are changes in the holding percentage in a subsidiary company, while maintaining control, the Bank reapportions the aggregate amounts recognized under "Other Profit", between the owners and the non-controlling interests.

Note 1 – Significant Accounting Policies (cont'd)

(3) Companies included on equity basis

Companies included on equity basis are entities in which the Group has significant influence on financial and operational policy, without having achieved control over them. It is assumed that holding between 20% and 50% of an investee grants material influence. When examining whether there is material influence, potential voting rights that are exercisable or immediately convertible to shares in the investee company, are to be taken into consideration.

Investments in shares of companies included on equity basis are stated according to the equity method and recognized initially at cost, based on the audited financial statements of these companies. The cost of the investment includes transaction costs. When the Bank achieves significant influence for the first time in an investment dealt with as an asset available for sale until the date significant influence is achieved, the equity method is applied retroactively.
Investments include goodwill calculated at the date of acquisition and shown after deducting accrued losses from impairment. The accounting policy of companies included on equity basis which is implemented by them is in accordance with generally accepted accounting principles in Israel or international accounting principles if the company included on equity basis is in a foreign country or is otherwise permitted by the Supervisor of Banks.

The financial statements of a company included on equity basis are prepared using an uniform accounting policy with the banking corporation with regard to similar transactions and events under similar circumstances; except for adjustments to accounting policy referring to subjects that are a core part of the banking business, that were implemented by a non-banking company included on equity basis. In addition, the financial statements of companies included on equity basis are prepared for the same dates and periods as those of the banking corporation.

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. Positive goodwill is not amortized and is included in the book value of the investment, and negative goodwill is recognized in profit and loss at the acquisition date with the approval of the Supervisor of Banks.

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.

Profits or losses from the realization of companies included on equity basis are charged to profit and loss under "Non-interest financing income – profits or losses from investment in shares" as part of activities not for trading purposes.
When the Group share in losses exceeds the value of the rights of the Group in the company dealt with under the equity method, the book value of those rights is reduced to zero.
The Group does not recognize additional losses of the investee company unless the Group has an additional obligation to the investee company. When there is an increase in the percentage of the holding in the company included on equity basis that is being dealt with under the equity method while retaining significant influence, the acquisition method is applied only with respect to the additional percentages held, while the previous holding remains unchanged.

When there is a reduction in the percentage of the holding in the company included on equity basis that is being dealt with under the equity method while retaining significant influence, the relative portion of the amounts recognized in capital reserves through other comprehensive profit in reference to the said company included on equity basis, is reclassified to profit and loss or retained earnings.

Note 1 – Significant Accounting Policies (cont'd)

When there is a loss of significant influence, the Group ceases to use the equity method as of the date it lost significant influence, and deals with the remaining investment as a financial asset. At this date it will recognize, in profit and loss under "Non-interest financing income – profits or losses from investment in shares" as part of activities not for trading purposes, the difference between the fair value of the balance of the investment and the book value of the investment.

Pursuant to the implementation of the International Standard that takes into consideration certain potential voting rights for purposes of determining significant control, the investment in a company included on equity basis that until 31 December 2010 was classified in the available for sale portfolio, was classified as of 1 January 2011 as a company included on equity basis. The Bank examines the necessity, in each reporting period, of recording impairment of its investment in companies included on equity basis - see paragraph U below.

G. Basis of recognition of income and expenses

Income and expenses are included on an accrual basis, except for the following:

- Income and expenses from securities held for trading and derivative financial instruments are recognized according to the changes in fair value.

- Interest accruing on problematic debts that were classified as non-accrual loans is recognized on a cash basis when there is no doubt with regard to collection of the remaining recorded debt balance of an impaired debt. In these situations, an amount collected on account of the interest that is recognized as interest income, is limited to the amount that would be accumulated in the reporting period on the remaining recorded balance of the debt according to the contractual interest rate. Interest income on a cash basis is classified in the statement of profit and loss as a interest income under the relevant heading. When there is doubt as to collection of the remaining recorded balance of debt, all payments collected serve to reduce the loan principal. In addition, interest on past-due amounts in respect of housing loans is recognized in the profit and loss statement on an actual collection basis.

- 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.

- Allocation fees for credit facilities, together with commissions on financing business, are recognized in the statement of profit and loss relative to the periods of the transactions.

- Operating commissions for granting services are charged to profit and loss when the service is granted.

- In successive periods of an impairment which is other than of a temporary nature, interest income from investments in debt instruments will be recognized in the following way:

  Beneficial interests acquired or beneficial interests that have continue to be held by the Bank in the securitization of financial assets, which are accounted for using the prospective interest method – the excess of the amount of expected cash flows to be collected over the fair value of the debt instrument will be recognized as interest income over the remaining life of the debt instrument. In rare instances in which the Bank has no reasonable estimate with regard to amounts and timing of expected cash flows to be collected from the debt instruments, the Bank recognizes income using the cost recovery method or recognizes income on a cash basis.

Other debt instruments – Income in the reporting period is accrued on the basis of the excess of expected cash flows of the debt instrument. (The base amount of the debt instrument at the date of impairment in value which is of a nature other than temporary constitutes its fair value).

H. Fair Value

Effective 1 January 2011, the Bank implements the rules set out in FAS 157 (ASC 820-10) that 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 and detailed instructions for implementation. In addition, as of 1 January 2012, the Bank applies the directive of the Banking Supervision Department on Fair Value Measurement that integrates the principles set out in Accounting Standards Update ASU 2011-04 on Fair Value Measurement in the Public Reporting Directives.

Fair value is defined as the amount/price that would be received from the sale of an asset or that would be paid to transfer a liability in a transaction between a willing seller and a willing buyer at the measurement date. The Standard requires, *inter alia*, for purposes of fair value valuation, making optimum use of observable inputs, and minimizing the use of unobservable inputs. Observable inputs provide information available to the market received from independent sources, whereas unobservable inputs reflect assumptions by the banking corporation.

FAS 157 stipulates a hierarchy of measurement techniques based on the determination if the inputs used for purposes of determining fair value are observable or unobservable. These types of input create a fair value hierarchy detailed as follows:

- Level 1 inputs: quoted prices (not adjusted) in active markets for identical assets or liabilities.

- Level 2 inputs: prices quoted for similar assets or liabilities in active markets; prices quoted for identical assets or liabilities in inactive markets; prices derived from evaluation methods in which all the significant inputs are observable in the market, or are supported by observable market data.

- Level 3 inputs: unobservable inputs for the asset or the liability deriving from evaluation model for which one or more of the significant inputs are not observable.

This hierarchy requires the use of observable market data, where such exist. When this is possible, the Bank considers relevant observable data in its evaluation, the scope and frequency of the transactions, the size of the bid-ask margin, and the size of adjustment required when comparing similar transactions, are all factors taken into account when determining the level of market liquidity and the degree of relevance of observable prices in those markets.

The level in the scale of fair value to which the fair value measurement of the financial instrument belongs is to be determined on the basis of the lowest level of the figure that is significant for the fair value measurement as a whole.

The implementation of the rules set out in FAS 157 allows for the recognition of day-one profits and do not require the fair value measurement of derivative instruments not traded on an active market be determined according to the transaction price.

The Standard requires the banking corporation to reflect credit risk and non-performance risk in the measurement of the fair value of debt, including derivative instruments, issued by the banking corporation and measured at fair value. Non-performance risk includes the credit risk of the banking corporation, but is not limited to this risk only.

For further details regarding the methods and main assumptions used for purposes of assessing the fair value of financial instruments, see Note 18.D below, under the subject of balances and fair value measurements of financial instruments.

Methods of assessment implemented by the Bank for measuring fair value are evaluated 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 addition, fair value measurement of financial instruments is made without taking into account the factor of the size of the holding with regard to financial instruments assessed in accordance with data of each of the levels, except for situation in which the premium or discount were taken into account in fair value measurement by market participants in the absence of Level 1 data.

Pursuant to transitional directives for 2011, which were extended also for 2012, specific instructions were given concerning methodology data used in calculating the fair value of derivative instruments. A banking corporation is not required to use complex models that include various scenarios of potential exposure in order to contend with the credit risk component included in the fair value of derivative instruments. In accordance with the above transitional directives, and pursuant to the instructions of the Supervisor of Banks, the Bank carries out the aforesaid adjustment calculation on a Group basis, while making use of a credit quality model according to groups of similar counterparties, e.g. based on internal ratings.

On 20 November 2012, a circular was published amending the Public Reporting Directives of the Supervisor of Banks regarding fair value measurements. The amendment incorporates in the Public Reporting Directives the rules for fair value measurement as prescribed in ASU 2011-04. The circular also set out a new uniform format for disclosure regarding certain disclosure requirements regarding the following:

- Information about Level 3:
    - Quantitative disclosure of significant unobservable inputs and a description of the valuation technique implemented by the Bank.
    - Qualitative discussion on sensitivity analysis of fair value measurement to changes in significant unobservable inputs.
- Classification by level within the fair value hierarchy for items not measured at fair value in the balance sheet, which requires disclosure of fair value.
- For each transfer from Level 1 to Level 2 and vice versa for items measured at fair value on a recurring basis, the item, amount of the transfer, the reason for the transfer and the policy of the banking corporation are to be described.
- Providing a detailed breakdown of the fair value hierarchy (split into 3 levels) for balances and fair value estimates of financial instruments.

The Bank applies the amendments prescribed by ASU 2011-04 and the circular of the Supervisor of Banks in the 2012 financial statements on a prospective basis. Accordingly, these financial statements do not include comparative figures for new disclosures. The initial adoption of ASU 2011-04 and the circular of the Supervisor of Banks will not have a material effect on the financial statements except for changes in presentation.

Note 1 – Significant Accounting Policies (cont'd)

The Fair Value Option for Financial Assets and Financial Liabilities

FAS 159 (ASC 825-10) allows a banking corporation to elect, on defined dates, to measure financial instruments and certain other items (the eligible items) at fair value, which under the 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 election 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 bases for measurement of similar types of assets and liabilities.

Notwithstanding the above, it is clarified by the Banking Supervision Department that a banking corporation shall not elect the fair value alternative unless it has developed prior know-how, systems, procedures, and controls at a high level, which will enable it to measure the item to a high degree of reliability. Thus, a banking corporation shall not elect the fair value alternative with regard to any asset requiring classification as level 2 or level 3 of the fair value hierarchy, or with regard to any liability, unless it receives prior approval to do so from the Banking Supervision Department.

I. Securities

(1) Securities in which the Bank invests are classified in three portfolios as follows:

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, and securities for which the banking corporation chose to make fair value measurement through the statement of profit and loss. Securities held for trading are stated at fair value at the reporting date. 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 on the reporting date, except for shares, options and venture capital funds in respect of which the fair value is not available, in which case they are stated at cost.

Differences between the fair value and the amortized cost, less a reserve for tax, are shown in a separate item within shareholders' equity, under other comprehensive profit. 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.

Note 1 – Significant Accounting Policies (cont'd)

(2) Fair Value

With regard to the determination of fair value, see paragraph H below.

In determining the fair value of securities and other financial instruments that are traded on an occasionally inactive market, significant use is made of discretion, including examining whether transactions have been made under pressure or coercion. In those cases where there is no available price quotation in an active market, the fair value is determined using generally accepted pricing models, based on evaluations obtained from experts in valuing financial instruments or on an independent system of the Bank. The evaluation methods include the use of various parameters, such as interest curves, currency rates and standard deviations, taking into account the risks inherent in the financial instrument (market risk, credit risk, non-marketability, etc.).

Most of the portfolio is calculated each month by a well-known international institution which is engaged in the calculation of fair value and is independent of the issuing entities and the marketing entities. The calculation is based mainly on the prices of transactions in active markets. The balance of the portfolio is revalued based on quotes from brokers or from the makers of the instruments, or based on the Bank's system.

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.

Interest income in respect of beneficial interests which have been acquired, such as asset-backed financial instruments, e.g., MBS, CLO, SCDO and CMO (except for high-quality loan instruments) is recognized using the prospective interest method (future interest that also anticipates future changes) , adjusting the interest rate used for recognizing interest for changes in the estimate of future cash flows. High quality loan beneficial interests are beneficial interests issued under the guarantee of the United States government or agencies of the U.S. government, and asset-backed securities whose international credit rating is at least AA.

The Bank's investments in venture capital funds are dealt with according to cost less losses from impairment of a nature other than temporary. Profits from venture capital investments are credited to the profit and loss statement when the investment is realized.

(3) Impairment

The Bank examines the necessity, in each reporting period, 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 considerations and 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.
- Duration of period in which the fair value of the security is lower than cost.
- Evaluation of repayment ability and rating.
- An adverse change in the situation of the issuer or in the state of the market as a whole.

The Bank's policy is to recognize the impairment of a security as having a nature other than temporary, at least in respect of the impairment of any security that fulfils one or more of the following conditions:

- 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 rating decrease 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. Only a rating decrease below BBB- is considered a significant rating decrease for purposes of this paragraph.
- 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 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.

  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.

J. Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

The Bank applies the measurement and disclosure principles prescribed in US Accounting Standard FAS 140 (ASC 860-10) - Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, amended by FAS 166 (ASC 860-10) - Transfers and Servicing of Financial Assets, for the purpose of dealing with transfers of financial assets and extinguishment of liabilities. In accordance with these principles, the transfer of a financial asset will be accounted for as a sale, if and only if, all of the following conditions are fulfilled: (1) the transferred financial asset has been isolated from the transferor, both in a state of bankruptcy or other receivership; (2) any recipient (or, if the recipient is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the financial assets it receives, each third-party holder of its beneficial interests) can pledge or exchange the assets (or beneficial interests) it received, and no condition exists that also constrains the recipient (or a third-party of its beneficial interests) from taking advantage of its right to pledge or exchange and provides the transferor with more than a trivial benefit; (3) the transferor or consolidated companies included in its financial statements or its agents do not maintain effective control over the financial assets or beneficial interests relating to the transferred financial assets.

In addition, in order for the transfer of some of the financial asset to be considered a sale, the part transferred must comply with the definition of participating interests. Participating interests must comply with the following criteria: the interest must represent a proportionate interest in relation to an entire financial asset; all cash flows received from the assets are divided proportionately among the participating interest holders in an amount equal to their share of ownership; the rights are not subordinated rights in relation to other rights; there is no right of recourse to the transferor or to other holders in participating interests (other than in the event of a breach of representations or warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits received by any holder of participating interests); and neither the transferor, nor the participating interest holder has the right to pledge or exchange the entire financial asset, unless all participating interest holders agree to pledge or exchange the entire financial asset.

If the transaction meets the conditions for treating a transaction as a sale, the transferred financial assets are deducted from the Bank's balance sheet. If the sale conditions are not fulfilled, the transfer is considered a secured debt. A sale of part of a financial asset which is not a participating interest is treated as a secured debt, i.e., the transferred assets continue to be recorded in the Bank's balance sheet and the proceeds from the sale will be recognized as a liability of the Bank.

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 resale 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 under net interest income (expense).

Pursuant to 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 interest 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.

The Bank deducts a liability if and only if the liability is repaid, i.e. 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.

Accounting Standards Update ASU 2011-03 – "Reconsideration of Effective Control for Repurchase Agreements" constitutes an update to the rules set out in FAS 166 (ASC 860).

Assessing the existence of effective control are to be based on the contractual rights and liabilities between the parties if the following conditions are met:

- The assets to be repurchased or redeemed are the same or substantially the same as those transferred;
- The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price; and
- The agreement is entered into contemporaneously with the transfer.

The Group applies the rules set out in ASU 2011-03 as of 1 January 2012 prospectively for transfers of assets after the effective date or of existing transactions in which there was modification after the effective date.

There was no significant effect from implementation of the Amendment.

K. Buildings and equipment

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 fixed assets have a different life span they are dealt with as separate items of fixed assets.

Buildings earmarked for sale are shown at the lower of cost or realizable value.

Profit or loss on the sale of fixed assets is included under "Other income " in the statement of profit and loss.

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 in the books. Ongoing maintenance costs of fixed asset items are charged to the profit and loss statement when incurred.

Costs of software

Pursuant to the Public Reporting Directives, the Bank classifies under this section the costs in respect of software assets acquired or costs capitalized as an asset in respect of software developed internally for its own use.

Software purchased is measured by costs less accumulated depreciation and losses from impairment in value.

Costs in connection with the development and adaptation of computer software intended for internal use are capitalized only if development costs can be measured reliably, the software 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.

Depreciation

Depreciation is calculated on the cost, in accordance with estimated useful life, on a straight line basis from the date the asset is ready for use. The Bank depreciates separately each part of a fixed asset for which a different useful life has been determined. Leasehold improvements are amortized over the leasing period, including an option which is likely to be exercised, or over its useful life, whichever is shorter. An asset is amortized when it is available for use.
The estimates regarding useful life and residual value are examined periodically.

In connection with impairment of non-monetary assets, see paragraph U below.

Leases

Leases, including leases of land from the Israel Land Authority or other third parties, where the Group materially bears all the risks and returns from the property, are classified as finance leases. At the commencement of the initial lease term, leased assets are recognized at an amount equal to the lower of fair value and the present value of future minimum lease payments. Future payments for exercising an option to extend the period of the lease with the Israel Land Authority are not recognized as part of the asset and related liability to the extent their amount is derived from the fair value of the land at future renewal dates of the lease agreement. After initial recognition, the asset is dealt with in accordance with accepted accounting policy regarding this asset.

The period of the lease is the period which cannot be canceled, for which the lessor made a contractual agreement for the lease of the asset together with any additional periods for which the lessee has the option of continuing to lease the asset, for an extra payment or for no extra payment, when it is reasonable certain at the date of the leasing commitment that the lessee will exercise the option.

The other leases are classified as operating leases, and the leased assets in these cases are not recognized in the balance sheet.

Payments in the framework of an operational lease are charged to the statement of profit and loss on a straight-line basis over the term of the lease.

Investment Property

Investment property is real estate (land or buildings – or part of the same – or both) held by the Bank (as owners or under a financial lease) for purposes of generating rental income or for an increase in equity value or both, and not the purposes of:

1. Use for production or supply of goods or services for administrative purposes; or

2. Sale in the normal course of business.

Investment property is measured initially at purchase cost plus transaction costs. In subsequent periods, investment property is measured at cost less accumulated amortization and losses from impairment.

Note 1 – Significant Accounting Policies (cont'd)

L. Issue expenses

Expenses of issue of debentures, bonds and subordinated notes are amortized by the effective interest method over the expected life of the instrument issued.

M. Derivative financial instruments including hedge accounting

The Bank holds derivative financial instruments for purposes of hedging foreign currency risks and interest rate risks, and also carries out activity in derivatives not for hedging purposes.

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 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 addition, the Bank applies hedge accounting in the "shortened" version which assumes full effectiveness in accordance with the provisions of the standard.

(1) 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 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 and recognized immediately and on a current basis in the statement of profit and loss.

(2) Asset and liability management

Hedge accounting is not applied with regard to derivative instruments serving as part of the 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.

(3) Other derivatives

Changes in the fair value of derivatives not used for hedging or exposure coverage, are charged immediately to profit and loss.

(4) Embedded derivatives

Embedded derivative instruments are separated from the 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, including credit risks attributable to certain embedded credit derivatives; (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.

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), pursuant to 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 re-measurement (a remeasurement event), such as a result of business combinations or material changes in the debt instrument. Such fair value election is irrevocable.

(5) Fair value

With regard to the determination of fair value, see paragraph H above.

N. Impaired Debts, Credit Risk and Allowance for Credit Losses

The Bank applies the Directive of the Supervisor of Banks on Measurement and Disclosure of Impaired Debts, Credit Risk, and the Allowance for Credit Losses as of 1 January 2011.
The Directive has been implemented with regard to all debt balances such as deposits in banks, bonds, securities borrowed or purchased under repurchase agreements, credit to the public, credit to the government, etc. Credit to the public and other debt balances for which no specific rules were made in the Public Reporting Directives regarding the measurement of the allowance for credit losses (such as credit to the government, deposits in banks, etc.) are reported in the books of the Bank according to the recorded debt balance. It should be explained that prior to 1 January 2011, the Bank applied different rules according to which the debt balance in the Bank's books included the interest component accumulated before the debt was classified as a non-income bearing problem debt. Accordingly, and in light of credit balances written off in accordance with the new directives, loan balances reported in periods before the initial implementation period of the Directive are not comparable with loan balances reported after the commencement of implementation. With regard to other debt balances, for which there are specific rules for measurement and recognition of impairment (such as bonds), the Bank continues to apply the same rules for measurement.

The Bank has decided on the procedures required to maintain an allowance for credit losses at a level appropriate to cover expected credit losses relating to its loan portfolio, including in respect of off-balance sheet credit risk. Allowances for credit losses include:

- Individual allowance for credit losses – The allowance is made based on the measurement of the impairment of the debt, based on the present value of future expected cash flows, discounted at the effective rate of interest of the debt; or, when a debt is dependent on collateral or when an asset is expected to be seized, according to the fair value of the collateral pledged to secure such credit (less costs of sale). The need for an individual allowance is assessed for each debt whose contractual balance (without deducting: accounting write-offs not involving a legal waiver, interest not recognized, allowances for credit losses, and collateral) is NIS 0.5 million or more, and any other debt identified for individual assessment by the Bank. In some of the consolidated subsidiary companies, the assessment is made also for lower amounts. The individual allowance is calculated for each debt classified as impaired (see below).

- Collective allowance for credit losses – This is implemented for large groups of relatively small and homogeneous debts, and in respect of debts that have been assessed individually and found not to be impaired. Measurement of credit losses is based on the transitional directives set out below. The allowance assessed on a group basis for off-balance sheet credit instruments is based on the rates of allowance determined for balance sheet credit, taking into account the percentage of off-balance sheet credit risk expected to be realized. The credit realization percentage is calculated by the Bank based on credit conversion coefficients as set out in Proper Conduct of Banking Business Directive No. 203 – Measurement and Adequacy of Capital – Credit Risk – Standardized Approach, with certain adjustments in cases where the Bank has prior experience indicating percentages for the realization of credit.

A temporary directive was issued for the years 2011-2013 (hereinafter: “the transitional period”), for calculating credit loss allowances on a collective basis. According to the temporary directive, the rate of allowances for credit losses on a collective basis will be determined for the transitional period based on the range of historical rates for provisions for doubtful debts during the years 2008-2010, segmented by sector of the economy, as well as on the actual rate of net accounting write-offs as of 1 January 2011. In addition to calculating the range of historical rates in the various sectors of the economy as mentioned above, the Bank, for purposes of determining the appropriate rate of the provision, takes into account other data, including conditions of the sector, macroeconomic data, a general assessment of the quality of credit to sectors of the economy, changes in volume and the trend of balances in arrears and impaired balances, and the effect of the changes on credit concentrations.

The minimum provision for doubtful debts in respect of housing loans is calculated according to a formula determined by the Supervisor of Banks, taking into account the extent of arrears, whereby the rates of the provision increase as the arrears grow. The application of the calculation of the provision according to the formula of the extent of arrears refers to all housing loans, except for loans not payable in regular installments and loans financing activity of a business nature. Similarly, a provision is made on the balance of housing loans not in arrears based on past statistics.

The Bank examines the overall appropriateness of the allowance for credit losses based on management's discretion taking into account the risks inherent in the loan portfolio.

The Bank also calculates a supplementary general provision under the policy for the provision for doubtful debts before the implementation of the directives on impaired debts, credit risk, and the allowance for credit losses.
These provisions are used only as an indicator for the collective allowance such that if the total collective allowance is less than the supplementary general provision, the allowance is to be made using the higher of the two calculations.

Classification of problem debts

The Bank classifies the balance of its various problem debts as follows: special mention, substandard, or impaired.

Special mention credit
Special mention balance sheet credit is a debt which has potential weaknesses in respect of which special attention is required by the management of the corporation. Off-balance sheet credit is classified as special mention credit if realization of the liability contingent on this item is "possible", and if the debts which may be recognized as a result of the contingent realization are suitable for classification in this category.

Substandard credit
Substandard balance sheet credit is credit which is insufficiently protected by the current established value and the debtor’s repayment ability, or by the pledged collateral, if any. Balance sheet credit risk classified as such has a well-defined weakness or weaknesses that put the realization of the debt at risk. Credit for which an allowance for credit losses is recognized on a collective basis will be classified substandard when it becomes a debt with arrears of 90 days or more.

Impaired credit
Identifying and classifying impaired credit
Impaired debt is credit of which the banking corporation, based on current information and events, will probably not be able to collect the entire amount due (principal and interest), according to the contractual

terms of the loan agreement. In particular, a debt is classified as impaired when its principal or interest is in arrears of more than 90 days, except if the debt is well secured or in collection proceedings. In addition, an impaired debt is also considered as a debt whose terms were changed due to problem debt restructuring.

Changing an impaired debt back to non-impaired status
An impaired debt reverts to being classified as a non-impaired debt if one of the two following conditions is met:
1. There are no components of principal or interest in regard thereof repayment has become due but have not been paid, and the Bank expects repayment of the remaining principal and interest in full under the terms of the contract (including accounting write-offs or amounts that have been provided for).
2. When the debt has become well-secured debt and is in process of collection.

Changing an impaired debt back to an impaired accrual status
A debt for which after restructuring there is reasonable certainty that it will be repaid in accordance with its new terms, is changed back for treatment as a debt accruing interest income under terms of restructuring, and any accounting write-off carried out in the debt is supported by an updated appraisal as to the financial condition of the debtor, based on continuous repayment performance of at least six months.

Problem Debt Restructuring
A debt which formally underwent a problem debt restructuring is defined as a debt in respect of which, for economic or legal reasons related to the debtor's financial difficulties, the Bank granted a waiver by way of modification of the terms of debt, in order to alleviate the burden for the debtor of near-term cash payments or by way of receipt of other assets as payment of the debt. For purposes of determining whether a debt agreement executed by the Bank comprises a problem debt restructuring, the Bank performs a qualitative examination of the totality of the terms of the arrangement and the circumstances under which it was made, in order to determine whether (1) the debtor is in financial difficulties and (2) the Bank granted a waiver under the arrangement to the debtor.

In order to determine whether the debtor is in financial difficulties, the Bank examines whether there are signs that point to the fact that the borrower is in difficulties at the time of the arrangement or the existence of a reasonable possibility that the borrower would get into financial difficulties if not for the arrangement.

The Bank examines, *inter alia*, the existence of one or more of the following circumstances:

- At the time of the debt arrangement the borrower is in default, including when any other debt of the borrower is in default; with regard to debts which at the time of the arrangement are not in arrears, the Bank estimates if according to the current repayment ability it is likely that in the foreseeable future the borrower will get into a default situation, and will not meet the original contractual terms of the debt;

- The debtor was declared bankrupt;

- Is under receivership, or there are significant doubts as to the borrower's continued existence as a going concern;

- And that without changing the terms of the debt, the debtor will not be able to raise debt from other sources at market rates of interest for debtors not in default. The Bank will conclude that the debtor was granted a waiver under the arrangement, even if under the arrangement an increase was made in the contractual interest rate, if one or more of the following situations exists:

- As a result of restructuring, the Bank is not expected to collect all amounts outstanding (including accrued interest according to the contractual terms);

- The updated fair value of the collateral, in respect of debts conditional on collateral, does not cover the contractual balance of the debt and indicates the inability to collect all amounts due;

- The debtor has no possibility of raising resources at the rate prevailing in the market for a debt with terms and characteristics such as those of the debt granted under the arrangement.

In addition, the Bank will not classify debt as a restructured problem debt if, under the arrangement, the debtor was granted a stay of payments that is not material, given the frequency of the payments in the contractual repayment period and the expected duration of the original debt. In this regard, if several arrangements were made involving changes in the terms of the debt, the Bank takes into account the cumulative effect of the previous arrangements for the purpose of determining whether the stay of payments is not material.

Restructured debts, including those that prior to the restructuring were examined on a group basis, will be classified as impaired debt and will be evaluated on an individual basis for purposes of making an allowance for credit losses, or an accounting write-off. Given that the debt, for which the problem debt restructuring was carried out, will not be paid in accordance with its original contractual terms, the debt continues to be classified as impaired debt, even after the debtor returns to the repayment schedule in accordance with the new terms.

Recognition of income:

At the time the debt is classified as impaired, the Bank defines the debt as a debt not accruing interest income, and ceases accruing interest income on it, except that stated above regarding certain impaired debts after restructuring. In addition, at the time the debt is classified as impaired, the Bank cancels all the interest income accrued but not yet collected, which was recognized as income in profit and loss. The debt remains classified as a debt not accruing interest income, as long as the impaired debt classification is not canceled. A debt that underwent a formal problem debt restructuring, and after the restructuring there is reasonable certainty that the debt will be repaid and will perform in accordance with its new terms, will be treated as an impaired debt accruing interest income. For details regarding recognition of income on a cash basis for debts classified as impaired, see paragraph G.

Regarding debts assessed and provided for on a collective basis, which are in arrears of 90 days or more, the Bank continues to accrue interest income. These debts are subject to methods of evaluation for the allowance for credit losses that ensure that the profit of the Bank is not overstated. Late-payment commissions for these debts are included as income on the date the Bank becomes entitled to receive them from the customer, provided that collection is reasonably secured.

Pursuant to the circular of the Banking Supervision Department of 29 December 2011 on the format of the statement of profit and loss of a banking corporation and adoption of generally accepted accounting principles in US banks on the measurement of interest income, the definition of "interest" was changed so as to include linkage differentials to the Consumer Price Index on the interest, exchange-rate differentials on the interest and linkage differentials to the Consumer Price Index on the principal (a component that previously was not considered as part of the interest). Directives concerning the change in definition of interest were implemented retroactively from 1 January 2012 onward. However, the Directives in connection with the change in the definition of "interest" in respect of impaired debts were implemented regarding debts classified as impaired from 1 January 2012 onward only.

Accounting write-off

- The Bank makes an accounting write-off for any debt or part thereof examined on an individual basis that is considered uncollectible, or a debt which the Bank has made efforts to collect over an extended period.

  The Bank makes an accounting write-off immediately against the allowance for credit losses for any part of a debt which exceeds the value of the collateral, which is identified as uncollectible.

The Bank makes an accounting write-off for any debt in respect of which the Bank is making efforts to collect the debt and for which individual allowances for credit losses have been made, generally within a period not exceeding two years.

- The Bank writes off problem debts in respect of which the allowance is measured based on a collective allowance for credit losses when the period of arrears exceeds 150 days.

It should be explained that accounting write-offs do not involve a legal waiver, and they reduce the reported balance of debt for accounting purposes only, while creating a new cost base for the debt in the Bank's books.

Doubtful Debts Provision Policy before the Implementation of the Directives on Impaired Debts, Credit Risk, and Allowance for Credit Losses

Provisions for doubtful debts are determined specifically, together with a general and a supplementary provision, in accordance with directives of the Supervisor of Banks. Provisions for doubtful debts in consolidated banking companies overseas are determined in accordance with generally accepted principles in their country of domicile.

The specific provision for doubtful debts is made based on a careful assessment by management of losses inherent in the credit portfolio, including debts in non-balance sheet items. In this assessment, management takes into account, among its other considerations, to what degree the risks are connected to the financial strength of the borrowers, based on information available to it regarding their financial condition, business activity, compliance with their obligations, and an assessment of the value of the collateral received from them.
Interest income in respect of a loan determined as doubtful is not recorded from the beginning of the quarter in which the debt was determined as doubtful. When the interest is collected, the interest income is recorded under other financial income.

A specific provision for housing loans granted by the Bank and investee banking companies in Israel is calculated in accordance with the directives of the Supervisor of Banks, taking into account the length of the period in arrears, with the rates of the provision increasing as the arrears increase.

The supplementary provision for doubtful debts is based on the quality of the customer credit portfolio, according to risk characteristics defined in the directives of the Supervisor of Banks. Different provision percentages are stipulated for each of the risk characteristics. The supplementary provision for doubtful debts is calculated according to percentages stipulated for the various characteristics. The general provision is in figures adjusted to the end of 2004, in an amount comprising 1% of total liabilities under the responsibility of the Bank and its investee banking companies as at 31 December 1991.

The effect of initial implementation in the sum of about NIS 1,319 million before tax and some NIS 721 million after tax have been recorded as a reduction in retained earnings as at 1 January 2011.

Initial implementation of the directives of the Supervisor of Banks regarding updating the disclosure on credit quality of debts and the allowance for credit losses

On 25 March 2012, a circular was promulgated by the Supervisor of Banks regarding updating the disclosure on credit quality of debts and the allowance for credit losses for the adoption of Accounting Standards Update ASU 2010-20 which requires wider disclosure obligations regarding debts balances, movement in the balance of the allowance for credit losses, any material purchases and sales of debts during the reporting period, and disclosures on credit quality.
In addition, disclosure is to be included on the credit quality of housing loans, a new disclosure for each of the credit segments and for each of the primary groups of debts as defined in the Directive, distinguishing between borrower activities in Israel and borrower activities abroad if material.

Note 1 – Significant Accounting Policies (cont'd)

The Group applies the provisions as from 1 January 2012 prospectively for the balance sheet data required for the first time by this Directive, while reclassifying comparative figures as far as possible. It is clarified that in the financial statements for 2012 it is not required to provide new disclosures regarding the restructuring of problem debt. Other disclosures required by this directive will be implemented as of the financial statements at 31 March 2013 and thereafter.
First-time implementation of the directive had no effect other than a change in presentation.

O. Assets transferred to Group ownership following the settlement of problem debts

Assets that were transferred to Group ownership following the settlement of problem 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.

P. Setting off assets and liabilities

The Bank sets off assets and liabilities for the same counterparty and reports their net balance in the balance sheet when the following cumulative conditions exist:

- When in respect of those liabilities there is a legally enforceable right to set off the liabilities from the assets;
- There is intent to repay the liabilities and realize the assets on a net basis or simultaneously.

The Bank sets off assets and liabilities with two different counterparties and reports a net balance in the balance sheet when the two cumulative conditions above exist, provided that there is an agreement between the three parties clearly defining the Bank's right of off-set in respect of those liabilities.

The Bank sets off deposits whose repayment to the depositor is conditional upon the amount collected from the credit, and the credit is granted from these deposits, in respect of which the Bank has no risk of loss from the credit. The interest margin from this activity is included under "Operating Commissions".

The Bank sets off between derivative instruments carried out with the same counterparty which are subject to a master netting arrangement. The offset is carried out only for purposes of calculating the indebtedness of the customer reported in the various notes.

Q. 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, there are legal proceedings whose chances or results 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:

- Probable risk – probability of realization of the risk exposure exceeding 70%. For claims included in this risk group, appropriate provisions are included in the financial statements.

- 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 only disclosure is made.

- 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 where the Bank determines that, in the view of Bank Management, with reliance on its legal advisors, it is not possible to evaluate the likelihood of realization of the risk exposure with regard to a normal claim and a claim approved as a class action, no provision is made.

In addition, the Group is exposed to legal claims that have not yet been made / submitted, *inter alia*, on the existence of a doubt in the interpretation of an agreement and/or the provision of a law, and/or the method of their implementation. This exposure is brought to the Group's attention in a number of ways. In assessing the risk arising from the demands / claims not yet submitted, the Group relies on internal assessments of the officials dealing with the issues and the management, who weigh the assessment of the risk for submitting a claim, the chance of the claim's success, if it is submitted, and payment in a compromise, if there be any. The assessment is based on accumulated experience in relation to the submission of claims and on an analysis of claims in their own right. In the nature of things, in light of the preliminary stage of clarification of the legal claim, the actual result could be different from the assessment made at a stage prior to the claim being submitted.

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 disclosure of material legal proceedings against the Bank and the consolidated companies.

R. Employee rights

There are appropriate reserves for all liabilities regarding employer/employee relations, pursuant to the law, agreements, accepted practice and management's expectations. Future liabilities for pensions and jubilee grants are calculated by a qualified actuary, using the accrued benefit valuation method, taking into account probabilities based on past experience. The capitalization rate of the reserves is 4%, as determined by the Supervisor of Banks, the mortality rate is based on updated instructions including a circular of the Commissioner of Capital Markets, Insurance and Savings in the Ministry of Finance that was published on the matter. The rate of increase in salary is based on past experience and varies according to the age of the employee.
Liabilities for retirement compensation and pensions are covered mainly by allocated funds deposited in pension and retirement provident funds. In respect of those amounts not covered as stated, a provision is included in the financial statements; see Note 15 – Employee Rights.

Instructions and Clarifications on the Strengthening of Internal Control over Financial Reporting relating to Employee Rights

During 2011, instructions were published by the Banking Supervision Department on the strengthening of internal control over financial reporting relating to employee rights. The instructions provide a number of clarifications concerning assessing the liability in respect of employee rights, and instructions in the matter of internal control over the financial reporting process on the subject of employee rights, with a requirement for the engagement of a certified actuary, the identification and classification of liabilities in respect of employee rights, the maintaining of internal controls for purposes of reliance on the actuary's valuation and its validation, as well as certain disclosure requirements.

It was stipulated, *inter alia*, that a banking corporation expecting to pay its employees, on their leaving, benefits in excess of contractual terms, shall take into account the percentage of employees expected to leave and the benefits expected, for the calculation of pension and jubilee grant obligations. As a result of the above instruction, the Bank made an estimate of the number of employees expected to leave early in the actuarial models on which pension and jubilee grant obligations are based, and benefits in excess of contractual terms were taken into account.

Note 1 – Significant Accounting Policies (cont'd)

Share-based payment transactions

Share-based payment transactions include transactions with employees that were settled with equity instruments. The fair value at the date that 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. Deferred tax in respect of a share-based payment is calculated in accordance with the difference between the exercise price and the price of the share.

In transactions in which the Bank also grants rights to equity instruments to employees of the subsidiary companies, the Bank treats this as a share-based payment transaction settled with equity instruments.

S. Tax expenses on income

Taxes on income include current and deferred taxes. Current and deferred taxes are charged to the statement of profit and loss, unless the taxes derive from business combinations, or are charged directly to equity if they derive from items recognized directly in equity.

Current taxes
Current tax is the amount of tax expected to be paid (or received) on income liable to tax for the year calculated at the applicable tax rates under laws that have been enacted or substantively enacted at the reporting date, including changes in tax payments relating to 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 profit 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 related expenses”.

Deferred taxes

The recognition of deferred tax relates to temporary differences between the Book value of assets and liabilities for financial reporting purposes and their value for tax purposes. However, the Group does not recognize deferred taxes for the following temporary differences:

Initial recognition of goodwill

The initial recognition of assets and liabilities in a transaction that is not a business combination and that does affect the accounting income and profit for tax purposes.

Differences resulting from investments in subsidiaries and companies included on equity basis, if the Group has control when the difference is reversed, and it is expected that they will not be reversed in the foreseeable future, whether by way of realization of the investment or by way of distribution of dividends in respect of the investment.

The measurement of deferred taxes reflects the tax consequences that will result from the way in which the Group expects, at the end of the reporting period, to reinstate or dispose of the book value of assets and liabilities.

Deferred taxes are measured at the tax rates expected to apply to the temporary differences at the date they are realized, based on the laws that have been enacted or substantively enacted by the balance sheet date.

A deferred tax asset for losses carried forward, unutilized tax credits, tax benefits and deductible temporary differences recognized in the books when it is more likely than not that it will be taxable income which can be utilized in the future. Deferred tax assets are reviewed at each reporting date and, if it is not expected that the related tax benefits will be realized, they are reduced.

In order to determine that it is possible to recognize a deferred tax asset, the Group takes into account all the available evidence - both positive evidence supporting the recognition of a deferred tax asset and negative evidence negating recognition as a deferred tax asset.

Offsetting deferred tax assets and liabilities

The Bank offsets deferred tax assets and liabilities if there is a legally enforceable right to offset current tax assets and liabilities, and they are attributable to the same taxable income taxed by the same tax authority in respect of the same entity that is assessed, or various companies in the Group that intend to settle current tax assets and liabilities on the basis of net or the tax assets and liabilities are settled simultaneously.

Additional tax on the distribution of dividends

The Group may be liable for additional tax in the event of distribution of dividends by Group companies. This additional tax is not included in the financial statements when the Group company policy is not to bring about the distribution of a dividend involving additional tax to the recipient company in the foreseeable future. In cases where the investee company is expected to distribute a dividend involving additional tax for the company, the Group creates a provision for tax in respect of the tax increment that the Group may incur in respect of the dividend distribution.

Additional taxes on income arising from the distribution of dividends by the Bank are charged to profit and loss at the date the liability to pay the related dividend is recognized.

Intercompany transactions

Deferred tax in respect of intercompany transactions in the consolidated accounts is recorded at the rate of tax of the acquiring company.

Uncertain tax positions

The Bank recognizes the effect of tax positions only if it is more likely than not that the positions will be accepted by the tax authorities or the Court. Recognized tax positions are measured at the maximum sum whose probability of realization exceeds 50%. Changes in recognition or measurement are reflected in the period in which changes occur in the circumstances that led to a change in judgment.

The Group applies the new provisions set out in the Public Reporting Directives on taxes on income as of 1 January 2012. The initial application had no material effect on the financial statements.

T. Earnings per share

The Bank reports basic and diluted earnings per share with regard to its weighted ordinary share capital. Basic earnings per share are 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 dilutive ordinary shares.

U. Statement of cash flows

The statement of cash flows is reported classified by cash flows from operating activities, investment activities, and financing activities.

The item "Cash and cash equivalents" includes cash and deposits with central banks and other banks for an original period not exceeding three months.

Initial implementation of the new directives of the Banking Supervision Department on the cash flow statement

The Group applies the new directives of the Banking Supervision Department on the statement of cash flows as of 1 January 2012 retroactively.

First-time implementation of the standard had no effect other than a change in presentation.

V. Impairment in value of non-monetary assets

(1) 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 amount 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, discounted by the pre-tax rate of interest, which are 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 is largely independent of assets in other groups ("cash-generating unit"). For the purpose of examining impairment of goodwill recognized in the framework of a business combination, 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. When there is a change in the composition of one or more cash-generating units to which the goodwill was allocated, the goodwill is to be reallocated to those units affected.

Assets of the head office 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 after 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.

(2) Impairment with regard to costs of in-house software development

Examination for impairment with regard to costs of in-house software development is to be carried out if the indicators stated in US GAAP exist:

(a) It is not expected that the software will provide any significant potential uses;

(b) A material change has occurred in the manner or scope of use of the software or of the expected use of the software;

(c) A material change has been made or will be made to the software;

(d) Costs for developing or adapting the software designated for in-house use deviate significantly from the sums projected in advance;

(e) It is no longer expected that the software will be completed and utilized.

If one or more of the indicators stated above exist, it is required to make an examination for impairment in accordance with the principles set out in IAS 36 – Impairment of Assets.

(3) Impairment of investments in companies included on equity basis reported according to the equity basis method

An investment in a company included on equity basis is examined for impairment when there is objective evidence indicative of impairment in accordance with IAS 39 – Preparation and Measurement of Financial Instruments.

Impairment is examined with relation to the investment as a whole. Goodwill representing part of the investment account in a company included on equity basis is not recognized separately, and is therefore not examined separately in the test for impairment. If there is objective evidence indicative that there may be impairment of the investment, the Group makes an evaluation of the amount refundable of the investment which is the higher of the useful value and its net sale price.

When determining the usage value of an investment in a company included on equity basis, the Group assesses its share in the present value of estimated future cash flows, which are forecast to be generated by the company included on equity basis, including cash flows from activities of the company included on equity basis and the consideration from the final realization of the investment, or the present value of estimated future cash flows that are forecast to stem from dividends received and the final realization.

A loss from impairment is recognized when the book value of the investment, after applying the equity base method, exceeds the recoverable amount, and is recognized under the "share of the banking corporation in operating gains or losses of companies included on equity basis, after taxes" in the profit and loss statement. A loss from impairment is not allocated to any asset, including goodwill comprising part of the investment account in the company included on equity basis. A loss from impairment will be canceled only if changes have taken place in assessments used in determining the recoverable amount of the investment from the date the loss from impairment was last recognized. The book value of the investment, after canceling the loss from impairment, shall not exceed the book value of the investment that would have been determined according to the equity base method if the loss from impairment had not been recognized. Cancelation of the loss from impairment will be recognized under the "share of the corporation in profits of companies included on equity basis, after taxes".

W. New Accounting Standards and Directives of the Supervisor of Banks in the period prior to their implementation

(1) In July 2006, the Israel Accounting Standards Board published Accounting Standard No. 29 – "Adoption of International Financial Reporting Standards". The standard prescribes that entities that are subject to the Securities Law, 1968, and that are required to report according to the regulations of that 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.

Note 1 – Significant Accounting Policies (cont'd)

In June 2009, the Banking Supervision Department 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. Pursuant to the circular, the target date for reporting of banking corporations and credit card companies according to IFRS standards is:

Standards on subjects that are a core part of the banking business – the Banking Supervision Department intends to make a final decision that will be made while taking into account the timetable laid down in the U.S., and progress made in the process of convergence between the international and U.S. standards boards.

Standards on subjects that are not a core part of the banking business were adopted gradually during 2011 and 2012. However, IAS 19 on "Employee Benefits" has not yet come into force, and will be adopted in accordance with the instructions of the Banking Supervision Department. The Supervisor of Banks is examining the change in accounting treatment of employee benefits. At this stage it is not yet known which standard will be adopted, if at all, and what will be the manner of its implementation and the date of its implementation. Implementation of the standard to be adopted by the Supervisor of Banks will have a material effect following the change in discount rates. The amounts of pension and long-service grant liabilities are calculated at present according to actuarial models. The discount rate is 4% linked to the index was determined by the Supervisor of Banks and reflects the average rate of long-term interest on government bonds. In addition, the actuarial calculations take into account the forecast of index-adjusted increase in salaries based on past experience that changes according to the age of the employee. The rates of increase range from 0.8% to 7.2%.

(2) Format of the statement of profit and loss for a banking corporation and adoption of generally accepted accounting principles in U.S. banks on the measurement of interest income

On 29 December 2011, a Supervisor of Banks circular was promulgated intended to adapt the Public Reporting Directives for purposes of adoption of the rules prescribed in accounting standards generally accepted in the US on “Nonrefundable Fees and Other Costs” - the directive establishes rules for commissions from originating loans and direct loan originating costs. Eligible fees and costs according to criteria specified in the directive will not be recognized immediately in the statement of profit and loss, but will be taken into account in calculating the effective interest rate of the loan. In addition, the directive changes the treatment of fees and costs associated with commitments to allocate credit, including credit card transactions. Furthermore, rules were set out in the directive regarding the treatment of changes in the terms of the debt that do not constitute a restructuring of a problem debt, the treatment of early repayments of debts, and the treatment of other transactions granting credit, such as syndicated transactions.

On 25 July 2012, a circular was published on the date of adoption of FASB Codification 310-20 – "Non-refundable fees and other costs" that postponed implementation until 1 January 2014.

(3) New system of International Financial Reporting Standards (IFRS) on consolidating financial statements and related issues

In May 2011, a new system of standards was published by the IASB as part of the joint standardization project of the IASB and FASB, effectively replacing the current standards on consolidating financial statements and joint ventures and including a number of changes with respect to companies included on equity basis.

3.1 International Financial Reporting Standard - IFRS 10 - Consolidated Financial Statements

The Standard replaces the guidelines of IAS 27 – Consolidated and Separate Financial Statements and the guidelines of SIC 12 - Consolidation of Special Purpose Entities regarding the consolidation of financial statements, so that the requirements of IAS 27 will be valid only for separate financial statements.

The Standard presents a new control model for determining whether an investor controls an investee and therefore has to consolidate it. This model is required to be applied with regard to all investee entities.
Control "*de facto*" will be considered when assessing effective control in an investee company. In addition, potential voting rights are to be taken into account in assessing control.

Notwithstanding the above, it should be noted that the issue of the accounting treatment of Variable Interest Entities is defined as a core part of banking business for which banks are required to implement the rules set forth in FAS 167 (ASC 810-10) instead of international standards rules.

The Standard is to be implemented for financial statements for annual periods beginning on or after 1 January 2013 or thereafter, retrospectively in accordance with the transitional provisions in the Standard.

3.2 International Financial Reporting Standard - IFRS 11 - Joint Arrangements

The Standard replaces the guidelines of IAS 31 - Interests in Joint Ventures, and amends some of the guidelines of IAS 28 - Investments in Associates and Joint Ventures.

The Standard defines joint arrangements as arrangements in which there is joint control and divides such arrangements into two categories:

- Joint activities – the parties with joint control have rights to assets relating to the arrangement and obligations to meet liabilities relating to the arrangement. Joint activities will be recognized in assets and liabilities and are to be dealt with in accordance with the relevant standards.
- Joint ventures - joint arrangements structured as a separate entity where the parties with joint control have rights to the net assets of the joint arrangement. Joint ventures are to be dealt by the equity method only.

The amended IAS 28 also states that IFRS 5 applies to an investment or part of it in a company included on equity basis or joint venture meeting the criteria for classification as held for sale. Until realization of that part of the investment that was classified as held for sale, the equity method continues to be applied on the part of the investment not classified as held for sale.

IFRS 11 is to be applied to financial statements for annual periods beginning on or after 1 January 2013 or thereafter, retrospectively in accordance with the transitional provisions in the Standard.

3.3 IFRS 12 - Disclosure of Interests in Other Entities

The Standard contains extensive disclosure requirements relating to interests in subsidiaries, joint arrangements, companies included on equity basis, and structured entities that are not consolidated. The Bank is not required to apply the disclosure requirements included in the Standard with regard to non-consolidated structured entities. For such entities the disclosure requirements set out in FAS 167 continue to apply.

The system of standards is to be applied for annual periods beginning on 1 January 2013 and thereafter on a retroactive basis.
The Group believes that the implementation of the system of standards is not expected to have a material effect on the financial statements.

(4) Directive on statement of comprehensive income

On 9 December 2012, a circular was published on the statement of comprehensive income. The purpose of the circular was the adaptation of the manner of presentation of the statement of comprehensive income to the requirements of accounting standards generally accepted in the U.S. The circular changes the manner of presentation of items of other comprehensive income in the financial statements such that items of other comprehensive income are be reported in a separate report entitled "Statement of Comprehensive Income" to be reported after the statement of profit and loss.
Furthermore, details of the composition and movements of "Accumulated Other Comprehensive Income" will appear in a new Note on accumulated other comprehensive income.

The amendments to this directive shall apply to reports for the first quarter of 2013 onwards and will be applied retrospectively.
The initial implementation of the Standard is not expected to have a material effect on the financial statements other than a change in presentation.

(5) Directive on offsetting assets and liabilities

On 12 December 2012, a circular was issued on offsetting assets and liabilities. The amendments set forth in this circular were aimed at adapting Section 15a of the Public Reporting Directives to accounting standards generally accepted in the U.S. The circular stipulates that, regarding offsetting derivatives, a banking corporation is to offset assets and liabilities arising from the same counterparty and will report their net balance in the balance sheet, if in respect of those liabilities it is has a legally enforceable right to offset the liabilities from the assets, it intends to repay the liabilities and realize the assets on a net basis or simultaneously, and the banking corporation and the counterparty owe each other determinable amounts.

Furthermore, it was also determined that under certain conditions a banking corporation may offset fair value amounts recognized in respect of derivative instruments and fair value amounts recognized in respect of the right to reclaim cash collateral or a commitment to repay collateral in cash arising from derivative instruments executed with the same counterparty in accordance with a net accounting agreement, even if the condition of the intention to repay on a net basis or simultaneously is not met.
A banking corporation is required to determine accounting policies to be implemented consistently for offsetting fair value amounts as stated above.
With regard to repurchase transactions, it is stipulated that a banking corporation may make an offset of "Securities purchased under agreements to resell" and "Securities purchased under agreements to repurchase" under certain conditions.
The circular also included extensive disclosure requirements, including disclosure of the banking corporation's policy determining whether to offset or not to offset such derivative instruments.

The amendments to this directive shall apply to financial statements for reporting periods commencing on 1 January 2013, and are to be implemented on a retroactive basis. However, in the quarterly reports in 2013, banking corporations may not provide disclosure required as a result of the first-time implementation of this directive with regard to comparative figures for the corresponding quarters in 2012.
The Group is examining the possible implications of implementing the circular.

Note 1 – Significant Accounting Policies (cont'd)

(6) Directive on disclosure of deposits

On 13 January 2013, a circular was published amending the Public Reporting Directives of the Supervisor of Banks on the disclosure of deposits. According to the circular, wide-ranging disclosure requirements were set out concerning deposits of the public, deposits from banks, and deposits of the government.

The amendments in this directive are to be implemented retroactively commencing with the report to the public for 2013 and onward.
Initial implementation of the amendments is not expected to have any effect on the financial statements, except for a change in presentation.

Note 2 - Cash and Deposits with Banks

	31 December 2012	31 December 2011
	NIS millions	
Cash and deposits with central banks	**43,248**	42,980
Deposits with commercial banks (a) (b)	**11,373**	10,051
Deposits with specialized banking entities (b)	**-**	13
Total	**54,621**	53,044
Including: Cash and deposits with central and commercial banks for original periods not exceeding three months	**51,644**	49,736

(a) After deduction of the allowance for credit losses.
(b) Reclassified.

Note: For liens – See Note 14.

Note 3 - Securities

	31 December 2012					31 December 2011				
		Amortized cost (for	Other comprehensive accumulated profit (loss)		Fair		Amortized cost (for	Other comprehensive accumulated profit (loss)		Fair
	Book value	shares - cost)	Profits	Losses	value (a)	Book value	shares - cost)	Profits	Losses	value (a)
	(NIS millions)									
(1) Securities available for sale:										
Bonds -										
Government of Israel	22,998	22,722	276	-	22,998	19,775	19,624	154	(3)	19,775
Foreign governments	6,454	6,442	13	(1)	6,454	3,675	3,677	3	(5)	3,675
Financial institutions in Israel	323	304	21	(2)	323	397	392	8	(3)	397
Financial institutions abroad	5,281	5,231	128	(78)	5,281	7,854	8,436	14	(596)	7,854
Asset-backed (ABS) or mortgage-backed securities (MBS)	5,049	4,993	76	(20)	5,049	2,444	2,492	26	(74)	2,444
Others in Israel	1,039	1,018	26	(5)	1,039	604	639	5	(40)	604
Others abroad	1,583	1,550	36	(3)	1,583	1,254	1,264	17	(27)	1,254
	42,727	42,260	576	(109)	42,727	36,003	36,524	227	(748)	36,003
Shares and mutual funds (b) (e)	2,167	1,726	453	(12)	2,167	2,191	1,876	341	(26)	2,191
Total securities available for sale	44,894	43,986	1,029 (c)	(121) (c)	44,894	38,194	38,400	568 (c)	(774) (c)	38,194

	31 December 2012					31 December 2011				
	Book value	Amortized cost (for shares - cost)	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value (a)	Book value	Amortized cost (for shares - cost)	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value (a)
	(NIS millions)									
(2) Securities held for trading:										
Bonds -										
Government of Israel	8,980	8,829	152	(1)	8,980	8,153	8,094	64	(5)	8,153
Foreign governments	311	311	-	-	311	183	180	3	-	183
Financial institutions in Israel	129	127	2	-	129	173	172	3	(2)	173
Financial institutions abroad	88	88	1	(1)	88	366	389	3	(26)	366
Asset-backed (ABS) or Mortgage-backed securities (MBS)	358	358	8	(8)	358	120	129	2	(11)	120
Others in Israel	707	697	13	(3)	707	330	352	-	(22)	330
Others abroad	742	682	60	-	742	56	53	3	-	56
	11,315	11,092	236	(13)	11,315	9,381	9,369	78	(66)	9,381
Shares and mutual funds	199	189	11	(1)	199	361	363	4	(6)	361
Total securities for trading	11,514	11,281	247 (d)	(14) (d)	11,514	9,742	9,732	82 (d)	(72) (d)	9,742
Total securities	56,408	55,267	1,276	(135)	56,408	47,936	48,132	650	(846)	47,936

See notes on next page.

Note 3 - Securities (cont'd)

Notes:

(a) With regard to fair value data, see Note 1.G – Significant Accounting Policies. The above quotations do not necessarily reflect the price which will be obtained upon sale of securities in large volumes.
(b) Including NIS 1,194 million with regard to shares and mutual funds which have no readily available fair value, which are shown at cost (31 December 2011 - NIS 1,185 million).
(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) In January 2013, the Bank sold part of the shares in Migdal Financial and Insurance Holdings Ltd. held by it, and at the date of publication of the report, the Bank holds 4.71% of the share capital of Migdal.

<u>General comments:</u>
Securities lent amounting to NIS 339 million (31 December 2011 – NIS 648 million) are shown under credit to the public.

For liens – see Note 14.
For details of results of investment activities in bonds and in shares and mutual funds – see Notes 20 and 21.

Note 3 - Securities (cont'd)

31 December 2012					
		Amortized	Other comprehensive accumulated profit (loss)*		
	Book value	cost	Profits	Losses	Fair value
	(NIS millions)				
3. Bonds available for sale					
Pass-through securities:					
Securities guaranteed by GNMA	257	257	1	(1)	257
Securities issued by FNMA and FHLMC	511	510	1	-	511
Total	768	767	2	(1)	768
Other mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	2,560	2,544	16	-	2,560
Other mortgage-backed securities	303	300	4	(1)	303
Total	2,863	2,844	20	(1)	2,863
Asset-backed securities (ABS)					
Credit card debtors	38	38	-	-	38
Lines of credit for any purpose secured by dwelling	2	2	-	-	2
Other credit to private persons	4	4	-	-	4
CLO debentures	1,371	1,334	54	(17)	1,371
Others	3	4	-	(1)	3
Total	1,418	1,382	54	(18)	1,418
Total asset-backed bonds available for sale	5,049	4,993	76	(20)	5,049

* Amounts charged to capital reserve as part of adjustments of securities available for sale to fair value.

Note 3 - Securities (cont'd)

31 December 2011					
	Book value	Amortized cost	Other comprehensive accumulated profit (loss)*		Fair value
			Profits	Losses	
	(NIS millions)				
3. Bonds available for sale					
Pass-through securities:					
Securities guaranteed by GNMA	114	109	5	-	114
Securities issued by FNMA and FHLMC	258	250	8	-	258
Total	372	359	13	-	372
Other mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	921	912	10	(1)	921
Other mortgage-backed securities	440	451	-	(11)	440
Total	1,361	1,363	10	(12)	1,361
Asset-backed securities (ABS)					
Debtors in respect of credit cards	40	41	-	(1)	40
Lines of credit for any purpose secured by dwelling	2	3	-	(1)	2
Other credit to private persons	5	5	-	-	5
CLO debentures	661	720	1	(60)	661
Others	3	1	2	-	3
Total	711	770	3	(62)	711
Total asset-backed bonds available for sale	2,444	2,492	26	(74)	2,444

* Amounts charged to capital reserve as part of adjustments of securities available for sale to fair value

Note 3 - Securities (cont'd)

	31 December 2012				
	Book value	Amortized cost	Unrealized profits from adjustments to fair value*	Unrealized losses from adjustments to fair value*	Fair value
	(NIS millions)				
4. Debentures for trading					
Pass-through securities					
Foreign securities	5	5	-	-	5
Total	5	5	-	-	5
Other mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	21	19	2	-	21
Other mortgage-backed securities	19	21	-	(2)	19
Total	40	40	2	(2)	40
Asset-backed securities (ABS)					
Credit card receivables	37	37	-	-	37
Lines of credit for any purpose secured by dwelling	3	2	1	-	3
Credit for purchase of vehicles	166	163	3	-	166
Other credit to private persons	16	16	-	-	16
Credit not to private persons	1	1	-	-	1
CDO debentures	28	33	-	(5)	28
Others	62	61	2	(1)	62
Total	313	313	6	(6)	313
Total asset-backed securities for trading	358	358	8	(8)	358

* These profits (losses) have been charged to profit and loss account.

Note 3 - Securities (cont'd)

	31 December 2011				
	Book value	Amortized cost	Unrealized profits from adjustments to fair value*	Unrealized losses from adjustments to fair value*	Fair value
	(NIS millions)				
4. Debentures for trading (cont'd)					
Pass-through securities					
Securities issued by FNMA and FHLMC	1	1	-	-	1
Other securities	5	6	-	(1)	5
Total	6	7	-	(1)	6
Other mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	96	95	1	-	96
Other mortgage-backed securities	8	11	-	(3)	8
Total	104	106	1	(3)	104
Asset-backed securities (ABS)					
Lines of credit for any purpose secured by dwelling	3	3	-	-	3
Credit not to private persons	4	4	-	-	4
CDO debentures	1	7	-	(6)	1
Others	2	2	1	(1)	2
Total	10	16	1	(7)	10
Total asset-backed securities for trading	120	129	2	(11)	120

* These profits (losses) have been charged to profit and loss account.

Note 3 - Securities (cont'd)

(5) Additional details regarding securities available for sale secured by assets for which unrealized losses are included for adjustments to fair value.

	31 December 2012					
	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses 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)	**351**	**(1)**	**-**	**-**	**351**	**(1)**
Other mortgage-backed securities (including REMIC, CMO and STRIPPED MBS)	**457**	**(1)**	**12**	**-**	**469**	**(1)**
Asset-backed securities (ABS)	**70**	**(2)**	**372**	**(16)**	**442**	**(18)**
Total	**878**	**(4)**	**384**	**(16)**	**1,262**	**(20)**

	31 December 2011					
	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses 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						
Other mortgage-backed securities (including REMIC, CMO and STRIPPED MBS)	569	(3)	224	(9)	793	(12)
Asset-backed securities (ABS)	298	(40)	390	(22)	688	(62)
Total	867	(43)	614	(31)	1,481	(74)

Note 3 - Securities (cont'd)

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 tranches) 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. Bonds issued by it are guaranteed by the Government National Mortgage Association.

Credit Default Swap – CDS
A financial instrument which transfers the issuer's credit exposure between parties to the transaction.

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance

A. Debts* and off-balance sheet credit instruments

1. Change in balance of credit loss allowance

	31 December 2012					
	Credit to the public				Banks and	
	Commercial	Residential	Other private	Total	governments	Total
	(NIS millions)					
Balance of credit loss allowance at beginning of year	**3,441**	**532**	**462**	**4,435**	**5**	**4,440**
Other changes in the credit loss allowance at 1 January 2012 (charge to equity)	**27**	**3**	**6**	**36**	**-**	**36**
Expenses in respect of credit losses	**1,156**	**(13)**	**93**	**1,236**	**-**	**1,236**
Accounting write-offs	**(1,084)**	**(47)**	**(430)**	**(1,561)**	**(1)**	**(1,562)**
Collection of debts written off in previous years	**155**	**-**	**264**	**419**	**-**	**419**
Net accounting write-offs	**(929)**	**(47)**	**(166)**	**(1,142)**	**(1)**	**(1,143)**
Translation differences reserve	**(4)**	**-**	**-**	**(4)**	**-**	**(4)**
Balance of credit loss allowance at end of year	**3,691**	**475**	**395**	**4,561**	**4**	**4,565**
Of which: in respect of off-balance sheet credit instruments	**413**	**-**	**34**	**447**	**-**	**447**

	31 December 2011 (a)					
	Credit to the public				Banks and	
	Commercial	Residential	Other private	Total	governments	Total
	(NIS millions)					
Balance of credit loss allowance at beginning of year	8,394	487	1,659	10,540	1	10,541
Net accounting write-offs recognized at 1.1.2011	(4,371)	-	(1,469)	(5,840)	-	(5,840)
Other changes in the credit loss allowance at 1 January 2011 (charge to equity)	530	123	421	1,074	-	1,074
Balance of allowance at 1.1.2011	4,553	610	611	5,774	1	5,775
Expenses in respect of credit losses	729	(9)	10	730	4	734
Accounting write-offs	(1,917)	(69)	(532)	(2,518)	-	(2,518)
Collection of debts written off in previous years	76	-	373	449	-	449
Net accounting write-offs	(1,841)	(69)	(159)	(2,069)	-	(2,069)
Balance of credit loss allowance at end of year	3,441	532	462	4,435	5	4,440
Of which: in respect of off-balance sheet credit instruments	429	-	35	464	-	464

(a) Beginning with the report for 2012, the Bank implemented for the first time the directives of the Banking Supervision Department on updating the disclosure of the credit quality of debts and the allowance for credit losses. Comparative figures for the previous year were reclassified as far as possible to adjust them to the format required under the said directives. For details, see Note 1.N.

* Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance (cont'd)

2. Additional information on the method of calculating the credit loss allowance in respect of debts* and on debts* on which it was calculated

	31 December 2012					
	Credit to the public				Banks and	
	Commercial	Residential	Other private	Total	governments	Total
	(NIS millions)					
Recorded debt balance of debts*:						
Examined on an individual basis	120,006	664	1,991	122,661	45,770	168,431
Examined on a collective basis	31,634	62,739	28,344	122,717	7,158	129,875
Of which the allowance was calculated by extent of arrears	-	563 **	-	563	-	563
Total debts*	151,640	63,403	30,335	245,378	52,928	298,306
Credit loss allowance by debts*:						
Examined on an individual basis	2,943	19	62	3,024	4	3,028
Examined on a collective basis	335	456	299	1,090	-	1,090
Of which the allowance was calculated by extent of arrears	-	275	-	275	-	275
Total allowance for credit losses	3,278	475	361	4,114	4	4,118

	31 December 2011 (a)					
	Credit to the public				Banks and	
	Commercial	Residential	Other private	Total	governments	Total
	(NIS millions)					
Recorded debt balance of debts*:						
Examined on an individual basis	137,202	551	1,476	139,229	52,576	191,805
Examined on a collective basis	20,730	57,200	28,128	106,058	-	106,058
Of which the allowance was calculated by extent of arrears	-	655 **	-	655	-	655
Total debts*	157,932	57,751	29,604	245,287	52,576	297,863
Credit loss allowance by debts*:						
Examined on an individual basis	2,836	9	29	2,874	5	2,879
Examined on a collective basis	174	506	413	1,093	-	1,093
Of which the allowance was calculated by extent of arrears	-	349	-	349	-	349
Total allowance for credit losses	3,010	515	442	3,967	5	3,972

(a) Beginning with the report for 2012, the Bank implemented for the first time the directives of the Banking Supervision Department on updating the disclosure of the credit quality of debts and the allowance for credit losses. Comparative figures for the previous year were reclassified as far as possible to adjust them to the format required under the said directives. For details, see Note 1.N.

* Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

** Including balance of allowance in excess of that required by the extent of arrears method calculated on a collective basis in the amount of NIS 41 million (2011 – NIS 69 million).

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance (cont'd)

B. Debts[1]

1. Credit quality and arrears

	31 December 2012 (NIS millions)					
		Problem debts[2]			Unimpaired debts - additional information	
Activity of borrowers in Israel Public - commercial	Non-problem debts	Not impaired	Impaired[3]	Total	In arrears of 90 days or more[4]	In arrears of 30 to 89 days[5]
Construction & real estate - construction	13,333	165	667	14,165	5	35
Construction & real estate - real estate activities	23,308	272	1,847	25,427	-	13
Financial services	12,059	395	716	13,170	-	16
Commercial - other	62,721	2,376	2,369	67,466	33	116
Total commercial	111,421	3,208	5,599	120,228	38	180
Private individuals - housing loans[6]	61,241	832	28	62,101	829	593
Private individuals - other	28,593	303	45	28,941	115	174
Total public - activity in Israel	201,255	4,343	5,672	211,270	982	947
Israeli banks	38,478	-	-	38,478	-	-
Government of Israel	282	-	-	282	-	-
Total activity in Israel	240,015	4,343	5,672	250,030	982	947
Activity of borrowers abroad						
Public - commercial						
Construction & real estate	7,296	205	874	8,375	76	68
Commercial - other	22,087	164	786	23,037	68	159
Total commercial	29,383	369	1,660	31,412	144	227
Private individuals	2,597	5	94	2,696	167	28
Total public - activity abroad	31,980	374	1,754	34,108	311	255
Foreign banks	14,003	-	5	14,008	-	-
Foreign governments	160	-	-	160	-	-
Total	46,143	374	1,759	48,276	311	255
Total public	233,235	4,717	7,426	245,378	1,293	1,202
Total banks	52,481	-	5	52,486	-	-
Total governments	442	-	-	442	-	-
Total	286,158	4,717	7,431	298,306	1,293	1,202

	31 December 2011 (a) (NIS millions)				
				Unimpaired debts - additional information	
Credit to the public	Not impaired	Impaired[3]	Total	In arrears of 90 days or more[4]	In arrears of 30 to 89 days[5]
Examined on individual basis	119,170	6,778	125,948	-	946
Housing loans by extent of arrears[6]	57,452	-	57,452	918	706
Examined on other collective basis	61,881	6	61,887	638	371
Total public	238,503	6,784	245,287	1,556	2,023
Total banks	50,895	8	50,903	-	-
Total governments	1,673	-	1,673	-	-
Total	291,071	6,792	297,863	1,556	2,023

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance (cont'd)

(a) Beginning with the report for 2012, the Bank implemented for the first time the directives of the Banking Supervision Department on updating the disclosure of the credit quality of debts and the allowance for credit losses. Comparative figures for the previous year were reclassified as far as possible to adjust them to the format required under the said directives. For details, see Note 1.N.

(1) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(2) Impaired, substandard or special mention credit risk, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans fior which there is no provision that are in arrears of 90 days or more.
(3) As a rule, impaired debts do not accrue interest income. For information on certain impaired debts under troubled debt restructuring, see Note 4.B.2.C.
(4) Classified as problem debts that are not impaired, accruing interest income.
(5) Accruing interest income. Debts in arrears of 30 to 89 days in the amount of NIS 143 million werer classified as problem debts that are not impaired.
(6) Including housing loans in the amount of NIS 230 million (31 December 2011 – NIS 275 million) with a provision by extent of arrears, in which an arrangement was signed for the repayment of arrears by the borrower, with a change made to the repayment schedule in respect of the loan balance of which the repayment date has not yet arrived.

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance (cont'd)

B. Debts[1] (cont'd)

2. Additional information on impaired debts

	31 December 2012				
	(NIS millions)				
A. Impaired debts and individual allowance Activity of borrowers in Israel Public - commercial	Balance[2] of impaired debts in respect of which there is an individual allowance[3]	Balance of individual allowance[3]	Balance[2] of impaired debts in respect of which there is no individual allowance[3]	Total balance[2] of impaired debts	Principal contractual balance of impaired debts
Construction & real estate - construction	79	22	588	667	1,910
Construction & real estate - real estate activities	1,406	187	441	1,847	3,125
Financial services	663	422	53	716	1,196
Commercial - other	1,398	584	971	2,369	5,773
Total commercial	3,546	1,215	2,053	5,599	12,004
Private individuals - housing loans	15	7	13	28	28
Private individuals - other	22	14	23	45	1,681
Total public - activity in Israel	3,583	1,236	2,089	5,672	13,713
Israeli banks	-	-	-	-	-
Government of Israel	-	-	-	-	-
Total activity in Israel	3,583	1,236	2,089	5,672	13,713
Activity of borrowers abroad Public - commercial					
Construction & real estate	537	238	337	874	1,101
Commercial - other	558	284	228	786	920
Total commercial	1,095	522	565	1,660	2,021
Private individuals	78	52	16	94	96
Total public - activity abroad	1,173	574	581	1,754	2,117
Foreign banks	-	-	5	5	6
Foreign governments	-	-	-	-	-
Total	1,173	574	586	1,759	2,123
Total public	4,756	1,810	2,670	7,426	15,830
Total banks	-	-	5	5	6
Total governments	-	-	-	-	-
Total*	4,756	1,810	2,675	7,431	15,836
*** Of which:**					
Measured by present value of cash flows	3,257	1,452	1,778	5,035	
Debts under troubled debt restructuring	1,132	87	584	1,716	

See notes on next page.

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance (cont'd)

B. Debts[1] (cont'd)

2. Additional information on impaired debts (cont'd)

	31 December 2011 (a)			
	(NIS millions)			
	Balance[2] of impaired debts in respect of which there is an individual allowance[3]	Balance of individual allowance[3]	Balance[2] of impaired debts in respect of which there is no individual allowance[3]	Total balance[2] of impaired debts
Total public	4,338	1,731	2,446	6,784
Total banks	2	1	6	8
Total governments	-	-	-	-
Total*	4,340	1,732	2,452	6,792
* Of which:				
Measured by present value of cash flows	2,600	986	1,995	4,595
Debts under troubled debt restructuring	744	64	92	836

B. Average balance and interest income	31 December 2012	31 December 2011 (a)
	(NIS millions)	
Average recorded debt balance of impaired debts in the reporting period	**7,279**	6,764
Total interest income recorded in the reporting period in respect of these debts in the period when they were classified as impaired	**62**	13
Total interest income that would heve been recorded in the reporting period if these debts accrue interest under their original terms	**616**	611
Of which: interest income recorded under the cash basis accounting method	**53**	12

(a) Beginning with the report for 2012, the Bank implemented for the first time the directives of the Banking Supervision Department on updating the disclosure of the credit quality of debts and the allowance for credit losses. Comparative figures for the previous year were reclassified as far as possible to adjust them to the format required under the said directives. For details, see Note 1.N.

(1) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(2) Balance of recorded debt.
(3) Individual allowance for credit losses.

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance (cont'd)

B. Debts[1] (cont'd)

2. Additional information on impaired debts (cont'd)

C. Impaired debts under restructuring	31 December 2012 (NIS millions)				
Activity of borrowers in Israel Public - commercial	Not accruing interest income	Accruing[2] in arrears of 90 days or more	Accruing[2] in arrears of 30 to 89 days	Accruing[2] not in arrears	Total[3]
Construction & real estate - construction	114	-	-	-	114
Construction & real estate - real estate activities	782	-	-	38	820
Financial services	93	-	-	-	93
Commercial - other	256	-	-	30	286
Total commercial	1,245	-	-	68	1,313
Private individuals - housing loans	3	-	-	-	3
Private individuals - other	21	-	-	3	24
Total public - activity in Israel	1,269	-	-	71	1,340
Israeli banks	-	-	-	-	-
Government of Israel	-	-	-	-	-
Total activity in Israel	1,269	-	-	71	1,340
Activity of borrowers abroad Public - commercial					
Construction & real estate	132	-	-	75	207
Commercial - other	68	-	-	74	142
Total commercial	200	-	-	149	349
Private individuals	11	-	-	12	23
Total public - activity abroad	211	-	-	161	372
Foreign banks	-	-	-	4	4
Foreign governments	-	-	-	-	-
Total	211	-	-	165	376
Total public	1,480	-	-	232	1,712
Total banks	-	-	-	4	4
Total governments	-	-	-	-	-
Total	1,480	-	-	236	1,716

See notes on next page.

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance (cont'd)

B. Debts[1] (cont'd)

2. Additional information on impaired debts (cont'd)

	31 December 2011 (a) (NIS millions)				
C. Impaired debts under restructuring (cont'd)	Not accruing interest income	Accruing[2] in arrears of 90 days or more	Accruing[2] in arrears of 30 to 89 days	Accruing[2] not in arrears	Total[3]
Total public	692	-	-	144	836
Total banks	-	-	-	-	-
Total governments	-	-	-	-	-
Total	692	-	-	144	836

(1) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(2) Accruing interest income.
(3) Included in impaired debts.

3. Additional information on housing loans

Year end balances by rate of financing (LTV)[1]

		31 December 2012 (NIS millions) Balance of housing loans			
		Total	Of which: bullet and balloon	Of which: variable interest	Off-balance sheet credit risk total
First charge: rate of financing	Up to 60%	32,413	2,901	25,351	2,265
	Above 60%	30,108	1,900	23,649	1,646
Second or without charge		834	61	659	23
Total		63,355	4,862	49,659	3,934

	31 December 2011 (NIS millions) Balance of housing loans			
	Total	Of which: bullet and balloon	Of which: variable interest	Off-balance sheet credit risk total
Total	57,455	5,012	44,449	3,469

(1) The ratio between the approved facility when the facility was granted and the value of the property, as approved by the Bank when the facility was granted.

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance (cont'd)

C. Credit to the public [(a)] and off-balance sheet credit risk [(b)] by size of debt per borrower

		31 December 2012		
Credit limit		Number of borrowers (c)	Credit (a)	Off-balance sheet credit risk (b)
NIS thousands			NIS millions	
From	To			
0	10	773,138	764	1,566
10	20	325,954	1,769	3,291
20	40	392,182	4,423	7,184
40	80	309,081	8,724	8,838
80	150	155,540	10,494	6,008
150	300	83,794	13,632	3,231
300	600	58,306	21,771	2,438
600	1,200	36,117	26,465	3,114
1,200	2,000	9,749	12,595	2,160
2,000	4,000	5,192	11,485	2,623
4,000	8,000	2,509	10,713	3,090
8,000	20,000	1,832	17,827	5,358
20,000	40,000	881	17,717	6,701
40,000	200,000	730	39,296	18,552
200,000	400,000	113	17,382	13,586
400,000	800,000	41	14,768	8,757
800,000	1,200,000	9	5,054	3,908
1,200,000	1,600,000	3	3,950	235
1,600,000	2,000,000	-	-	-
2,000,000	2,400,000	3	4312	2119
2,400,000	2,800,000	-	-	-
2,800,000	3,200,000	1	2,878	62
3,200,000	3,301,000	1	2,175	1,126
Total		2,155,176	248,194	103,947

Commencing with a credit level of NIS 8,000 thousand, the classification is set out by the specific consolidation method; with respect to the other borrowers, credit has been classified by the category consolidation method.

(a) Before the effect of allowances for credit losses, and before the effect of collateral permitted for deduction for purposes of single borrower and group of borrowers indebtedness; with the addition of the fair value of derivative instruments in the amount of NIS 2,816 million. Open credit card transactions have been allocated to credit levels by the category consolidation method.

(b) Credit risk in off-balance sheet financial instruments as calculated for purposes of single borrower restrictions.

(c) Number of borrowers by total credit and credit risk.

The definition of "borrower" and the definition of debt, including off-balance sheet credit risk, are in accordance with the directives of the Banking Supervision Department for amendment of Proper Conduct of Banking Business Directive No. 313 - "Restrictions on the Debt of a Single Borrower and of a Group of Borrowers".

Note 4 – Credit Risk, Credit to the Public and the Credit Loss Allowance (cont'd)

C. Credit to the public [(a)] and off-balance sheet credit risk [(b)] by size of debt per borrower (cont'd)

		31 December 2011		
Credit limit		Number of borrowers (c)	Credit (a)	Off-balance sheet credit risk (b)
NIS thousands			NIS millions	
From	To			
0	10	745,889	813	1,657
10	20	316,725	1,685	3,021
20	40	348,893	4,160	5,979
40	80	288,475	8,287	7,969
80	150	148,739	9,892	5,739
150	300	82,429	13,412	3,122
300	600	56,505	20,745	2,374
600	1,200	32,461	23,272	2,767
1,200	2,000	8,870	11,252	1,878
2,000	4,000	5,079	11,093	2,495
4,000	8,000	2,516	10,935	2,927
8,000	20,000	1,890	18,086	5,712
20,000	40,000	884	17,893	6,710
40,000	200,000	769	42,007	19,597
200,000	400,000	94	16,784	9,198
400,000	800,000	49	17,983	8,892
800,000	1,200,000	14	7,592	5,529
1,200,000	1,600,000	5	4,527	2,011
1,600,000	2,000,000	3	2,535	2,559
2,000,000	2,400,000	1	1,640	566
2,400,000	2,651,000	2	5,009	293
Total		2,040,292	249,602	100,995

Commencing with a credit level of NIS 8,000 thousand, the classification is set out by the specific consolidation method; with respect to the other borrowers, credit has been classified by the category consolidation 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 4,315 million. Open credit card transactions were allocated to credit levels by the category consolidation method.
(b) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of single borrower restrictions.
(c) Number of borrowers by total credit and credit risk.

Note 5 - Credit to Governments

	31 December 2012	31 December 2011
	(NIS millions)	
Credit to the government	**283**	316
Credit to foreign governments	**159**	132
Total credit to governments	**442**	448

Note 6 - Investments in and Details of Investee Companies

A. Composition:

	31 December 2012	31 December 2011
	Companies included on equity basis	Companies included on equity basis
	NIS millions	
Total investments in shares stated on equity basis (including other assets and goodwill)	**2,129**	2,266
Loans from shareholders	**0**	4
Total investments	**2,129**	2,270
Including - post-acquisition profits	**1,360**	1,505
Post-acquisition changes in shareholders' equity:		
Adjustments in respect of companies included on equity basis (a)	**(52)**	(23)
Details regarding goodwill and other intangible assets:		
Amortization period	**0 -20 years**	10 -20 years
Original amount, net	**218**	188
Unamortized balance	**151**	144

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Details on book value and market value of quoted investments:

	31 December 2012		31 December 2011	
	Book value	Market value	Book value	Market value
	NIS millions			
The Israel Corporation Ltd.	**1,568**	**3,367**	**1,749**	**3,291**
Total	**1,568**	**3,367**	**1,749**	**3,291**

Note 6 - Investments in and Details of Investee Companies (cont'd)

B. Group's equity in profits of companies included on equity basis

	2012	2011	2010
	NIS millions		
Group's equity in operating profit of companies included on equity basis	(31)	143	452
Provision for deferred taxes	(36)	5	(32)
Group's equity in after-tax operating profits of companies included on equity basis	(67)	148	420

C. Details regarding investee companies

(1) Holdings in Non-banking Holding Corporations (Conglomerates)

The Bank's holdings in 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 more than 1% of the means of control in only one conglomerate (a corporation whose capital is more than some NIS 2,000 million and that operates in more than three branches of the economy). The Bank holds one conglomerate - The Israel Corporation.

It should be noted that under the legislation passed pursuant to the capital market reform, a Bank is allowed to hold five percent of the capital of an insurance company and ten percent of the capital of a corporation controlling an insurance company. In addition, under the amendment to the Banking (Licensing) Law in March 2010, a Bank is allowed to hold only one insurance company whose shareholders' equity under Section 35 of the Financial Services Supervision Law (Insurance), 1981, exceeds NIS 2,000 million.

Note 6 - Investments in and Details of Investee Companies (cont'd)

C. Details regarding investee companies (cont'd)

(2) Details of a subsidiary company consolidated for the first time

On 10 February 2011, an agreement (hereinafter: "the purchase agreement") was signed between Bank Leumi Le-Israel Ltd. (hereinafter: "Leumi"), directly or through a company under its control, and Island Tower Foundation, Helena S. Safdié, Levy Edmundo Safdié, and G.RS. Participations S.A.R.L., the owners of the Bank Safdié SA in Switzerland (hereinafter: “Bank Safdié”), according to which Leumi will purchase, directly or through a company under its control, all of the share capital in the acquired bank, subject to conditions precedent specified in the agreement. On 30 November 2011, after the fulfilling of the conditions precedent appearing in the agreement, the purchase transaction was completed and Leumi acquired all of the share capital of Bank Safdié. In accordance with the purchase agreement, the total consideration paid on the date of closing is about SFR 143 million, of which SFR 110 was paid to the sellers and the balance of SFR 33 was deposited in trust to secure adjustments to the proceeds deriving from changes in the assets under management by Bank Safdié during the 24-month period following the date of the transaction’s closing, and additional adjustments according to formulas agreed upon by the parties. The surplus cost amounted to NIS 138 million. NIS 44 million was attributed to customer portfolios. On 3 January 2012, the merger was formally completed in the context of which the activities of Bank Safdié merged with the activities of Bank Leumi Switzerland.

	At acquisition date (NIS millions)
Total assets (a)	3,141
Balance of attributed surplus cost generated on acquisition of subsidiary	53
Balance of goodwill created on acquisition of subsidiary	85
Net profit attributed to Bank's shareholders at date of acquisition	2

(a) As reported by the Bank.

Note 6 - Investments in and Details of Investee Companies (cont'd)

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		Other equity investments (i)		Contribution to net profit attributed to shareholders of the banking corporation		Dividend recorded		Other items in accumulated shareholders' equity (b)		Guarantees for the company in favour of parties outside the Group	
		31 December		31 December		31 December		31 December		31 December		31 December		31 December		31 December	
		2012	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
		(%)	(%)	**(%)**	(%)	NIS millions											
In Israel																	
Arab-Israel Bank Ltd.	General banking services	**99.7**	99.7	**99.7**	99.7	**524**	421	**157**	158	**103**	108	**-**	-	**-**	(22)	**-**	-
Leumi Mortgage Bank Ltd. (k)	Provision of housing loans	**-**	100.0	**100.0**	100.0	**-**	2,769	**-**	1,009	**303**	203	**-**	-	**-**	(76)	**-**	-
Leumi Agricultural Development Ltd.		**100.0**	100.0	**100.0**	100.0	**58**	59	**-**	-	**1**	1	**2**	-	**-**	-	**-**	-
Leumi Industrial Development Ltd.		**99.6**	99.6	**99.8**	99.8	**105**	105	**-**	-	**2**	1	**2**	-	**-**	-	**-**	-
Leumi Partners Ltd. (c)	Business and financial services	**100.0**	100.0	**100.0**	100.0	**426**	379	**1,177**	1,200	**(68)**	(114)	**-**	-	**115**	(58)	**552**	-
Leumi Leasing and Investments Ltd. (d)	Equipment leasing and granting loans	**99.5**	99.5	**99.8**	99.8	**964**	937	**-**	-	**27**	35	**-**	-	**-**	-	**2**	2
Leumi Finance Company Ltd.	Raising capital by bond issues	**100.0**	100.0	**100.0**	100.0	**158**	154	**-**	-	**12**	12	**12**	11	**4**	1	**-**	-
Leumi Card Ltd.	Provision of credit card services	**80.0**	80.0	**80.0**	80.0	**986**	874	**-**	-	**144**	142	**-**	-	**-**	(54)	**-**	-
Leumi Securities and Investments Ltd.		**100.0**	100.0	**100.0**	100.0	**19**	18	**-**	-	**2**	2	**1**	63	**-**	-	**-**	-
Leumi Capital Market Services Ltd.	Operating services to provident and mutual funds	**100.0**	100.0	**100.0**	100.0	**34**	30	**-**	-	**4**	7	**-**	-	**-**	-	**-**	-
Leumi Financial Holdings Ltd.	Financial holdings	**100.0**	100.0	**100.0**	100.0	**474**	434	**-**	-	**8**	9	**-**	-	**-**	-	**-**	-
Abroad																	
Bank Leumi le-Israel Corporation	Holding company - registered in the U.S.	**100.0**	100.0	**100.0**	100.0	**540**	553	**-**	-	**-**	27	**-**	-	**(13)**	5	**-**	-
Bank Leumi USA (e)	General banking services - registered in the U.S.	**99.9**	99.9	**99.9**	99.9	**2,016**	1,977	**-**	-	**90**	183	**-**	-	**(51)**	7	**56**	-
Bank Leumi (UK) plc	General banking services - registered in the U.K.	**99.8**	99.8	**99.8**	99.8	**792**	686	**505**	428	**42**	102	**-**	-	**5**	(3)	**-**	-
Leumi Private Bank (f) (j)	General banking services - registered in Switzerland	**94.8**	94.6	**98.6**	98.0	**1,060**	479	**195**	203	**(18)**	53	**-**	269	**20**	(6)	**-**	-
Leumi Re Ltd.	Insurance	**100.0**	100.0	**100.0**	100.0	**93**	84	**-**	-	**9**	29	**-**	19	**-**	-	**-**	-
Bank Leumi (Luxembourg) SA	General banking services - registered in Luxembourg	**100.0**	100.0	**100.0**	100.0	**153**	130	**56**	55	**15**	22	**-**	-	**8**	-	**12**	7
Bank Leumi Romania (g)	General banking services - registered in Romania	**99.9**	99.9	**99.9**	99.9	**254**	229	**-**	-	**8**	(21)	**-**	-	**17**	-	**49**	49
Companies held by Bank Leumi USA																	
Leumi Finance Corporation (h)		**99.9**	99.9	**99.9**	99.9	**5,176**	5,263	**-**	-	**(87)**	391	**-**	-	**-**	-	**-**	-
Leumi USA Investment Corporation (h)		**99.9**	99.9	**99.9**	99.9	**3,720**	3,717	**-**	-	**(22)**	318	**-**	-	**-**	-	**-**	-

See notes on next page.

Note 6 - Investments in and Details of Investee Companies (cont'd)

Notes:

(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 share in their results less each company's share in the results of other companies in the Bank Group in respect of the abovementioned investments.
(b) Including adjustments in respect of presentation of the securities available for sale of consolidated companies by fair value.
(c) The Bank's share in a capital reserve in respect of the benefit in controlling shareholders' loans is NIS 104 million.
(d) The Bank's share in a capital reserve in respect of the benefit in controlling shareholders' loans is NIS 82 million.
(e) The investment in the company was made by Bank Leumi Le-Israel Corporation.
(f) The investment includes a balance of goodwill, in the amount of NIS 145.7 million (2011 – NIS 25.4 million).
(g) The investment is after deducting the balance of goodwill.
(h) Property companies established by Bank Leumi U.S.A. and 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 statements and translation thereof into shekels, income (losses) were generated on the consolidated capital, which are offset from Bank Leumi U.S.A.
(i) Other equity investments include capital notes and shareholders' loans.
(j) Shareholders' equity at the beginning of the year of Bank Safdié that was merged with the subsidiary in Switzerland, amounted to NIS 579 million.
(k) On 31 December 2012, the activities of Leumi Mortgage Bank were merged with Leumi.

Note 6 - Investments in and Details of Investee Companies (cont'd)

D. Details concerning principal investee companies (cont'd)

(2) Companies included on equity basis (a)

						Investments in shares											
Name of company	Principal area of activity	Percentage of equity granting a right to profits		Percentage of voting rights		At book value		At market value		Contribution to net profit attributed to shareholders of the banking corporation		Dividend recorded		Other items in accumulated shareholders' equity (c)		Guarantees for the company in favour of parties outside the Group	
		31 December		31 December		31 December		31 December		31 December		31 December		31 December		31 December	
		2012	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
		(%)	(%)	**(%)**	(%)	(NIS millions)											
The Israel Corporation Ltd. (b)	Holding company	**18.1**	18.1	**18.1**	18.1	**1,568**	1,749	**3,367**	3,291	**(110)**	97	**81**	43	**(22)**	51	**109**	409

(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 36 million (31 December 2011 – NIS 41 million).
(c) Includes translation adjustment reserves and other funds accumulated in retained earnings.

Leumi Mortgage Merger

On 9 September 2012, the Board of Directors of the Bank approved the merger of Leumi Mortgage Bank with the Bank. On 10 September 2012, the Board of Directors of Leumi Mortgage Bank approved the implementation of the said merger. The merger took place on 31 December 2012 ("the Merger Date").

As at 31 December 2012, the merger was completed and was registered with the Registrar of Companies, after all of the preconditions for its conclusion had been fulfilled.

The merger which was executed is a statutory merger, whereby Leumi Mortgage transferred its assets and liabilities to the Bank, and Leumi Mortgage was dissolved without liquidation, pursuant to the provisions of Chapter 1 of the Eighth Part of the Companies Law, 1999, and subject to the provisions of Chapter 2, Part E2 of the Income Tax Ordinance, such that on completion of the merger, Leumi Mortgage ceased to exist.

With effect from 15 January 2013, the banking license of Leumi Mortgage Bank was canceled.

Note 6 - Investments in and Details of Investee Companies (cont'd)

E. Goodwill and Intangible Assets

	Goodwill	Customer securities portfolios	Total
	(NIS millions)		
Cost			
As at 31 December 2010	188	-	188
Additions	-	-	-
Acquisitions in business combinations	-	138	138
As at 31 December 2011	188	138	326
Additions	1	-	1
Update pursuant to allocation of surplus cost*	85	(55)	30
As at 31 December 2012	**274**	**83**	**357**
Amortization and losses from impairment			
Balance at 31 December 2010	143	-	143
Amortization for the year	1	1	2
Balance at 31 December 2011	144	1	145
Amortization for the year	12	11	23
As at 31 December 2012	**156**	**12**	**168**
Amortized balance at 31 December 2012	**118**	**70**	**189**

Book value			
As at 31 December 2010	45	-	45
As at 31 December 2011	130	136	267
As at 31 December 2012	**118**	**70**	**189**

* Update pursuant to updated estimate for allocation of surplus cost in business combination.

Note 7 – Buildings and Equipment

A. Composition:

	Buildings and real estate (a)	Equipment, furniture and vehicles	Software	Total
	NIS millions			
Cost				
As at 31 December 2011	3,338	3,025	4,136	10,499
Additions	**70**	**269**	**496**	**835**
Disposals	**(11)**	**(50)**	**(32)**	**(93)**
Translation adjustment reserve	**(2)**	**(1)**	**(0)**	**(3)**
As at 31 December 2012	**3,395**	**3,243**	**4,600**	**11,238**
Accumulated depreciation				
As at 31 December 2011	1,716	2,397	2,733	6,846
Current year provision	**83**	**181**	**464**	**728**
Recognized losses from impairment	**47**	**-**	**-**	**47**
Disposals	**(9)**	**(47)**	**(31)**	**(87)**
Translation adjustment reserve	**(1)**	**-**	**-**	**(1)**
As at 31 December 2012	**1,836**	**2,531**	**3,166**	**7,533**
Balance after depreciation as at 31 December 2012	**1,559**	**713**	**1,433**	**3,705**
Balance after depreciation as at 31 December 2011	1,622	628	1,403	3,653

(a) Including leasehold installations and improvements.

B. Average depreciation rate:

	31 December 2012	31 December 2011
Buildings and real estate	**3.31%**	4.06%
Equipment, furniture and motor vehicles	**16.53%**	17.35%

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 134 million (31 December 2011 – NIS 135 million).

D. Investment property - buildings and real estate not used by the Group, mainly rental buildings, amount to NIS 28 million in the balance sheet (31 December 2011 – NIS 24 million).

E. The item "Buildings and equipment" includes improvements and leasehold rights, including payments on account. Some of the buildings are on leased land. Assets in the amount of NIS 182 million (31 December 2011 – NIS 236 million) in the balance sheet have not yet been registered in the name of the Bank at the Land Registry Office. 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 62 million (31 December 2011 – NIS 20 million) are shown net of a provision for anticipated losses. The fair value of the assets earmarked for sale at 31 December 2012 was NIS 101 million (31 December 2011 - NIS 40 million).

G. The balance of software includes costs capitalized during the year relating to the development of computer software in the amount of NIS 228 million (31 December 2011 – NIS 207 million).

Note 8 – Other Assets

	31 December 2012	31 December 2011
	NIS millions	
Deferred tax asset, net - see Note 26.I.	**2,598**	2,396
Excess of funds allocated for severance pay over provision – see Note 15.C	**333**	227
Assets transferred to ownership of the Group as a result of settlement of problem loans	**12**	25
Value of insurance policies in foreign branch	**404**	406
Excess of advance tax payments over current provisions	**60**	239
Expenses to be amortized on issuance of debentures, bonds and subordinated notes	**57**	61
Accrued income	**167**	134
Prepaid expenses	**226**	207
Other receivables and prepayments	**672**	509
Total other assets	**4,529**	4,204

Note 9 - Deposits of the Public

	31 December 2012	31 December 2011
	NIS millions	
Demand deposits	**75,355**	63,134
Time and other deposits	**211,506**	212,688
Deposits in savings plans (a)	**2,677**	3,582
Total deposits of the public	**289,538**	279,404

Note 10 - Deposits from Banks

	31 December 2012	31 December 2011
	NIS millions	
Commercial banks:		
Demand deposits (a)	**2,398**	3,325
Time deposits	**1,181**	1,066
Acceptances	**481**	638
Specialized banking entities:		
Demand deposits (a)	**-**	3
Time deposits	**13**	24
Total deposits from banks	**4,073**	5,056

(a) Reclassified.

Note 11 – Debentures, Bonds and Subordinated Notes

	Average duration (a)	Internal rate of return (a)	31 December	
	(Years)	%	2012	2011
			NIS millions	
Debentures and bonds (b)**:**				
In Israeli currency linked to the CPI	1.97	5.03	1,282	1,210
Subordinated notes (b):				
Unlinked Israeli currency	3.91 (c)	5.03	6,301	4,987
In Israeli currency linked to the CPI (d)	4.19(c)	4.20	19,932	23,372
In Swiss Francs	5.3(c)	4.1	10	-
In U.S. dollars	-	-	-	430
Total debentures, notes and subordinated notes			27,525	29,999

(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 not yet charged to profit and loss has been deducted from the amount of the debentures.

(c) The average duration as of the date of change in interest is based on a calculation of the effective average duration as calculated for purposes of Exhibit D, in unlinked subordinated notes is 1.90 years, in those linked to the CPI is 4.33 years and in subordinated notes in Swiss Francs is 0.80 years.

(d) Of which: subordinated notes (unquoted) deemed Upper Tier 2 capital in the amount of NIS 510 million (31 December 2011 - NIS 503 million) that in certain circumstances may be converted into shares.

(e) On 16 May 2011, in accordance with a permit received from the Israel Securities Authority, the Leumi Finance published a shelf prospectus for the issue of up to 9 series of debentures (series 179 to 187), up to 11 series of subordinated notes (Series N to W) for NIS 4 billion nominal value of each. In addition, the shelf prospectus allows for the issue of up to NIS 2,950,000,000 nominal value of subordinated notes (Series L) and NIS 3,350,000,000 nominal value of subordinated notes (Series M), in the framework of an expansion of quoted series first issued by means of a shelf prospectus dated 14 September 2010. The shelf prospectus dated 16 May 2011 is valid for two years from its publication.

According to the Shelf Offer Report dated 7 September 2011, Leumi Finance issued a total of about NIS 1.4 billion subordinated notes in the expansion to Series L – M as set out below:

Subordinated notes in the expansion of Series L amounting to NIS 1,142,941,000 par value (proceeds of NIS 1,144,083,941) are due to be repaid in one installment on 10 September 2017, are linked (principal and interest) to the consumer price index for July 2010 and bear interest at 2.6% per annum, payable on 10 September of each year from 2012 to 2017 (inclusive).

Subordinated notes in the expansion of Series M amounting to NIS 276,039,000 par value (proceeds of NIS 275,486,922) are due to be repaid in one installment on 10 September 2017, are not linked (principal and interest) to the any index and bear interest at 5.4% per annum, payable on 10 September of each year from 2012 to 2017 (inclusive).

The subordinated notes have been approved by the Bank of Israel as lower Tier 2 capital.

According to the Shelf Offer Report of 9 November 2011, Leumi Finance issued a total of some NIS 2 billion of subordinated notes in the expansion of Series L and an issue of Series N as follows:

Subordinated notes in the expansion of Series L amounting to NIS 1,078,669,000 par value (proceeds of NIS 1,105,635,725). For further details in respect of Subordinated Notes Series L, see above.

Subordinated notes in the expansion of Series N amounting to NIS 860,745,000 par value are due to be repaid in one installment on 9 November 2020, are linked (principal and interest) to the consumer price index for September 2011 and bear interest at 3.4% per annum, payable on 10 November of each year from 2012 to 2020 (inclusive).

The subordinated notes have been approved by the Bank of Israel as lower Tier 2 capital.

(f) In 2012, the company made one issue to the public pursuant to a shelf prospectus published on 15 May 2011 and a Shelf Offer Report published on 25 January 2012. In this issue, subordinated notes (Series M) and subordinated notes (Series N) in expansion of the quoted series, as follows:

1. NIS 1,280,000,000 par value subordinated notes (Series M), due to be repaid in one installment on 10 September 2017, not linked (principal and interest) to any index and bearing interest at 5.4% per annum (effective interest 5.1%), payable on 10 September of each year from 2012 to 2017. Pursuant to the results of

the offer, conducted on the unit price, subordinated notes (Series M) were issued at a price of NIS 1.035 for each NIS 1 par value, for proceeds of NIS 1,324,800,000).

2. NIS 1,010,000,000 par value subordinated notes (Series N), due to be repaid in one installment on 10 November 2020, linked (principal and interest) to the CPI index and bearing interest at 3.4% per annum (effective interest 3.35%), payable on 10 November of each year from 2012 to 2020. Pursuant to the results of the offer, conducted on the unit price, subordinated notes (Series N) were issued at a price of NIS 1.011 for each NIS 1 par value, for proceeds of NIS 1,021,110,000).

Subordinated notes (Series M-N) that were issued as stated, were listed for trading on the Tel Aviv Stock Exchange. And the proceeds that the company received from their issue were deposited in Bank Leumi for use at its discretion and on its responsibility, on the same repayment and linkage terms as the terms of the same series and at the same interest rate as the series with the additional margin of 0.1% per annum.

Note 12 - Other Liabilities

	31 December 2012	31 December 2011
	(Audited)	
	NIS millions	
Deferred tax liability, net – see Note 26.I.	**144**	118
Excess of current provisions for taxes over advance payments	**68**	33
Excess of provisions for severance pay and pensions over amounts allocated - see Note 15.C.	**4,960**	4,288
Provisions for unutilized vacations and long service bonus	**912**	897
Deferred income	**460**	537
Allowance for credit losses in respect of off-balance sheet items	**447**	464
Accrued expenses in respect of salaries and related expenses	**306**	494
Payables in respect of credit cards	**5,931**	5,606
Accrued expenses	**344**	399
Market value of securities sold short	**484**	838
Other payables and credit balances	**1,520**	1,063
Total other liabilities	**15,576**	14,737

Note 13 - Shareholders' Equity and Capital Adequacy

A. Share capital

	31 December 2012		31 December 2011	
	Authorized	**Issued and paid***	Authorized	Issued and paid
	(NIS)		(NIS)	
Ordinary shares of NIS 1.0 each	**3,215,000,000**	**1,473,551,221**	2,215,000,000	1,473,551,221

*All shares issued are registered in the names of the shareholders. Shares that have been or will be issued have been or will be converted into ordinary stock which is transferable in units of NIS 1.0.

On 1 August 2012, the General Meeting approved an increase in the authorized capital of the Bank to NIS 3,215,000,000 by creating 1 billion ordinary shares of NIS 1 par value, which are to be converted into stock after their issue and payment in full.

The ordinary stock is listed on the Tel-Aviv Stock Exchange.

NIS 400.000,000 par value deferred index-linked deposits/capital notes (unquoted), issued in June and July 2002, and repayable on 30 June 2011, and that were recognized by the Bank of Israel as Upper Tier 2 capital of the Bank, are convertible, in certain circumstances defined by the Supervisor of Banks, according to the conversion formula as set out in the conditions of the deposit/capital, to 150,480,664 ordinary shares of the Bank, as of the date of the report.

B. Dividend

In accordance with the recommendation of the Board of Directors of the Bank, and approvals by the General Meeting, the Bank distributed a cash dividend for 2010 in the amount of NIS 1.4 billion. The dividend was paid in amounts and on dates as follows: NIS 500 million in November 2010, NIS 500 million in January 2011, and NIS 400 million in June 2011.

Note 13 - Shareholders' Equity and Capital Adequacy (cont'd)

B. Capital adequacy

Calculated pursuant to Proper Conduct of Banking Business Directives Nos. 201-211 on the subject of "Measurement and Adequacy of Capital".

1. In balance sheet terms		
	31 December 2012	31 December 2011
	(NIS millions)	
Capital for purposes of calculating capital ratio		
Tier 1 capital, after deduction	**24,312**	23,225
Tier 2 capital, after deduction	**17,978**	18,020
Total capital	**42,290**	41,245
Weighted balance of risk assets	**-**	
Credit risk	**253,838**	258,601
Market risk	**9,710**	9,011
Operational risk (b)	**20,841**	20,095
Total weighted balance of risk assets	**284,389**	287,707
Ratio of capital to risk assets		
Ratio of Tier 1 capital to risk assets	**8.55%**	8.07%
Ratio of total capital to risk assets	**14.87%**	14.34%
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	9.00%

2. Principal subsidiary companies		
Arab Israel Bank		
Ratio of Tier 1 capital to risk assets	**10.84%**	11.30%
Ratio of total capital to risk assets	**14.76%**	15.60%
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	9.00%
Leumi Card Ltd.		
Ratio of Tier 1 capital to risk assets	**16.00%**	14.80%
Ratio of total capital to risk assets	**16.00%**	14.80%
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	9.00%
Bank Leumi USA (a)		
Ratio of Tier 1 capital to risk assets	**11.56%**	10.45%
Ratio of total capital to risk assets	**14.47%**	13.23%
Ratio of total minimum capital required by the local authorities	**10.00%**	10.00%

See notes on next page.

Note 13 - Shareholders' Equity and Capital Adequacy (cont'd)

3. Capital components for capital ratio calculation purposes (in consolidated balance sheet terms)

	31 December 2012	2011 דצמבר 31
	NIS millions	
Tier 1 capital		
Shareholders' equity	**24,426**	23,592
Minority interest of external shareholders in equity of consolidated subsidiaries	**307**	254
Less goodwill	**235**	175
Less intangible assets	**105**	162
Less losses from adjustment to fair value of securities avaliable for sale	**-**	218
Less other deductions from Tier 1 capital	**81**	66
Total Tier 1 capital	**24,312**	23,225
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	**333**	-
General provision for doubtful debts	**428**	428
Hybrid capital instruments	**6,071**	6,012
b. Lower Tier 2 capital		
Subordinated notes	**11,228**	11,646
c. Deductions from Tier 2 capital		
Investments in companies other than non-banking which have a significant effect	**56**	51
Other deductions	**26**	15
Total Tier 2 capital	**17,978**	18,020

(a) The United States office is not obliged to calculate the capital adequacy ratio in accordance with Basel II. Accordingly, the ratios presented are according to Basel I.

(b) First Pillar capital allocation in respect of operational risk is in accordance with the Standardized Approach.

Note 14 – Liens and Restrictive Conditions

As at 31 December 2012 and 31 December 2011, debentures and notes issued by consolidated companies in Israel are not secured by floating charges on their assets. Foreign branches and consolidated companies 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 426 million (31 December 2011 - NIS 524 million). Total liabilities in respect of which assets were pledged amount to NIS 377 million (31 December 2011 - NIS 446 million).

The Bank executes short-term lending of securities in foreign currency from the available portfolio, via the Euroclear clearinghouse, for other customers of the clearinghouse, without knowing the identity of the borrowers. The lending is carried out under a full guarantee of the Euroclear clearinghouse which is an AA+ rated financial institution. The value of the balance of the securities lent to the Euroclear clearinghouse as of 31 December 2012 was about NIS 117 million (31 December 2011 - NIS 75 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.

The amount of the Risk Fund is to be tphe average highest debit balance that the member had in the six months ending in the calendar month prior to the update. The Fund updates the amounts 4 times a year.

In addition – the bank has signed a credit facility of US$ 150 million with the Euroclear Clearing System to guarantee securities settlement by customers. The credit facility is backed up by securities held by the Bank in the Euroclear Clearing System.

Each of the members of the Risk Fund pledges securities 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 2012 was NIS 74 million (31 December 2011 – NIS 191 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.A 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 198 million (about 19% of the Fund).

Note 14 – Liens and Restrictive Conditions (cont'd)

The Bank, like any other member of the Clearing System, is entitled to secure its liabilities to the Maof Clearing System risk fund by means of pledging government bonds and deposits. The total of the debentures pledged by the Bank to the Maof Clearing System in respect of the activity of the customers, the *nostro*, and risk fund as at 31 December 2012 was NIS 1,380 million (31 December 2011 – NIS 1,791 million).

The Bank participates in an arrangement for ensuring the finality of settlement in default situations in which there is an insufficient balance in the clearing account of one or more of the other participants, as a participant in the RTGS (*"Zahav"*) System, and a holder of a clearing account in the system and a member of the *Masav* payment system and the banking clearing system ("participant"). In the event of default, each non-defaulting participant ("surviving participant") is to bear the debit charges of the participant that defaulted, according to the relative share of the surviving participant divided by the difference between 100% and the relative share of the participant that defaulted. The relative share of the Bank at 31 December 2012 in the *Masav* system is 15.989% and in the bank clearing system – 23.79% (this percentage is updated every six months according to the relative weighting of debit charges of each participant that were passed through the payment system relevant to the previous six months). The total ceiling for participation for all participants is NIS 300 million in the clearing system and NIS 150 million in the bank clearing system. In the event of default, on the business day following the date of default, immediately after the system opens, the Bank of Israel will send a multi-party payment instruction debiting the clearing account of the defaulting participant and crediting the clearing accounts of the surviving participants with the amount that each surviving participant paid in the framework of the arrangement, with the addition of interest at the Bank of Israel rate. The default arrangement is not intended to deal with a situation of a known or probable insolvency. In the event of insolvency, the proceedings will be passed to the Banking Supervision Department.

The Bank and its consolidated companies engage with foreign banks into CSA (Credit Support Annex) agreements that 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 2012, the Group had made deposits in favor of foreign banks totaling NIS 1,112 million (31 December 2011 – NIS 1,588 million).

The Bank and its consolidated companies engage with foreign banks into agreements 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 2012, the Group had deposited an amount of US$ 268 million in the above banks (31 December 2011 – US$ 222 million).

The Bank has signed a debenture, in accordance with the Bank has pledged by way of a first fixed charge and assignment by way of pledge, unlimited in amount, in favor of the Bank of Israel, all of the assets and rights in specific accounts held in the name of the Bank of Israel, in the Tel Aviv Stock Exchange Clearinghouse, in Euroclear Bank or in any other clearinghouse to which the Bank and the Bank of Israel must agree. The mortgaged assets in the accounts of Euroclear Bank, or in another account maintained in the clearinghouse outside Israel, are also mortgaged under a first ranking floating lien in favor of the Bank of Israel.

This pledge is to secure all the liabilities of the Bank in connection with credit that the Bank of Israel has extended or will extend and the placing of collateral to secure it, as detailed in the credit documents, except for credit according to a credit agreement between the Bank of Israel and the Bank and a secured debenture dated May 21, 2008.

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,

Note 14 – Liens and Restrictive Conditions (cont'd)

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 2010-2012.

	31 December 2012	31 December 2011
	(NIS millions)	
Sources of securities received which the Bank may sell or pledge, by fair value, excluding set-offs:		
Securities received in securities borrowing transactions against cash	**1,435**	1,225
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	**1,007**	442

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.

In September 2010, the Bank signed a deed of pledge, at the instructions of the Federal Reserve, under which it pledged monetary deposits in favor of Bank Leumi USA, in connection with loans given by Bank Leumi USA with collateral of obligations by Bank Leumi Le-Israel, in support of these obligations. The amount of the pledge at 31 December 2012 was US$ 49 million (31 December 2011 - US$ 92 million).

Note 15 – Employee Rights

A. Collective labor agreement regarding privatization

On 30 November, 2005 a special collective labor agreement was signed between management of the Bank and the employees' representatives in respect of the privatization process in the Bank.

The collective 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 collective 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.

This agreement was approved by the General Meeting on 2 February 2006.

On 17 November 2010, a special collective agreement was signed concerning the rights of employees, between the Bank and the representative body of employees of the Bank ("the Collective Agreement" or "the "Transaction") further to the agreement and resolution of the Board of Directors of the Bank. The Collective Agreement was approved by the Audit Committee, and thereafter, by the Board of Directors, on 21 November 2010, and by the General Meeting, on 28 December 2010. According to the Collective Agreement, the effectiveness of the consents to the abovementioned special collective agreement dated 30 November 2005 between the Bank and representatives of the employees ("the previous collective agreement") will be extended. Pursuant to the Collective Agreement, the consent that was in the previous collective agreement, to extend until 31 December 2010 the validity of the Employment Code and all collective agreements and arrangements, as well as all the agreements, procedures and practices granting rights to Bank employees, who are currently in the Bank, according to their individual status, was extended for a further period of four years – until 31 December 2014.

It was further provided in the collective agreement that the "industrial peace" undertaken by the representatives of the employees as stated in paragraph 7 of the previous collective agreement would continue to be in effect.

With regard to the effect of the option plan and the issue of shares to employees, see section H. below.

B. Severance pay and pensions

(1) General

For employees that commenced their employment with the Bank since 1 January 1999 (hereinafter: "2nd generation employees") 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: ("1st 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 40% for the first 15 years of employment, i.e. 2.67% per annum, 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 current pension distribution is that about 76% choose a pension, while the remainder chose severance pay and provident funds), and past experience regarding disability, etc.

The actuarial calculation is based on the updated provisions of the Chief Actuary in the Ministry of Finance with respect to mortality rates from March 2013, 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 0.9% to 7.2%.

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.

Note 15 – Employee Rights (cont'd)

(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, a medical check-up (for some of the alumni) 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 2012 for expected costs in respect of the above entitlements in the period following the employment period according to actuarial calculation amounts to some NIS 128 million (31 December 2011 – NIS 105 million).

(3) Early retirement for employees under personal employment contracts

(a) Ms. Rakefet Russak-Aminoach serves in the position of President and CEO of the Bank as of 1 May 2012. The monthly salary of the President and Chief Executive Officer, commencing May 2012, is NIS 180,000 (linked to the increase in the CPI. In accordance with the terms of her position and employment in the Bank, the President and CEO is entitled, in the event of termination of the employee-employer relationship between her and the Bank, to the following conditions: in the event of dismissal before her employment in the Bank amounts to 15 years, the President and CEO will be entitled to an amount equalling 250% of her last monthly salary multiplied by the number of years of her employment at the Bank, with the addition of pension deductions and provident funds. In the event of dismissal after 15 years and above of employment with the Bank or retirement, the President and CEO will be entitled to choose between (a) compensation in the amount equivalent to 200%, multiplied by the number of years of her employment in the Bank, with the addition of pension deductions and provident funds; and (b) an immediate pension on retirement from the Bank. The rate of retirement pension to the President and CEO is as set out in sub-paragraph c. below concerning members of management. In the event of resignation, the President and CEO will be entitled to compensation of an amount equal to 100% of her last monthly salary multiplied by the number of years of her employment at the Bank, with the addition of pension deductions and provident funds, whereas if the resignation is after 15 years or more of working in the Bank, the President and CEO will be entitled to compensation in the amount of 200% of her last monthly salary multiplied by the number of years of her employment at the Bank, with the addition of pension deductions and provident funds.

The Bank and the President and CEO are each entitled to terminate the working relationship by giving advance notice of 6 months.

(b) Under the employment contract with Ms. Galia Maor, the former President and Chief Executive Officer of the Bank that was signed at the beginning of 1996 (and subsequently amended and signed in 2004) (hereinafter: "the contract"), Ms. Maor is entitled to a pension immediately upon her retirement.

Ms. Maor retired from her position as President and CEO of the Bank on 30 April 2012, and from May 2012 until January 2013 there was a period of advance notice

Note 15 – Employee Rights (cont'd)

between her and the Bank after cessation of work. On 31 January 2013, the employee-employer relationship between Ms. Maor and the Bank came to an end.

(c) The Bank signed personal contracts with members of Management of the Bank (1st generation) and with a group of senior executives of the Bank (executive vice presidents, senior assistants to the CEO, and assistants to the CEO), according to which the Bank has undertaken to pay an immediate pension, in the event of dismissal of such an employee, if their age plus the number of years of employment with the Bank amounts to 75, or 80 under the new contracts. The years of service of a member of Management (if the employee served at least 7 years as a member of Management) will be counted as additional years of seniority for purposes of the said aggregate years of service.
The pension for members of Management will be calculated at the rate of 40% for the first 15 years of employment, i.e. 2.67% per annum, and 1.5% for each additional year until signing a personal contract, 2% for each year under a personal contract, and 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 40% for the first 15 years of employment, i.e. 2.67% per annum, 1.5% for each additional year until signing a personal contract, and 2% for 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 their age plus the number of years of employment with the Bank does not amount to 75, or 80 as mentioned) of their latest monthly salary multiplied by the number of years of employment, plus the amounts accumulated to their credit in the provident fund. In such case, the employees are 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.

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.

According to the personal contracts with members of the management of the Bank, who are not 1st generation or 2nd generation in the Bank, in the event of dismissal, these members of Management will not be entitled to a pension from the Bank, but to compensation amounting to 250% of the last monthly salary for each year of employment in the Bank, with the addition of monies accrued in the provident fund from which are deducted the amounts accrued in the severance pay fund. Any employee, as aforesaid, who voluntarily resigns will be entitled to 100% of severance

Note 15 – Employee Rights (cont'd)

pay, plus the monies in the provident fund after deduction of the amounts accrued in the severance pay fund.

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, after deduction of the amounts accrued in the severance pay fund.

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, after deduction of the amounts accrued in the severance pay fund; or alternatively, 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.

The maximum additional expense that the Bank can incur in the event of the employees mentioned above being immediately dismissed amounts to NIS 364 million (including salary tax payable on the pension) (2011 – NIS 355 million). Since it is not likely that all the above mentioned employees will be dismissed immediately, the Bank recorded a provision at the rate of 25% of the above amount, in the amount of NIS 110 million (including salary tax) (2011 – NIS 90 million). The above amounts also include members of Management.

After amendment of the personal employment contracts of members of Management, as stated above, part of the said provision was attributed specifically to members of Management, the balance of which at 31 December 2012 was NIS 12 million (31 December 2011 – NIS 14 million).

(4) The Chairman of the Board of Directors of the Bank

The Audit Committee, the Board of Directors and the General Meeting of the Bank has approved the terms of employment of the Chairman of who is employed in a full-time position as Executive Chairman.

The Chairman's employment is for a period of three years, commencing 4 August 2010, ("**the employment period**"). If, at the end of the employment period, the Chairman elects for a further term of office, the conditions of engagement between the parties will continue to apply. However, in this event, the conditions regarding early notice and entitlement to adaptation grant will not apply.

The Bank and the Chairman have the option of discontinuing the engagement between them on giving early notice, in the following cases: (1) if the Chairman's employment is terminated during the employment period because of involuntary retirement, the early notice period will be up to 9 months, providing that it is not extended beyond the date of the end of the employment period; (2) if the Chairman's employment is terminated in the employment period as a result of voluntary retirement (except in exceptional circumstances in which compensation may be denied the Chairman) and if the Chairman's employment has terminated after the employment period (as far as chosen for an additional term of office) – the early notice period will last 6 months. It is clarified that the Bank will be authorized to demand that the early notice period will be actual employment, in whole or in part. In the early notice period, the Chairman will be entitled to a salary and the rest of the related conditions.

If the Chairman's employment is terminated for any reason whatsoever (except in exceptional circumstances in which compensation may be denied the Chairman), the Chairman will be entitled to compensation amounting to 150% of the last salary times the number of years (and/or part thereof) of his term of office as Chairman of the Board of Directors, in addition to the Chairman's entitlement to the monies and rights accrued in the severance pay fund and pension fund. If the Chairman's employment is terminated during the employment period as a result of compulsory retirement or if the Chairman's employment as Chairman is terminated at the end of the employment period, for any reason whatsoever – the Chairman will be entitled for a six-month period of adaptation, in which the Chairman will receive monthly salaries (include related conditions). The period of adaptation will commence after the end of the early notice period (if any). The Chairman further undertook to a six-month cooling-off period, in which he is entitled to a salary and the rest of the related conditions. It is clarified that in a period in which the cooling-off period overlaps the early notice period and/or the adaptation period, in whole or part, the Chairman will be entitled only to payment in respect of the early notice period or the adaptation period, as applicable.

C. Details of provisions and amounts funded

Amounts of provisions and amounts funded for severance pay and pensions are included in the balance sheet as follows:

	31 December 2012	31 December 2011
	NIS millions	
Provision for severance pay (a)	**3,024**	2,902
Amounts funded for severance pay (1) (a)	**(3,319)**	(3,000)
Provision for pensions (a)	**5,096**	4,314
Amounts funded for pensions	**(174)**	(155)
Excess of provisions over amounts funded, net	**4,627**	4,061
Excess of provisions over amounts funded, net, included in "other liabilities"	**4,960**	4,288
Excess of amounts funded included in "other assets"	**333**	227
Excess of provisions over amounts funded, net (2)	**4,627**	4,061

(a) Reclassified.

(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.

Total liabilities for pensions to employees who commenced work in the Bank before 1 January 1999 totaled NIS 7,615 million at 31 December 2012. To cover this liability, severance monies are deposited in Central Severance Pay Funds in the amount of NIS 2,581 million as well as provident monies deposited in provident funds in the amount of NIS 3,886 million which are managed by the management company owned by the members of these funds, as stated in paragraph F below. Provident monies are set off from pension liabilities and are not shown in the balance sheet and are also not detailed in the above table. The difference between the above provisions and amounts funded is provided for by the Bank and included under liabilities in the Bank's balance sheet.

Note 15 – Employee Rights (cont'd)

D. 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 678 million (in 2011 – NIS 674 million).

Calculation of the liability is made on an actuarial basis and takes into account, based on past experience, the probability that on the determining date, the employee will still be employed by the Bank. The said calculation is made using the capitalization rate published by the Supervisor of Banks (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 0.8% to 7.2%.

The provision for special service vacations is made on an actuarial basis taking into account past experience with respect to utilization of such vacations.

E. Provision for vacations

There is a provision of NIS 235 million under "Other Liabilities" for unutilized vacation pay (31 December 2011 - NIS 222 million). The provision is calculated on the basis of the latest salary plus related benefits.

F. Provident and severance pay funds of the employees of the Bank

The Bank deposits provident monies for "1st generation" employees in the Bank Leumi and Leumi Mortgage Bank Employees Provident Funds, which are managed by a management company owned by the members of the funds.

The Bank provides the company with the services it requires to manage the funds, as permitted by law.

Commencing in 2008, these funds became non-pension payment provident funds, and provident monies funds cannot be withdrawn from these funds, unless they have been transferred to pension payment provident funds and subject to the conditions applying to the said funds.

In addition, as of 2011 the possibility of depositing monies in the Central Severance Pay Funds was restricted by law, and the Bank deposits severance monies in the provident fund in the name of the employees of the Bank.

G. Bonus Program for Senior Managers

Set out below is the senior manager bonus program that ended on 31 December 2012. Remuneration of senior officers for 2013 and onward will be carried out in accordance with remuneration policy and a remuneration program to be presented for discussion and approval by the authorized bodies in the Bank and in accordance with that set out in Amendment 20 of the Companies Law.

The Board of Directors of the Bank 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”) in March 2010 and an update of the program in September 2011 (the “Bonus Program”) .

Note 15 – Employee Rights (cont'd)

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.

2. The bonus of the senior managers will be determined as set out below:

2.1 Determination of the amount of the overall annual bonus to the senior managers – The amount 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 paragraph 2.3 below (hereinafter: the "adjusted rate of return").

In the context of the September 2011 update to the bonus program, the overall amount of the annual bonus to senior managers was updated (both positive and negative) in accordance with the increase in the number of members of Management, and in accordance with changes in the status of members of Management. As explained below, no change was made to the maximum potential overall bonus, which stands at NIS 30 million, and no change was made to the maximum negative bonus, which stands at NIS 20 million. In addition, no change or update was made to the share of the Chairman of the Board of Directors and the President and CEO.

Only an adjusted rate of return which is equal to or higher than 8% will create an entitlement to a (positive) bonus. In light of the abovementioned update to the bonus program, the overall amount of the bonus to senior managers (positive and negative) for 2012 onwards was raised by 9%, and in respect of the change during 2011, the overall amount of the bonus to senior managers (positive and negative) was raised by about 6%, as follows:

For 2011: if the adjusted rate of return is 8%, the overall amount of the bonus will be 0.53% of the adjusted net profit[1]. If the adjusted rate of return is 9%, the overall amount of the bonus will be 0.7208% of the adjusted net profit. If the adjusted rate of return is 10%, the overall amount of the bonus will be 0.901% of the adjusted net profit, and if the adjusted rate of return is 12% or more, the overall amount of the bonus will be 1.06% of the adjusted net profit.

For 2012 onwards: if the adjusted rate of return is 8%, the overall amount of the bonus will be 0.545% of the adjusted net profit[1]. If the adjusted rate of return is 9%, the overall amount of the bonus will be 0.7412% of the adjusted net profit. If the adjusted rate of return is 10%, the overall amount of the bonus will be 0.9265% of the adjusted net profit, and if the adjusted rate of return is 12% or more, the overall amount of the bonus will be 1.09% 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. As stated, the overall amount of the bonus will in no case exceed NIS 30 million.

[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)

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 Chief Risk Officer (CRO), 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 score 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 scores 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; (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 (Balance Score Card) score for the assessed year.

2.4 The method of calculating the personal bonus for each of the Senior Managers is as follows:

In the context of the bonus program update, the normative ratios[2] for allocating the overall bonus were adjusted to the change in the overall bonus amount. As no change or update was made to the share of the Chairman of the Board of Directors and the President and CEO, their normative share decreased relatively, as explained below:

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2.4.1 Chairman of the Board of Directors - The amount of the bonus for the Chairman of the Board of Directors will be determined on the basis of (1) the weighted personal score comprising 60% based on the Bank's BSC score and 40% based on the personal evaluation score given by the Board of Directors, and (2) the Chairman's relative normative[2] share of the overall bonus, determined by the Board of Directors, which in light of the bonus program update, decreased from the rate of 16.7% to the rate of 15.56% for 2011, and to 15.31% for 2012 onward.

2.4.2 CEO - The amount of the bonus for the CEO will be determined on the basis of: (1) the weighted personal score comprising 60% based on the Bank's BSC score and 40% based on the personal evaluation score given by the Board of Directors, and (2) the relative normative share of the overall bonus, determined by the Board of Directors,

[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.

which, in light of the bonus program update, decreased from the rate of 20.8% to the rate of 19.7% for 2011, and to 19.14% for 2012 onward.

2.4.3 The other senior managers - The amount of the bonus for the remaining senior managers will be determined on the basis of: (1) the weighted personal score comprising 60% based on the BSC score of the unit headed[3] by the senior manager and 40% based on the personal evaluation score 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 score for the senior management: the contribution to ongoing business activity and results; the contribution to controlling of the level of risk; reaching 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, capital issues, 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, in light of the bonus program update, the relative normative share of the other Senior Managers increasing from 62.5% to 64.74% for 2011, and to 65.55% for 2012 onward.

The bonus to the Chief Internal Auditor, the Chief Accountant and the CRO 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 score (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 was adjusted with respect to 14 senior managers (and for part of 2011, 15 senior managers). If the number of senior managers is less than 14, the program will be adjusted and the amount of the bonus reduced by the value of the normative bonuses of the senior managers who have been subtracted. If the number of senior managers exceeds 14, 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] Other than the BSC for the Senior Deputy CEO, for whom the overall BSC score of the Bank will be used.

Note 15 – Employee Rights (cont'd)

3.2 Failure to comply with the ratio of capital to risk assets set out in Proper Conduct of Banking Business Directive No. 311, or in any other directive which replaces it.

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 overall amount of the negative bonus was updated in the context of the bonus program update and rose from 1% to 1.09% of the "determinative return differential" as of 2012 (and in respect of 2011 it rose to 1.06%) as stated below, multiplied by the Bank's weighted capital.

The overall amount of the 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 score will be adjusted through its deduction from a fixed number – 200 (such that a score of 70 will become a score of 130); and (3) the negative differential will be adjusted by multiplying it by the Bank's weighted score, 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 score of each senior manager will be determined in accordance with section 2.4 above. Because of the negative bonus, the weighted score will be converted into an adjusted weighted score, through its deduction from a fixed number – 200 (such that, for example, a score of 80 will become a score of 120). The reversal is required such that to the extent that a particular Senior Manager's score is lower, his share of the negative bonus will be greater.

4.2.2 The adjusted weighted score (divided by 100) will be multiplied by the particular senior manager's relative normative score, 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.

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 leaves the Bank for retirement[4], or who leaves 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, 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. 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 leaves 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

[4] Including at an age when, according to the personal labor agreement between the manager and the Bank, the manager is entitled to resign and receive 200% severance pay.

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.

7. 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 2011 or any other year.

8. 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.

9. 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.

Appropriate provisions have been made in the financial statements.

H. Sale of Shares to Employees

In accordance with the agreements concerning the privatization of the Bank, and in accordance with agreements reached between the Accountant-General in the Finance Ministry and the employees of the Bank, an outline prospectus was published on 6 April 2011 for the offer by the State of Israel of the Bank's shares to employees of the Bank, Arab-Israel Bank Ltd., Leumi Mortgage Bank Ltd., and the Restaurant Association of Employees of Bank Le-Israel B.M. (registered association) ("the participants", "the outline prospectus").

On 17 May 2011, the purchase was completed by the participants, in accordance with and subject to arrangements and conditions detailed in the outline prospectus, of 6,339,730 shares held by the State of Israel representing 0.43% of the Bank's issued and paid-up share capital of the Bank, as at the date of publication of the outline prospectus. On 24 May 2011, the General Meeting of the Bank approved the offer of 9,442 shares to the Chairman of the Board of Directors of the Bank, and the grant of a loan by the Bank to purchase the shares. On 30 May 2011, the Bank was informed by the Ministry of Finance that on 29 May 2011, the sale of the shares to the Chairman of the Board of Directors was completed.

The price per share for purposes of the offer to participants according to the outline prospectus was NIS 13.20825 per share as at 19 January 2011, and this share price was linked to the Consumer Price Index using the "last known index" method, with the base index being the index for the month of December 2010, that was published on 14 January 2011.

The share price was NIS 13.3002797 (The price of the shares purchased by the Chairman of the Board of Directors was NIS 13.37813).

The allocation of shares to the participants and the determination of the number of shares offered each participant, was made relative to the salary serving as a basis for social provisions for those participants for the month of January 2011, in accordance with the terms of the outline prospectus. The Chairman of the Board (as stated above) and the President and CEO of the Bank are included in the participants.

The shares will be blocked for a period of four years from the determining date (as defined in the outline prospectus), and will be deposited with a trustee.

In addition, the Audit Committee and the Board of Directors approved the granting of loans to the participants for the purchase of the shares offered in the outline prospectus.

The value of the benefit to the employees and to the Chairman of the Board of Directors in respect of the aforesaid purchase, which was assessed by an external valuer, includes a number of components, and amounts to some NIS 13 million. This amount was recorded as a salary expense in accordance with the value of the benefit on the day it was granted and this amount remains fixed. A benefit of NIS 13 million was recorded in a capital reserve.

To finance the purchase of the shares, the Bank extended loans to the employees amounting to some NIS 43 million, with repayment in one amount at the end of the blocked period of the shares, of which loans amounting to NIS 12 million are linked to the Consumer Price Index, bearing interest at 1.55%, and loans amounting to NIS 31 million are unlinked based on the prime rate less 0.75%. The loans are not under non-recourse conditions. The amount of the loans was deducted from the Bank's capital.

I. Streamlining – Structural change

In 2012 an expense was recorded of about NIS 323 million for bringing forward the retirement of employees under the program for reducing manpower in the Bank pursuant to the plan for structural change in the Bank. This program is to be spread over the years 2012-2014.

J. Effect of the change in the rate of tax

On 30 August 2012, Value Added Tax Order (Tax Rate on Noninterest-Profit Organizations and Financial Institutions) (Amendment), 2012, was published in the Official Gazette (*Reshumot*), updating the rate of value added tax in respect of profit tax and payroll tax for financial institutions to 17% from 1 September 2012. As a result of the said change, the statutory tax rate, which applies to banking corporations, rose in 2012 from 35.34% to 35.53%, and in 2013, it will rise to 35.9%. In addition, the rate of payroll tax, which applies to financial institutions, increased to 17% with respect to salary payable for work from September 2012 and thereafter, instead of 16% for the whole of 2012 and 15.5% for 2013 and thereafter.

The above changes resulted in an increase of the balance of liabilities in respect of employee rights of about NIS 63 million, before the relative tax effect.

Note 16 - Assets and Liabilities Classified by Linkage Basis

	31 December 2012						
	Israeli currency		Foreign currency (a)				
	Unlinked	Linked to the CPI	In U.S. dollars	In Euro	In other currencies	Non-monetary items (b)	Total
	NIS millions						
Assets							
Cash and deposits with banks	39,306	277	8,971	1,686	4,154	227	54,621
Securities	27,179	4,761	16,249	3,976	1,877	2,366	56,408
Securities borrowed or purchased under agreements to resell	1,435	-	-	-	-	-	1,435
Credit to the public, net (c)	137,700	54,847	32,924	6,622	9,077	94	241,264
Credit to governments	13	269	124	36	-	-	442
Investments in companies included on equity basis	-	-	-	-	-	2,129	2,129
Buildings and equipment	-	-	-	-	-	3,705	3,705
Assets in respect of derivative instruments	7,538	184	2,988	260	168	300	11,438
Other assets and intangible property	2,849	3	893	8	178	787	4,718
Total assets	216,020	60,341	62,149	12,588	15,454	9,608	376,160
Liabilities							
Deposits of the public	151,962	28,467	79,894	17,620	11,257	338	289,538
Deposits from banks	1,694	166	1,765	318	130	-	4,073
Deposits from governments	15	109	319	8	-	-	451
Securities loaned or sold under agreements to repurchase	951	-	56	-	-	-	1,007
Debentures, bonds and subordinated notes	6,301	21,214	-	-	10	-	27,525
Liabilities in respect of derivative instruments	7,973	561	3,141	593	230	264	12,762
Other liabilities	8,553	5,330	629	28	285	751	15,576
Total liabilities	177,449	55,847	85,804	18,567	11,912	1,353	350,932
Difference (d)	38,571	4,494	(23,655)	(5,979)	3,542	8,255	25,228
Effect of non-hedging derivative instruments:							
Derivative instruments (except options)	(18,424)	(6,280)	22,507	6,687	(4,490)	-	-
Options in the money, net (in terms of underlying asset)	(431)	-	231	5	195	-	-
Options out of the money, net (in terms of underlying asset)	(133)	-	284	(146)	(5)	-	-
Total	19,583	(1,786)	(633)	567	(758)	8,255	25,228
Effect of non-hedging derivative instruments:							
Options in the money, net (discounted par value)	(575)	-	273	(20)	322	-	-
Options out of the money, net (discounted par value)	(1,630)	-	2,042	(436)	24	-	-

(a) Including linked to foreign currency.
(b) Including derivative instruments whose underlying asset is a non-monetary item.
(c) After deduction of credit loss allowances attributable to linkage bases in the amount of NIS 4,114 million.
(d) Shareholders' equity includes minority interest.

Note 16 - Assets and Liabilities Classified by Linkage Basis (cont'd)

	31 December 2011						
	Israeli currency		Foreign currency (a)				
	Unlinked	Linked to the CPI	In U.S. dollars	In Euro	In other currencies	Non-monetary items (b)	Total
	(NIS millions)						
Assets							
Cash and deposits with banks	38,666	326	9,441	1,535	3,003	73	53,044
Securities	19,846	7,985	10,711	5,262	1,580	2,552	47,936
Securities borrowed or purchased under agreements to resell	1,225	-	-	-	-	-	1,225
Credit to the public, net (c)	132,948	52,423	38,825	6,778	10,263	83	241,320
Credit to governments	49	267	106	26	-	-	448
Investments in companies included on equity basis	4	-	-	-	-	2,266	2,270
Buildings and equipment	-	-	-	-	-	3,653	3,653
Assets in respect of derivative instruments	4,238	155	6,671	66	332	111	11,573
Other assets and intangible property	2,671	7	994	23	58	632	4,385
Total assets	199,647	61,163	66,748	13,690	15,236	9,370	365,854
Liabilities							
Deposits of the public	145,719	25,915	78,084	18,791	10,719	176	279,404
Deposits from banks	1,425	213	2,688	410	320	-	5,056
Deposits from governments	39	186	275	19	-	-	519
Securities loaned or sold under repurchase agreements	385	-	57	-	-	-	442
Debentures, bonds and subordinated notes	4,987	24,582	430	-	-	-	29,999
Liabilities in respect of derivative instruments	4,086	650	6,558	339	351	85	12,069
Other liabilities	8,129	4,948	726	37	208	689	14,737
Total liabilities	164,770	56,494	88,818	19,596	11,598	950	342,226
Difference (d)	34,877	4,669	(22,070)	(5,906)	3,638	8,420	23,628
Effect of non-hedging derivative instruments:							
Derivative instruments (except options)	(14,491)	(4,472)	18,915	5,312	(5,264)	-	-
Options in the money, net (in terms of underlying asset)	(838)	-	(527)	716	649	-	-
Options out of the money, net (in terms of underlying asset)	9	-	260	(333)	64	-	-
Total	19,557	197	(3,422)	(211)	(913)	8,420	23,628
Effect of hedging derivative instruments:							
Options in the money, net (discounted par value)	(1,387)	-	(273)	873	787	-	-
Options out of the money, net (discounted par value)	937	-	(393)	(582)	38	-	-

(a) Including linked to foreign currency.
(b) Including derivative instruments whose underlying asset is a non-monetary item.
(c) After deduction of credit loss allowances attributable to linkage bases in the amount of NIS 3,967 million.
(d) Shareholders' equity includes minority interest.

Note 17 - Assets and Liabilities Classified by Repayment Date and Linkage Basis (a)

31 December 2012	Estimated future contractual cash flows											Balance sheet balance (d)		
	Upon demand and up to one month (e)	One month to three months (e)	Three months to one year (e)	One year to two years	Two years to three years	Three years to four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total cash flows	Without fixed maturity (b)	Total	Contractual rate of return (g)
	NIS millions													
Israeli currency – unlinked:														
Assets	76,885	19,359	44,144	25,014	13,552	9,634	8,814	19,984	15,526	5,607	238,519	1,898	216,020	4.72
Liabilities	125,763	12,683	22,741	7,223	2,372	1,857	3,465	3,553	349	183	180,189	721	177,449	4.37
Difference	(48,878)	6,676	21,403	17,791	11,180	7,777	5,349	16,431	15,177	5,424	58,330	1,177	38,571	
Derivative instruments (except options)	(2,080)	(10,732)	(7,072)	1,694	(167)	(64)	(68)	355	(103)	(86)	(18,323)	-	(18,424)	
Options (in terms of underlying asset)	(505)	(327)	271	(7)	9	-	-	-	-	-	(559)	-	(564)	
Israeli currency - linked to the CPI:														
Assets	1,664	1,318	8,285	7,941	6,923	5,204	5,204	17,680	14,225	4,560	73,004	26	60,341	2.99
Liabilities	1,998	1,714	12,164	8,439	9,098	5,737	6,895	12,167	2,829	1,713	62,754	1,737	55,847	4.01
Difference	(334)	(396)	(3,879)	(498)	(2,175)	(533)	(1,691)	5,513	11,396	2,847	10,250	(1,711)	4,494	
Derivative instruments (except options)	(513)	(726)	(2,570)	(1,958)	(151)	(250)	284	(220)	(303)	-	(6,407)	-	(6,280)	
Foreign currency- local operations (c):														
Assets	15,009	4,039	8,070	8,137	4,401	4,872	2,656	4,939	1,382	366	53,871	168	51,067	2.72
Liabilities	49,051	13,964	14,361	1,770	794	743	540	823	49	-	82,095	-	81,807	1.07
Difference	(34,042)	(9,925)	(6,291)	6,367	3,607	4,129	2,116	4,116	1,333	366	(28,224)	168	(30,740)	
Derivative instruments (except options)	2,593	11,458	11,322	264	318	314	(29)	(135)	406	86	26,597	-	26,566	
Options (in terms of underlying asset)	505	327	(271)	7	(9)	-	-	-	-	-	559	-	564	
Foreign currency - integrated foreign operations:														
Assets	14,783	4,137	8,924	2,974	3,345	2,219	1,697	1,457	509	97	40,142	180	39,124	2.28
Liabilities	19,957	3,891	6,806	1,108	427	156	2,177	14	23	4	34,563	65	34,476	0.76
Difference	(5,174)	246	2,118	1,866	2,918	2,063	(480)	1,443	486	93	5,579	115	4,648	
Financial instruments (excluding options)	-	-	(1,680)	-	-	-	(187)	-	-	-	(1,867)	-	(1,862)	

See notes on next page.

Note 17 - Assets and Liabilities Classified by Repayment Date and Linkage Basis (cont'd)(a)

31 December 2012

	Estimated future contractual cash flows											Balance sheet balance (d)		
	Upon demand and up to one month (e)	One month to three months (e)	Three months to one year (e)	One year to two years	Two years to three years	Three years to four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total cash flows	Without fixed maturity (b)	Total	Contractual rate of return (g)
	NIS millions													
Non-monetary items:														
Assets	-	-	-	-	-	-	-	-	-	-	-	9,608	9,608	
Liabilities	-	-	-	-	-	-	-	-	-	-	-	1,353	1,353	
Difference	-	-	-	-	-	-	-	-	-	-	-	8,255	8,255	
Total:														
Assets	108,341	28,853	69,423	44,066	28,221	21,929	18,371	44,060	31,642	10,630	405,536	11,880	376,160	3.74
Liabilities	196,769	32,252	56,072	18,540	12,691	8,493	13,077	16,557	3,250	1,900	359,601	3,876	350,932	2.87
Difference (f)	(88,428)	(3,399)	13,351	25,526	15,530	13,436	5,294	27,503	28,392	8,730	45,935	8,004	25,228	

31 December 2011

	Estimated future contractual cash flows											Balance sheet balance (d)		
	Upon demand and up to one month (e)	One month to three months (e)	Three months to one year (e)	One year to two years	Two years to three years	Three years to four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total cash flows	Without fixed maturity (b)	Total	Contractual rate of return (g)
	NIS millions													
Total:														
Assets	107,823	30,031	69,878	39,480	27,175	22,158	16,504	46,737	29,651	9,585	399,022	11,174	365,854	4.29
Liabilities	186,480	30,898	55,694	24,120	10,461	10,104	9,079	21,364	3,256	1,778	353,234	2,579	342,226	3.22
Difference (f)	(78,657)	(867)	14,184	15,360	16,714	12,054	7,425	25,373	26,395	7,807	45,788	8,595	23,628	

(a) In this Note, forecast 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 965 million (31 December 2011 – NIS 525 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 revolving account conditions is classified in accordance with the period of the credit facility: credit within limit of facilities of NIS 12.1 billion (31 December 2011 - NIS 13.3 billion). Over-limit credit in the amount of NIS 0.4 billion (31 December 2011 - NIS 0.3 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 4.5 billion as at 31 December 2012 (31 December 2011 - NIS 5.1 billion).

Note 18 - Contingent Liabilities and Special Commitments

	31 December 2012		31 December 2011	
	Contract balances	Balance of allowance for credit losses	Contract balances	Balance of allowance for credit losses
	(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	**1,823**	**5**	2,060	5
Credit guarantees	**5,793**	**76**	7,360	82
Guarantees to apartment purchasers	**13,538**	**18**	11,461	24
Other guarantees and liabilities	**16,504**	**221**	15,698	219
Unutilized credit card facilities	**22,582**	**21**	20,519	23
Other unutilized revolving credit facilities and credit facilities in accounts on demand	**14,434**	**31**	14,037	30
Irrevocable commitments to provide credit which has been approved and not yet granted (a)	**20,892**	**60**	22,979	64
Commitments to issue guarantees	**10,818**	**15**	11,694	17
Unutilized facilities for activity in derivative instruments	**6,129**	**-**	4,386	-
Approval in principle for a guaranteed rate of interest	**3,689**	**-**	2,410	-

(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 224 million (31 December 2011 – NIS 229 million). This commitment is only made in a situation where financing difficulties do not facilitate securitization. Currently and in the past the liquidity facility was not utilized. The lines provided by the Bank represent a small part of the overall volume of liquidity lines provided to those entities. The Bank does not provide these entities with any other kind of support.

	31 December 2012	31 December 2011
	(NIS millions)	
B. Off-balance sheet commitments for transactions based on extent of collections (a)		
Balance of credit from deposits based on extent of collections (b)		
Israeli currency unlinked	**1,160**	1,326
Israeli currency linked to the CPI	**4,493**	5,189
Foreign currency	**410**	464
Total	**6,063**	6,979

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Cash flows in respect of collection commissions and interest margins on activities based on the extent of collections as at December 31

	Up to one year	One to three years	Three to five years	Five to ten years	Ten to twenty years	More than twenty years	Total 2012	Total 2011
	(NIS millions)							
1. CPI linked sector (c)								
Cash flows of futures contracts	**35**	**44**	**42**	**83**	**37**	**1**	**242**	275
Expected future cash flows after management estimate of early repayments	**38**	**46**	**40**	**81**	**35**	**-**	**240**	270
Discounted expected future cash flows after management estimate of early repayments (d)	**37**	**43**	**36**	**66**	**25**	**-**	**207**	225
2. Unlinked shekel sector								
Cash flows of futures contracts	**4**	**4**	**4**	**6**	**1**	**-**	**19**	21
Expected future cash flows after management estimate of early repayments	**4**	**4**	**4**	**6**	**1**	**-**	**19**	21
Discounted expected future cash flows after management estimate of early repayments (d)	**4**	**4**	**3**	**5**	**1**	**-**	**17**	18

(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 327 million (31 December 2011 - NIS 417 million) are not included in this table.
(c) Including foreign currency sector.
(d) Discounting was at the rate of 2.69% (2011 – 3.24%).

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

	2012	2011
	(NIS millions)	
B. Off-balance sheet commitments for activity based on extent of collection (cont'd)		
Information on loans granted during the year by mortgage banks:		
Loans from deposits on collection basis	**34**	15
Standing loans	**15**	4
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 (a)	**270**	219
Second year (a)	**198**	181
Third year	**182**	157
Fourth year	**165**	141
Fifth year	**132**	98
After five years	**846**	510
Total	**1,793**	1,306
(2) Commitments to purchase securities (a)	**531**	239
(3) Commitments to invest in and acquire buildings and equipment	**217**	321
(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	**12**	17
Fourth year	**3**	12
Fifth year	**-**	3
Sixth and subsequent years	**-**	-
Total future deposits	**49**	66

(a) Restated.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

D. In the 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 success of the claims, 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, each of which exceeding NIS 2 million, and regarding which the chances of the claims succeeding are not remote, amounts to some NIS 184 million.

(1) The following are details of claims in material amounts in excess of 0.5% of the equity of the Bank at 31 December 2012 (about NIS 130 million):

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 claimant group amounts to NIS 10 billion. No specific sum of the amount of the claim has been clearly attributed to any 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 revolving credit accounts at identical rates and amounts, as a result of a prohibited restrictive arrangement. On 21 January 2008, the Tel Aviv District Court 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. In the context of the appeal proceedings, the Attorney General submitted his position on 27 May 2010, the essence of which is that the decision of the District Court cannot remain as is, since identical prices between banks themselves do not provide a basis for a reasonable possibility of the existence of a restrictive arrangement, and that in his opinion the matter should be returned to the District Court for the completion of clarification and the handing down of a new decision. On 21 November 2011, the Attorney-General submitted a further opinion dealing with the implications of the decision by the Anti-Trust Commissioner dated 26 April 2009, under the heading "Restrictive Arrangements between Bank Hapoalim, Bank Leumi, Bank Discount, Bank Mizrahi, and the First International Bank, concerning the Transfer of Information relating to Commissions" ("the decision"). The essence of this additional position is that in the view of the Attorney General the decision justifies the approval of a class action. It should be noted that the Attorney General also referred to the decision in the footnotes to his position of May 2010, where it stated that this decision refers to commissions, whereas the decision that is the subject of the appeal refers to interest rates. Proceedings in the District Court are suspended until the handing down of a decision on the request for approval of the appeal submitted by the Bank.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

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. The petitioners claim that this is exploitation of monopolistic power and that there is a real concern that the lack of competition between the respondents, regarding all matters concerning the households sector, is the result of a restrictive arrangement between the parties. It is also alleged that this is misleading consumers regarding the normal price for credit service to the household.

The alleged damage is NIS 5.6 billion according to one method, and NIS 5.2 billion according to a second method. 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 District Court granted a stay of these proceedings in this request 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 A. above.

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 amount of the claims ranges from some NIS 787,000 to some NIS 1,350,000. Pursuant to the Court's ruling, the proceedings for all of the abovementioned claims were combined, and they will be heard as one claim. The aggregate amount of the claims is some NIS 276 million. The plaintiffs are the purchasers of vacation apartments in the Nofit Hotel project 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 were 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 ordered a stay of proceedings in the claims until a judgment had been given in the appeal submitted on the aforesaid ruling. On 17 June 2010, the appeal was dismissed, and following this, the Bank filed a petition to dismiss the aforesaid 260 claims. On 20 June 2010, the Court handed down a decision which determined that there were grounds for dismissing the claims, and requested the parties' response. The plaintiffs have notified the court of their desire to continue the proceedings. The plaintiffs filed petitions to amend the claims, and the Bank filed a petition to dismiss the claims outright under the finality of judgment rule. On 14 May 2012, the Court found in favor of the petition of the Bank and rejected the claim outright. The plaintiffs filed an appeal against the verdict in the District Court.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

D. 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, prior to the reform of bank commissions, the Bank charged its customers commissions that were higher than agreed in the list of tariffs. In those cases where a partial sale of securities was carried out during the quarter for which the minimum commission per security set out in the list of tariffs was charged, and at the end of the quarter there remained a balance of the securities bearing the same name, the Bank charged commission on them according to the rate also set out in the list of tariffs. 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, and that the Bank breached its duty of fair disclosure, and that its notices are even misleading. The Bank has filed its response to the petition for the approval of the claim as a class action. On 8 September 2011, the District Court dismissed the petition for approval of the claim as a class action. On 6 November 2011, the petitioner submitted notice of appeal to the Supreme Court against the above verdict.

E. 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 said 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 were not), the Bank collects interest on such expenses at the interest rate applicable to the account (which in many cases is excess interest on arrears) and not at the interest and linkage rates which the Bank is permitted to collect in accordance with the Adjudication of Interest and Linkage Law, 1961. The requested remedy is the reimbursement of all excess amounts charged by the Bank, without an indication of the amount, although it is alleged that "this is a vast amount" and that the lawsuit is filed in the name of all the Bank's customers whose accounts were charged with legal expenses during the seven years preceding the filing of the petition to approve the class action. The Bank has submitted its response to the petition for approval of the claim as a class action. On 18 October 2009, the District Court approved the claim as a class action. On 15 November 2009, the District Court gave an order postponing the execution of its decision for approval of the claim as a class action, until the decision of the Supreme Court in the petition for leave of appeal against the said decision, filed by the Bank on 18 November 2009. On 27 July 2011, the Bank's petition to grant leave of appeal against the decision of the District Court approving the claim as a class action, was dismissed in the Supreme Court, and hearings in the claim were returned to the District Court.

F. On 29 October 2009, a claim for declaratory judgments was filed in the Central District Court to the effect, *inter alia*, 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 determined 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%. On 11 February 2010, a monetary claim of NIS 829 million was submitted, to replace the claim for declaratory judgments that was dismissed. A statement of defense was submitted, preliminary statements of testimony were submitted; evidence was heard in the claim and summaries submitted.

G. On 3 May 2010, a petition for approval of a class action was filed in the Central District Court claiming an amount of some NIS 209 million as of the date the claim was filed. The plaintiff is interested in representing all those holding debentures of Heftziba Hofim Ltd. ("Heftziba Hofim"), prior to the suspension of their trading at the beginning of August 2007. The petitioner claims that during the years 2006-2007, prior to the end of each quarter, the Bank granted loans in amounts of tens of millions of shekels to a company wholly owned by Mr. Boaz Yonah. According to the petitioner's claim, these funds were transferred for a short period of time to the account of Heftziba Hofim, and helped it to make momentary false presentations to the public regarding its true financial condition. The petitioner claims that as a result of cooperation by the Bank and the false representations made to the public, the investments of those holding debentures of Heftziba Hofim were eventually written off. The Bank's response has been filed to the petition for approval of the claim as a class action.

H. On 13 July 2011, a petition was filed in the Tel-Aviv District Court for approval of a class action against Automatic Bank Services Ltd. (hereinafter: "ABS") and against Bank Hapoalim B.M., Bank Leumi Le-Israel B.M., First International Bank of Israel B.M., and Israel Discount Bank B.M. ABS is a service company jointly owned by the banks mentioned above, whose activities include operating an independent network of automatic teller machines (ATM). It is claimed in the petition that when withdrawing cash from an ATM operated by ABS, the user is not provided with fair disclosure that in addition to the commission charged by ABS for the withdrawal, he will be charged additional commission by the bank in which his account is held. In addition, it is claimed in the petition that the banks are not authorized to charge its customers additional commission, after they were already charged for the withdrawal by ABS. The total amount claimed in the class action, in the opinion of the petitioners, is NIS 153.3 million, with the addition of linkage differentials and interest. There are no details of the distribution between the defendants. Mediation proceedings are taking place between some of the parties.

I. On 7 September 2011, a petition for approval of a class action was filed against the Bank (formerly Leumi Mortgage Bank), Mizrahi Tefahot Bank Ltd. and Bank Hapoalim B.M. The amount of the class action claimed against all the respondent banks is approximately NIS 927 million as at 1 January 2010, and the amount of the class action against Leumi Mortgage Bank is about NIS 327 million. The petitioners claim that the respondent banks charged housing-loan borrowers "compound interest in advance", contrary to the law and to the loan agreements, which stipulate that only the unpaid balance of principal will bear interest. The reliefs claimed are payment of compensation and/or reinstatement of damage caused to borrowers and the amounts charged unlawfully, and the granting of a court order against the respondent banks to change the way they act in all areas related to charging and collecting interest. The Bank filed its response to the petition with the Court. In a preliminary hearing in the claim on 16 October 2012, the Court requested the Supervisor of Banks to address several questions that arose in the opinion of each of the parties to the claim. In accordance with the request of the Court, the Bank of Israel submitted its responses to the questions raised by the parties concerning the claim on 31 December 2012.

(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.

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, (hereinafter: “the Banks”). It is claimed that the Banks had an illegal restrictive arrangement regarding the rates of the commissions they collect from their customers, that they abused their monopolistic power (the Banks constituting, it is argued, an oligopoly), and that they unlawfully enriched themselves at the expense of their customers. It is claimed, as an estimate, that had the rates not been coordinated between the Banks, the commissions would have been significantly lower, by at least 25%. The total aggregate amount of the damage is estimated in the amount of NIS 3.5 billion, with the heading of the petition indicating the amount of the claim as NIS 3 billion. No specific attribution has been made of the damage claimed from 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. The hearing in this file was incorporated with a later claim (see description in paragraph B. below). 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 Commissioner’s determination of 26 April 2009 in the Restrictive Practices Court. On 23 February 2012, the Court decided to continue the stay of proceedings until the decision of the Restrictive Practices Court on the appeal filed against the Commissioner's determination.

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 Tefahot Bank and the First International Bank. The petition is based on the Antitrust Commissioner’s determination of 26 April 2009. The petitioners allege that in accordance with the determination, the banks made restrictive arrangements for the exchange of information on commissions, to the detriment of competition between them, and which caused damage to the members of the group whose representation is sought in the petition, and that such was reflected in overpayments of commissions. The petitioners estimate the amount of the class action against all the respondents at NIS 1 billion. The petition does not make any clear attribution of a specific claimed amount to each of the respondents. Proceedings in the petition for approval have been stayed for two years, as stated in the decision of 29 November 2009, described in paragraph A. above. On 23 February 2012, the Court decided to continue the stay of proceedings until the decision of the Restrictive Practices Court on the appeal filed against the Commissioner's determination.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

C. On 7 March 2012, a petition was filed in the Tel-Aviv District Court for approval of a class action against Automatic Bank Services Ltd. ("ABS") and its shareholders: Poalim, Leumi, First International, Israel Discount and Mizrahi (Mizrahi transferred its ownership and remained as a holder of rights), and against Casponet Co. Ltd. and its shareholders Visa-CAL, Tamir Fishman Trust Services, and Verifone. ABS and Casponet are service companies operating an independent network of automatic banking machines for withdrawing cash (ATM). The petition for approval is based on the claim that the plaintiffs charge excessive withdrawal commissions by restricting withdrawal amounts in ATM's not located in a branch of a bank (a limit of NIS 2,000 at an ATM of ABS, and NIS 500 at an ATM of Casponet), so that a customer wanting to withdraw a sum exceeding the maximum for withdrawal is forced to carry out a number of withdrawals, for each of which they have to pay a large commission. With regard to the plaintiff banks, the petitioners claim that they are responsible for all the failings of ABS and Casponet by virtue of their being shareholders and controlling owners of them. The total amount claimed in the class action, in the opinion of the petitioners, is about NIS 2.2 billion. There are no details of the distribution between the defendants.

D. On 11 October 2012, a claim and petition for approval of a class action was filed in the Tel Aviv District Court against Leumi, First International, Mizrahi-Tefahot and Israel Discount Bank. The plaintiffs claim that the bank accounts of the Bank's customers against whom collection proceedings are being conducted, and who made payments directly to files in the Execution Office, were updated at a date later than the date of payment. Due to the delay in updating payments in the bank account, the plaintiffs were charged excessive interest charges. The plaintiffs claim that the entry in the bank account is important for the client, and it should not be made with value two days later. The remedies requested in the claim and petition are: the refund of excess amounts paid by customers, injunctions and declarative orders for updating payments in the accounts, from now on, with value of the date the amounts were actually made to the Execution Office, and the amendment of accounts still under proceedings, in accordance with the correct value dates. According to the plaintiffs, the amount of the class action cannot be estimated at this time.

E. On 6 February 2013, a petition for approval of a class action was filed in the Tel Aviv District Court against the Bank in the amount of NIS 12 billion. The petitioners claim that the Bank charged a high rate of over-limit interest, in contradiction with the *Heter Iska* (loan agreement under Jewish law) received from the Rabbinical Court for Monetary Affairs, which caused damages to all customers who took loans from the Bank while relying on the *Heter Iska*. Using interest charges as a "punishment" against the borrower is outside the purview of the *Heter Iska* and accordingly all over-limit interest charges should be refunded to customers retrospectively for 7 years. A further claim of the petitioners is that the Bank misled customers by concealing the existence of the *Heter Iska*.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

(3) The following are details of claims and petitions for approval of class actions in material amounts that were filed against subsidiaries of the Bank (hereinafter, "the subsidiaries"). In the opinion of the Management of the Bank, and in reliance on the opinion of the management of each of the subsidiaries, which is based on the opinion of subsidiaries' legal advisors as to the chances of these proceedings, appropriate provisions have been included in the financial statements, insofar as required, to cover damages resulting from such claims:

A. 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'alot Ltd., Keshet Debentures Ltd. ("Keshet"), Bank Leumi le-Israel Trust Company ("the Trust Company"), Aaron Biram, Eran Fuchs, Moti Ma'aravi, Rami Ordan, Excellence Nessuah Underwriting (1993) Ltd. and Expert Financing Ltd. The amount claimed against all the respondents in the class action stands at some NIS 286 million. The complaint makes no clear attribution of a specific claimed amount against any of the respondents. The petition for approval refers to debentures issued by Keshet, backed up by notes issued by Lehman Brothers Bankhaus AG. The petitioner claims that on the collapse of Lehman Brothers, the price of the debenture collapsed and trading was suspended. 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 take various actions to prevent or reduce, according to the petitioner, the damage he alleges was caused to the debenture-holders. The Trust Company has filed its response to the petition for approval of the claim as a class action.

E. The Bank is a guarantor for members of some of the provident funds that were managed by Leumi Capital Market Services Ltd. (formerly Leumi Gemel Ltd.), whose operations were sold to Psagot Provident Funds Ltd. ("Prizma"). The guarantee secures the repayment of the original principal amounts that were deposited amounting on 31 December 2012 to NIS 2,922 million in nominal values. The value of the assets of the above funds at 31 December 2012 amounts to NIS 5,698 million. In addition, this guarantee does not apply to deposits in accounts that were opened in the above funds from 22 January 2007.

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.

F. 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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

G. Letters of indemnity

(1) The Bank has undertaken in advance to grant 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 litigation expenses in connection with the privatization of the Bank.

(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 its directors and officers, and the lawyers dealing with the issues on behalf of the Company, in respect of monetary liability that may be imposed on them and reasonable litigation expenses in connection with the issue of debentures and other products by the Company to the public that the Company publishes from time to time. The indemnification is limited to the amounts of the issues executed by the Company.

(3) The Bank has undertaken in advance to indemnify the office holders in the Bank and personal managerial contract holders in the Bank who are not officers of the Bank ("the managerial contract holders") 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, including, *inter alia*, the routine banking activity of the Bank, an offer of securities 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: (1) the maximum amount in respect of the actual realization of the indemnity to all the officers of the Bank and to the officers of the subsidiaries and the managerial contract holders, 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 the directives of the Supervisor of Banks, as reflected in the last financial statements of the Bank published immediately prior to the date of the actual indemnification; (2) the maximum amount in respect of the actual realization of the indemnity does not impair the minimum capital requirement in accordance with the directives of the Supervisor of Banks. The obligation for indemnification is also for reasonable litigation expenses incurred as a result of 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 an 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, or in connection with a monetary sanction. The letter of indemnity also includes a further obligation for indemnification for expenses and/or payment to the injured party of a breach in accordance with and subject to that stipulated in the Streamlining of Enforcement Proceedings in the Securities Authority Law (Legislative Amendments), 2011 ("the Streamlining of Enforcement Proceedings Law"), as well as expenses in connection with proceedings under Section G-1 of the Antitrust Law, 1988. The obligation for indemnification will be in effect only after exhaustion of the rights of the officer toward a third party (e.g. an insurer).

In addition, the Bank granted exemption from liability to officers in the Bank and personal contract holders for damage as a result of breach of their obligation of caution *vis-à-vis* the Bank.

The Bank also undertook in advance 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, in similar wording to the indemnity given to officers. The Bank exempted the legal advisor to the Board of Directors from liability in connection with the provision of the said legal services.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

(4) The Bank has undertaken to indemnify employees of the Bank for expenses and/or payment to the injured party of a breach or subject to that stipulated in the Streamlining of Enforcement Proceedings Law, in accordance with the usual terms appearing in letters of indemnity given by the Bank.

(5) The Bank has undertaken to indemnify external advisors in respect of an obligation or loss including in respect of other legal expenses in connection with the services they receive from the Bank.

(6) 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") of the activities and the share capital of the member companies of the Psagot Ofek Group in respect of certain damages and subject to certain conditions.

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.

In addition, the Bank has undertaken to indemnify Harel Mutual Fund Management Ltd. (hereinafter: "Harel"), in accordance with a transaction for the sale of the assets of Leumi Pia, in the event that a monetary obligation will be imposed on Harel in connection with the examination by the Israel Securities Authority and in connection with obligations and liabilities of the Bank *vis-à-vis* the tax authorities.

(7) 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.

(8) The Bank and subsidiary companies have undertaken to indemnify the international credit companies "Visa" and "MasterCard" in respect of fulfillment of the obligations of the subsidiaries concerning "Visa" and "MasterCard" credit card activity, whichever applicable.

(9) Pursuant to the merger agreement between the Bank and Leumi Mortgage Bank Ltd. ("Leumi Mortgage") from 10 September 2012, the Bank assumed, in place of Leumi Mortgage for all intents and purposes, as of 31 December 2012, all the liabilities of Leumi Mortgage, including any commitment of agreement of any type, including letters of indemnity given by Leumi Mortgage to office holders of Leumi Mortgage.

(10) From time to time, the Bank provides subsidiary companies with letters of indemnity, limited and unlimited as to amount and period, to secure indemnities granted by them to officer holders due to risks applicable to office holders in the companies, and for purposes of the subsidiary companies complying with regulatory directives. In addition, the Bank has given letters of indemnity to Bank employees and to office holders of subsidiaries in respect of a list of events which are specified therein.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

(11) The Bank and its subsidiaries, from time to time and in circumstances generally accepted in the normal course of business, are accustomed to give letters of indemnification, limited and unlimited as to amount and period.

H. 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. 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) In 2006, an arrangement was submitted for approval of the Antitrust Tribunal (hereinafter: "the tribunal") that was reached between Leumi Card, IsraCard Ltd., Israel Credit Cards Ltd., and the banks controlling each one of these companies (hereinafter "the parties requesting approval"), with regard to the issuer's commission rates (cross-commission), and the structure of categories applying to credit card companies during the application of the arrangement.

Since then, proceedings have taken place on the matter between the parties requesting approval and the Antitrust Commissioner (hereinafter: "the Commissioner"), in the context of which an expert was appointed by the tribunal for purposes of evaluating the implications for competition of the cross-commission rate set out in the arrangement.

On 7 March 2012, the Antitrust Tribunal gave its judicial approval to an arrangement submitted by the credit card companies and the Commissioner on the matter of the rate of cross-commission, which is expected to decrease gradually to 0.7% in 2014. The arrangement between the Commissioner and the credit card companies is in force until 2018.

On 29 March 2012, an appeal was filed in the Supreme Court by one of the companies opposing the agreement, against the verdict of the Antitrust Tribunal that approved the agreement. It should be emphasized that the appeal does not relate to the amount of cross-commission, or the rate of reduction as set out in the verdict of the Antitrust tribunal.

The said arrangement is expected to materially affect both Leumi Card’s income as an issuer and also its expenses as a clearer in the coming years.

(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 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.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

I. Israel Corporation Ltd. – a company included on equity basis

(1) Legal claims have 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 therein. In addition, legal proceedings are being taken against a consolidated company, and laws have been passed and orders issued relating to the activities of this company.

The managements of the above companies, based on the opinions of their legal advisors, 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 company of the Israel Corporation included on equity basis is dependent on receiving services from infrastructure companies and natural gas suppliers in order to carry on its activities.

J. 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 submitted an appeal against this ruling. On 22 February 2011, the response of the Commissioner to the appeal was submitted. Arbitration proceedings took place between the parties which were not successful. On 29 July 2012, the Bank received the letter of the Antitrust Tribunal according to which the Commissioner is considering publishing a supplementary ruling regarding the transfer of information detailed in the Commissioner's response to the appeal, but were deleted from it at the request of the banks, according to which these transfers of information constituted restrictive practices. The Bank was given the opportunity to submit its position to the Commissioner before the Commissioner makes his decision to publish a supplementary ruling. At this stage, the effects of the ruling cannot be assessed.

K. The United States authorities (the "U.S. authorities") are conducting wide-ranging investigations against foreign banks in connection with activities of the banks with customers who are U.S. taxpayers ("U.S. customers"), on suspicion of a breach of U.S. law. In the context of the said investigations, which are also being conducted against the Group, the U.S. authorities have submitted and are continuing to submit various subpoenas for information and documents concerning U.S. customers and have summoned customers and former employees of banks which are part of the Group, to testify and provide documents in connection with U.S. customers and the banking services given to them by the Group. The Group is cooperating with the U.S. authorities, in providing information and in the procedural steps required, as allowed by law. In addition, the Group is conducting an investigation of the subject by means of outside parties hired by it for this purpose. These outside parties are continuing with their investigation. At this stage, the investigation has not been concluded.

Following further examinations conducted at the Bank's initiative, the Bank decided to make a provision of approximately NIS 340 million. The provision was made to cover the expense that might be caused to the Group due to the investigations that are being conducted by the U.S. authorities with regard to the U.S. Customers. This provision also includes expenses for advisors and other external service providers which the Bank hired with respect to the investigations.

In light of the fact that there is no certainty regarding the level of expense that might be caused to the Group in the context of the investigations, it is entirely possible that the related expense will be significantly higher. It should be noted that the provision does not constitute an acknowledgement to any claim that might be raised against the Group by the U.S. Authorities.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

L. In March 2012, an indictment was served against Leumi Romania and against members of the credit committee of Leumi Romania, regarding a transaction in the account of a customer, who, according to the General Prosecutor in Romania, was not lawfully carried out. The indictment was submitted as a result of a complaint by the customer who alleged that he incurred damage as the result of the bank's action (the amount of the damage is not material). On 28 November 2012, the court in Romania accepted Bank Leumi Romania's arguments that the General Prosecutor in Romania had no authority to serve an indictment against it and against certain of its employees/managers, and decided to send the file back to the General Prosecutor for rewording and resubmission of the indictment. The General Prosecutor and the complainant have appealed the decision.

M. In December 2012, Leumi Romania received an invitation to arbitration (a "pre-trial" proceeding is required before submitting a claim) in connection with the sale of Bank Eurom to the Bank. According to the claim, the Bank owes various entities that were involved in the sale of various amounts aggregating US$ 228 million and CHF 10 million.

Note 18A – Derivative Instruments and Hedging Activity

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 fails 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 risks include 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 which 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.

- The said activity does not refer to derivative instruments embedded in other activities.

Note 18B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates

a. Scope of activity

	31 December 2012				
	Interest rate contracts		Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts
	Shekel – index	Other			
	(NIS millions)				
(1) Nominal amount of derivative instruments					
a) Hedging derivatives (a)					
Forward contracts	-	-	1,525	-	-
Swaps	-	2,659	-	-	-
Total	-	2,659	1,525	-	-
Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest	-	2,613	-	-	-
b) ALM derivatives (a)(b)					
Futures contracts	-	6,740	232	23,393	2,075
Forward contracts	14,535	21,450	119,241	-	624
Exchange-traded options					
Options written	-	2,470	7,048	7,038	614
Options purchased	-	2,470	7,048	7,038	614
Other options					
Options written	-	17,589	18,802	1,366	503
Options purchased	-	17,751	19,038	1,475	526
Swaps	704	224,499	22,405	6,509	427
Total	15,239	292,969	193,814	46,819	5,383
Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest	-	129,033	-	-	-
c) Other derivatives (a)					
Swaps	-	-	-	-	-
Total	-	-	-	-	-
d) Credit derivatives and foreign exchange spot contracts					
Credit derivatives in which the banking corporation is a guarantor	-	-	-	-	-
Credit derivatives in which the banking corporation is a beneficiary	-	-	-	-	187
Foreign exchange spot contracts	-	-	8,219	-	-
Total	-	-	8,219	-	187
Aggregate Total	15,239	295,628	203,558	46,819	5,570

(a) Excluding credit derivatives and spot foreign currency exchange contracts.

(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

Note 18B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

a. Scope of activity (cont'd)

	31 December 2012				
	Interest rate contracts Shekel-index	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 (a)					
Gross positive fair value	**-**	**1**	**30**	**-**	**-**
Gross negative fair value	**-**	**225**	**22**	**-**	**-**
b. ALM derivatives (a)(b)					
Gross positive fair value	**133**	**8,196**	**2,493**	**473**	**110**
Gross negative fair value	**297**	**7,926**	**3,726**	**481**	**105**
c. Other derivatives (a)					
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	**-**	**-**	**-**	**-**	**-**
Credit derivatives in which the banking corporation is a beneficiary					
Gross positive fair value	**-**	**-**	**-**	**-**	**2**
Gross negative fair value	**-**	**-**	**-**	**-**	**-**

(a) Except credit derivatives.
(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

Note 18B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

a. Scope of activity (cont'd)

31 December 2011

	Interest rate contracts Shekel – index	Interest rate contracts Other	Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts
	(NIS millions)				
(1) Nominal amount of derivative instruments					
a) Hedging derivatives (a)					
Swaps	-	3,241	-	-	-
Total	-	3,241	-	-	-
Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest	-	3,078	-	-	-
b) ALM derivatives (a)(b)					
Futures contracts	-	1,354 (c)	-	18,139 (c)	1,175
Forward contracts	11,598	16,691	138,561	-	1,098
Exchange-traded options					
Options written	-	6	5,190	9,330	-
Options purchased	-	6	5,185	9,330	-
Other options					
Options written	15	18,127	34,910	1,023	720
Options purchased	-	14,938	30,234	1,038	681
Swaps	914	183,325	18,308	8,055	1,168
Total	12,527	234,447	232,388	46,915	4,842
Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest	-	91,476	-	-	-
c) Other derivatives (a)					
Swaps	-	-	-	-	-
Total	-	-	-	-	-
d) Credit derivatives and foreign exchange spot contracts					
Credit derivatives in which the banking corporation is a guarantor	-	-	-	-	-
Credit derivatives in which the banking corporation is a beneficiary	-	-	-	-	-
Foreign exchange spot contracts	-	-	12,490	-	-
Total	-	-	12,490	-	-
Aggregate Total	12,527	237,688	244,878	46,915	4,842

(a) Excluding credit derivatives and spot foreign currency exchange contracts.
(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.
(c) Reclassified.

Note 18B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

a. Scope of activity (cont'd)

	31 December 2011				
	Interest rate 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 (a)					
Gross positive fair value	-	9	-	-	-
Gross negative fair value	-	195	-	-	-
b. ALM derivatives (a)(b)					
Gross positive fair value	103	6,648	4,449	284	80
Gross negative fair value	322	6,600	4,622	289	85
c. Other derivatives (a)					
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	-	-	-	-	-
Credit derivatives in which the banking corporation is a beneficiary					
Gross positive fair value	-	-	-	-	-

(a) Excluding credit derivatives.
(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

Note 18B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

b. Credit Risk in Respect of Derivative Instruments by Counterparty to the Contract

	31 December 2012					
	Stock Exchanges	Banks	Dealers/ brokers	Governments and central banks	Others	Total
	(NIS millions)					
Balance sheet balances of assets deriving from derivative instruments (a) (b)	**143**	**8,621**	**738**	**1**	**1,935**	**11,438**
Off-balance sheet credit risk in respect of derivative instruments (c)	**-**	**513**	**3**	**80**	**6,063**	**6,659**
Total credit risk in respect of derivative instruments	**143**	**9,134**	**741**	**81**	**7,998**	**18,097**

	31 December 2011					
	Stock Exchanges	Banks	Dealers/ brokers	Governments and central banks	Others	Total
	NIS millions					
Balance sheet balances of assets deriving from derivative instruments (a) (b)	132	7,258	479	-	3,704	11,573
Off-balance sheet credit risk in respect of derivative instruments (c)	-	672	1	64	4,130	4,867
Total credit risk in respect of derivative instruments	132	7,930	480	64	7,834	16,440

(a) There were no net accounting arrangements.

(b) Of which a balance sheet amount of stand-alone derivative instruments in the sum of NIS 11,438 million (31 December 2011 – NIS 11,573 million) included under other assets.

(c) 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 limitations on debts of borrowers.

Note 18B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

c. Details of Repayment Dates – Nominal Values: Year-end balances

	31 December 2012				
	Up to three months	From three months to one year	From one year to five years	Over five years	Total
	(NIS millions)				
Interest contracts:					
Shekel – index	**1,516**	**7,578**	**4,735**	**1,410**	**15,239**
Other	**28,086**	**58,122**	**125,942**	**83,478**	**295,628**
Foreign currency contracts	**121,092**	**60,489**	**8,300**	**13,677**	**203,558**
Contracts in respect of shares	**41,092**	**3,511**	**2,216**	**-**	**46,819**
Commodities and other contracts	**3,617**	**1,558**	**395**	**-**	**5,570**
Total	**195,403**	**131,258**	**141,588**	**98,565**	**566,814**

	31 December 2011				
	Up to three months	From three months to one year	From one year to five years	Over five years	Total
	NIS millions				
Interest contracts:					
Shekel – index	2,810	5,209	3,558	950	12,527
Other	17,522	(a) 50,184	84,988	84,994	237,688
Foreign currency contracts	152,528	72,772	8,859	10,719	244,878
Contracts in respect of shares	41,427	(a) 4,876	612	-	46,915
Commodities and other contracts	3,774	632	436	-	4,842
Total	218,061	133,673	98,453	96,663	546,850

(a) Reclassified.

Note 18C – Balances and Fair Value Assessments of Financial Instruments

(1) General

This note includes information regarding the determination of the fair value of financial instruments according to directives of the Supervisor of Banks. Most of the financial instruments of the Bank do not have a market value because they do not have an active trading market. Their fair value is therefore determined on the basis of the present value of future cash flows, discounted at an interest rate that reflects the interest at which the Bank would have effected a similar transaction on the reporting date. The estimated fair value is calculated by means of estimating future cash flows and a subjective determination of the discount rate. Therefore, in respect of most financial instruments, the reported fair value does not necessarily indicate the realizable value of the financial instrument on the reporting date. The estimate of fair value is made on the basis of interest rates in effect on the reporting date and does not take into account interest rate fluctuations. Under different interest rates the fair value calculated may be significantly different. This is true especially in respect of financial instruments with interest at fixed rates or those 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. In addition, 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 operating 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 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 impaired loans by NIS 30 million as of the end of 2011.

The fair value of current account balances classified as impaired 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 impaired debts were calculated after deducting the effect of accounting write-offs and allowances in respect of credit losses.

Note 18C – Balances and Fair Value Assessments of Financial Instruments (cont'd)

Deposits with banks and credit to governments - by the discounted future cash flows method, at interest rates at which similar transactions were executed on the reporting date.

Securities – Quoted securities at their market value. Unquoted securities, shares at cost, and debentures according to a model which takes into account the present value of future cash flows discounted at the appropriate discount rate, and which also takes into account the probability of failure and market value.

Financial liabilities:

Deposits of the public - The balance of the deposits is classified according to a number of categories according to operating 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 for the period remaining until maturity. 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, which 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 18C – Balances and Fair Value Assessments of Financial Instruments (cont'd)

	31 December 2012				
	Book value	Fair value			
		Level 1 (1)	Level 2 (1)	Level 3 (1)	Total
	(NIS millions)				
Financial assets					
Cash and deposits with banks	**54,621**	**11,750**	**37,225**	**5,638**	**54,613**
Securities (2)	**56,408**	**40,458**	**13,102**	**2,848**	**56,408**
Securities borrowed or purchased under agreements to resell	**1,435**	**-**	**1,435**	**-**	**1,435**
Credit to the public, net	**241,264**	**2,018**	**62,894**	**177,556**	**242,468**
Credit to governments	**442**	**-**	**30**	**450**	**480**
Assets in respect of derivative instruments	**11,438**	**523**	**9,580**	**1,335**	**11,438**
Other financial assets	**1,244**	**399**	**-**	**845**	**1,244**
Total financial assets	**366,852** (3)	**55,148**	**124,266**	**188,672**	**368,086**
Financial liabilities					
Deposits of the public	**289,538**	**1,957**	**126,146**	**163,335**	**291,438**
Deposits from banks	**4,073**	**-**	**3,172**	**829**	**4,001**
Deposits from governments	**451**	**-**	**272**	**211**	**483**
Securities loaned or sold under agreements to repurchase	**1,007**	**-**	**1,007**	**-**	**1,007**
Debentures, bonds and subordinated notes	**27,525**	**22,616**	**390**	**7,330**	**30,336**
Liabilities in respect of derivative instruments	**12,762**	**503**	**11,787**	**472**	**12,762**
Other financial liabilities	**7,451**	**399**	**-**	**7,026**	**7,425**
Total financial liabilities	**342,807**(3)	**25,475**	**142,774**	**179,203**	**347,452**
Off-balance sheet financial instruments					
Transactions in which the balance reflects a credit risk	**283**	**-**	**-**	**283**	**283**

(1) Level 1 - Fair value measurements using prices quoted in an active market.
Level 2 – Fair value measurements using other significant observable inputs.
Level 3 – Fair value measurements using significant unobservable inputs.

(2) For further details of the book value and fair value of securities, see Note on Securities.

(3) Of which assets and liabilities on NIS 99,196 million and NIS 86,777 million, respectively, whose book value is the same as fair value (instruments that are shown in the balance sheet at fair value) or are an approximation of fair value (instruments for an original period of 3 months for which the book value is used as an approximation of fair value). For further information on instruments measured for fair value on a recurring basis and on a non-recurring basis, see Notes 18D and 18F.

Note 18C – Balances and Fair Value Assessments of Financial Instruments (cont'd)

	31 December 2011				
	Book value	Fair value			
		Level 1 (1)	Level 2 (1)	Level 3 (1)	Total
	(NIS millions)				
Financial assets					
Cash and deposits with banks	53,044	9,717	39,233	4,018	52,968
Securities (2)	47,936	34,219	11,600	2,117	47,936
Securities borrowed or purchased under agreements to resell	1,225	-	1,225	-	1,225
Credit to the public, net	241,320	1,600	68,285	172,036	241,921
Credit to governments	448	-	49	429	478
Assets in respect of derivative instruments	11,573	437	7,571	3,565	11,573
Other financial assets	1,011	321	-	690	1,011
Total financial assets	356,557 (3)	46,294	127,963	182,855	357,112
Financial liabilities					
Deposits of the public	279,404	1,122	102,342	177,416	280,880
Deposits from banks	5,056	-	3,033	1,896	4,929
Deposits from governments	519	-	117	433	550
Securities loaned or sold under agreements to repurchase	442	-	442	-	442
Debentures, bonds and subordinated notes	29,999	20,660	5,016	5,844	31,520
Liabilities in respect of derivative instruments	12,069	440	10,970	659	12,069
Other financial liabilities	7,444	321	-	7,095	7,416
Total financial liabilities	334,933 (3)	22,543	121,920	193,343	337,806
Off-balance sheet financial instruments					
Transactions in which the balance reflects a credit risk	279	-	-	279	279

(1) Level 1 - Fair value measurements using prices quoted in an active market.
Level 2 – Fair value measurements using other significant observable inputs.
Level 3 – Fair value measurements using significant unobservable inputs.

(2) For further details of the book value and fair value of securities, see Note on Securities.

(3) Of which assets and liabilities on NIS104,305 million and NIS 84,986 million, respectively, whose book value is the same as fair value (instruments that are shown in the balance sheet at fair value) or are an approximation of fair value (instruments for an original period of 3 months for which the book value is used as an approximation of fair value). For further information on instruments measured for fair value on a recurring basis and on a non-recurring basis, see Notes 18D and 18F.

Note 18D – Items Measured for Fair Value on a Recurring Basis

(a) Items measured for fair value on a recurring basis

	31 December 2012			
	Fair value measurements using:			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Book value
	(NIS millions)			
Assets				
Securities available for sale:				
Israeli government bonds	20,965	2,033	-	22,998
Foreign government bonds	6,261	182	11	6,454
Bonds of Israeli financial institutions	260	63	-	323
Bonds of financial institutions abroad	610	4,548	123	5,281
Asset-backed (ABS) or mortgage-backed (MBS) bonds	113	3,535	1,401	5,049
Other bonds in Israel	645	394	-	1,039
Other bonds abroad	564	945	74	1,583
Shares available for sale	972	-	-	972
Total securities available for sale	30,390	11,700	1,609	43,699
Securities held for trading:				
Bonds held for trading	9,885	1,402	-	11,287
Shares and mutual funds held for trading	183	-	-	183
Total securities held for trading	10,068	1,402	-	11,470
Assets in respect of derivative instruments:				
Interest contracts	27	7,613	690	8,330
Foreign currency contracts	31	1,795	619	2,445
Share contracts	209	131	14	354
Commodity and other contracts	60	41	12	113
Activity in the Maof market	196	-	-	196
Total assets in respect of derivative instruments	523	9,580	1,335	11,438
Others:				
Credit and deposits in respect of the lending of securities	2,244	4	-	2,248
Other	399	-	-	399
Total others	2,643	4	-	2,647
Total assets	43,624	22,686	2,944	69,254
Liabilities:				
Liabilities in respect of derivativeinstruments:				
Interest contracts	27	8,267	154	8,448
Foreign currency contracts	10	3,322	318	3,650
Share contracts	209	153	-	362
Commodity and other contracts	60	45	-	105
Activity in the Maof market	197	-	-	197
Total liabilities in respect of derivative instruments	503	11,787	472	12,762
Others:				
Deposits in respect of the lending of securities	1,957	21	-	1,978
Other	399	142	-	541
Total others	2,356	163	-	2,519
Total liabilities	2,859	11,950	472	15,281

Note 18D – Items Measured for Fair Value on a Recurring Basis (cont'd)

(a) Items measured for fair value on a recurring basis (cont'd)

	31 December 2011 (a)			
	Fair value measurements using:			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Book value
	(NIS millions)			
Assets				
Securities available for sale:				
Israeli government bonds	18,361	1,414	-	19,775
Foreign government bonds	3,451	214	10	3,675
Bonds of Israeli financial institutions	335	62	-	397
Bonds of financial institutions abroad	982	6,759	113	7,854
Asset-backed (ABS) or mortgage-backed (MBS) bonds	372	1,335	737	2,444
Other bonds in Israel	172	432	-	604
Other bonds abroad	407	775	72	1,254
Shares available for sale	1,006	-	-	1,006
Total securities available for sale	25,086	10,991	932	37,009
Securities held for trading:				
Bonds held for trading	8,772	609	-	9,381
Shares and mutual funds held for trading	361	-	-	361
Total securities held for trading	9,133	609	-	9,742
Assets in respect of derivative instruments:				
Interest contracts	94	4,907	1,759	6,760
Foreign currency contracts	-	2,583	1,790	4,373
Share contracts	26	25	14	65
Commodity and other contracts	22	56	2	80
Activity in the Maof market	295	-	-	295
Total assets in respect of derivative instruments	437	7,571	3,565	11,573
Others:				
Credit and deposits in respect of the lending of securities	1,600	-	-	1,600
Other	321	-	-	321
Total others	1,921	-	-	1,921
Total assets	36,577	19,171	4,497	60,245
Liabilities:				
Liabilities in respect of derivative instruments:				
Interest contracts	95	6,715	298	7,108
Foreign currency contracts	2	4,148	361	4,511
Share contracts	26	44	-	70
Commodity and other contracts	22	63	-	85
Activity in the Maof market	295	-	-	295
Total liabilities in respect of derivative instruments	440	10,970	659	12,069
Others:				
Deposits in respect of the lending of securities	1,122	44	-	1,166
Other	321	177	-	498
Total others	1,443	221	-	1,664
Total liabilities	1,883	11,191	659	13,733

(a) Reclassified.

Note 18D – Items Measured for Fair Value on a Recurring Basis (cont'd)

(b) Items measured for fair value on a non-recurring basis

	31 December 2012			
	Fair value measurements using:			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
	(NIS millions)			
Collateral-dependent impaired credit	-	-	**2,012**	**2,012**
Other assets	-	-	**-**	**-**
Total	-	-	**2,012**	**2,012**

	31 December 2011			
	Fair value measurements using:			
	Prices quoted in an active market (Level 1)	Other significantob servable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
	(NIS millions)			
Collateral-dependent impaired credit	-	-	2,183	2,183
Other assets	-	-	-	-
Total	-	-	2,183	2,183

Note 18E – Changes in items measured for fair value on a recurring basis included in Level 3

	31 December 2012								
	Changes in items measured for fair value included in Level 3								
		Total realized and unrealized profits (losses)							Unrealized profits (losses)
	Fair value at beginning of the year	In profit and loss	In other comprehensive profit	Acquisitions	Sales	Extinguish-ments	Transfers to or from Level 3	Fair value at 31 December 2012	in respect of instruments held at 31 December 2012
	(NIS millions)								
Assets									
Bonds available for sale:									
Foreign government bonds	10	-	-	1	-	-	-	11	-
Bonds of financial institutions in Israel	-	-	-	-	-	-	-	-	-
Bonds of financial institutions abroad	113	2	10	-	-	(2)	-	123	10
Asset-backed (ABS) or mortgage-backed (MBS) bonds	737	81	96	873	(296)	(90)	-	1,401	160
Others in Israel	-	-	-	-	-	-	-	-	-
Others abroad	72	1	2	-	-	(1)	-	74	3
Total bonds available for sale	932	84	108	874	(296)	(93)	-	1,609	173
Total shares available for sale	-	-	-	-	-	-	-	-	-
Bonds for trading	-	-	-	-	-	-	-	-	-
Shares for trading	-	-	-	-	-	-	-	-	-
Assets in respect of derivative instruments:									
Interest contracts	1,759	(1,047)	-	-	-	(58)	36	690	(384)
Foreign currency contracts	1,790	(1,347)	-	176	-	-	-	619	407
Share contracts	14	-	-	-	-	-	-	14	14
Commodity and other contracts	2	10	-	-	-	-	-	12	12
Total assets in respect of derivative instruments	3,565	(2,384)	-	176	-	(58)	36	1,335	49
Total assets	4,497	(2,300)	108	1,050	(296)	(151)	36	2,944	222
Liabilities									
Liabilities in respect of derivative instruments:									
Interest contracts	298	(168)	-	-	-	-	24	154	(91)
Foreign currency contracts	361	(43)	-	-	-	-	-	318	(43)
Total liabilities in respect of derivative instruments	659	(211)	-	-	-	-	24	472	(134)
Total liabilities	659	(211)	-	-	-	-	24	472	(134)

Note 18E – Changes in items measured for fair value on a recurring basis included in Level 3 (cont'd)

	31 December 2011 (a)								
	Changes in items measured for fair value included in Level 3								
		Total realized and unrealized profits (losses)							Unrealized profits (losses)
	Fair value at beginning of the year	In profit and loss	In other comprehensive profit	Acquisitions	Sales	Extinguish-ments	Transfers to or from Level 3	Fair value at 31 December 2011	in respect of instruments held at 31 December 2011
Assets									
Bonds available for sale:									
Foreign government bonds	18	-	-	-	(8)	-	-	10	(9)
Bonds of financial institutions abroad	112	8	(4)	-	-	(3)	-	113	1
Asset-backed (ABS) or mortgage-backed (MBS) bonds	856	168	(133)	376	(468)	(62)	-	737	8
Others in Israel	21	7	-	-	-	(2)	(26)	-	-
Others abroad	70	6	(2)	-	-	(2)	-	72	1
Total bonds available for sale	1,077	189	(139)	376	(476)	(69)	(26)	932	1
Assets in respect of derivative instruments:									
Interest contracts	778	1,024	-	-	-	(47)	4	1,759	1,095
Foreign currency contracts	1,085	342	-	363	-	-	-	1,790	1,053
Share contracts	518	(504)	-	-	-	-	-	14	14
Commodity and other contracts	10	(8)	-	-	-	-	-	2	(3)
Total assets in respect of financial instruments	2,391	854	-	363	-	(47)	4	3,565	2,159
Total assets	3,468	1,043	(139)	739	(476)	(116)	(22)	4,497	2,160
Liabilities									
Liabilities in respect of derivative instruments:									
Interest contracts	310	(13)	-	-	-	-	1	298	(37)
Foreign currency contracts	762	(401)	-	-	-	-	-	361	86
Commodity contracts	1	(1)	-	-	-	-	-	-	-
Total liabilities in respect of derivative instruments	1,073	(415)	-	-	-	-	1	659	49
Total liabilities	1,073	(415)	-	-	-	-	1	659	49

(a) Reclassified.

Note 18F – Quantitative Information on Items Measured for Fair Value included in Level 3

	Fair value	Assessment technique	Unobservable inputs	Range	Average
Assets	**(in NIS millions)**				
Securities available for sale					
Asset-backed securities (ABS) or Mortgage-backed securities (MBS)	1,401	Discounting cash flows	Margin	95-778 bp	229 bp
			Probability of default	2%-6%	4.50%
			Rate of early repayment	20%	20%
			Loss rate	40%-80%	60%
Assets in respect of derivative instruments					
Interest contracts	117	Discounting cash flows	Inflation forecasts	0%-1.8%	0.9%
Interest contracts	573	Discounting cash flows	Transaction counterparty risk	0.22%-6.99%	3.61%
Foreign currency contracts	139	Discounting cash flows	Inflation forecasts	0%-1.8%	0.9%
Foreign currency contracts	480	Discounting cash flows	Transaction counterparty risk	0.22%-6.99%	3.61%
Share contracts	14	Discounting cash flows	Transaction counterparty risk	0.22%-6.99%	3.61%
Commodities and other contracts	12	Discounting cash flows	Transaction counterparty risk	0.22%-6.99%	3.61%
Liabilities					
Liabilities in respect of derivative instruments					
Interest contracts	154	Discounting cash flows	Inflation forecasts	0%-1.8%	0.9%
Foreign currency contracts	318	Discounting cash flows	Inflation forecasts	0%-1.8%	0.9%

Note 18G – Information on the Sensitivity of Fair Value Measurements to Changes in Unobservable Inputs

1. Unobservable inputs used for the fair value measurement of asset-backed or mortgage-backed securities are margin rates, probability of default, early repayment rate, and the severity of a loss in the event of default. Any significant increase/decrease in unobservable parameters will be reflected in a significantly lower/higher fair value.

2. The unobservable input used for the fair value measurement of derivatives is the forecast rate of inflation. Any change in the forecast rate of inflation will affect the fair value of transactions in accordance with the indexation position of the Bank for these transactions. The more the inflation forecast increases (decreases), and the Bank is committed to pay the amount linked to the index, the more the fair value of the transactions will decrease (increase). The more the inflation forecast increases (decreases), and the counterparty to the transaction is committed to pay the Bank the amount linked to the index, the more the fair value of the transactions will increase (decrease).

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies

Control of the Bank

Bank without a controlling core

On 19 March 2012, the Banking Law (Legislative Amendments), 2012 was published in the Official Gazette *(Reshumot)*. The law amended the Banking Law (Licensing), the Banking Ordinance and Section 37 of the Securities Law (hereinafter "**the Amendment**"). The main purpose of the Amendment is the adaptation of the law to the supervisory framework required in the case of a banking corporation without a controlling core in which all the holders of the means of control do not require a permit under the Banking Law, including the proposal, appointment and term of office of directors in a banking corporation without a controlling core.

On 23 March 2012, the term of office of the Bank Shares Committee, established by virtue of the Bank Shares in the Arrangement Law (Temporary Provision), 1993 (hereinafter "**the Bank Shares Law**"), ended. The said committee had been authorized to use, for and on behalf of the State, the voting rights accorded by the State's holdings in the Bank. In light of the Amendment, effective 24 March 2012, the Bank is defined, pursuant to the provisions of the law, as a bank without a controlling core and with no shareholder specified as the controlling shareholder in the Bank.

Since the Bank has become a bank without a controlling core, the only people entitled to propose to a general meeting candidates for election as director are the following: a statutory committee set up within the framework of the Amendment for the proposal and appointment of directors in a banking corporation; and a shareholder holding more than 2.5% of the means of control in the bank (as defined in the Amendment – "significant holder") or a "body of holders" of shareholders (as defined in the Amendment). A candidate for the office of director in a bank must comply with a number of conditions, restrictions and limitations stipulated in the law that guarantee that he is not involved with the bank and/or to shareholders holding more than 2.5% of the means of control in the bank. In addition, a shareholder who holds more than 1% of a certain class of the means of control in a bank is obliged to report his holdings to the bank and to the Supervisor of Banks, and the bank must report to the public on every shareholder who holds more than 2.5% of a certain class of the means of control in the bank. The obligation to report to the public will also apply with regard to a shareholder who holds between 1% and 2.5% of the means of control in the bank, if the said shareholder consents to publication to the public as aforesaid, and if he does not so consent, he will not be entitled to join a body of holders for the purpose of proposing candidates for the office of director to the general meeting.

The State of Israel's holdings in the shares 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 Law. As set forth 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 2012, the State of Israel held 6.028% of the issued share capital and 6.46% of the voting rights in the Bank.

Pursuant to the provisions of the Bank Shares Arrangement (Temporary Provisions) (Utilization of Voting Rights Conferred by virtue of the Shares in Bank Leumi Ltd.), 2012, published in the Official Gazette *(Reshumot)* on 6 June 2012, from the termination of the term of office of the Shares Committee mentioned above, the voting rights conferred by virtue of the Bank's shares held by M.I. Properties Ltd. will be utilized.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

Pursuant to the provisions of an outline prospectus dated 6 April 2011 regarding the sale of 0.43% of the Bank's issued capital by the State to its employees, during the period when the shares sold to the Group's employees are blocked, and as long as the State's shareholding percentage in the Bank exceeds 5%, an irrevocable power of attorney may be granted to the State to vote by virtue of the shares sold to the Group's employees as aforesaid, and to use the right to appoint directors by virtue of the shares.

Interested party transactions

On 18 October 2012, the Bank was notified by an interested party, Shlomo Eliahu Holdings Ltd. and Eliahu Insurance Company Ltd., controlled by Mr. Shlomo Eliahu, (collectively, "Eliahu"), that Eliahu Insurance Company Ltd. had sold off-market 16,326,531 ordinary shares of NIS 1 par value each of the Bank. Following this sale, Eliahu held some 8.49% of the Bank's share capital ("the direct holdings in the Bank").

Acquisition of control in Migdal Insurance and Financial Holdings Ltd.("Migdal" and "Migdal transaction", as applicable) by Eliahu:

On 29 October 2012, Eliahu gave notice to the Bank of the completion of the Migdal transaction, and accordingly, that the permit and trust deed had come into effect, as explained below.

Further to the report received from Eliahu, published in Immediate Report by the Bank on 29 August 2012, Mr. Shlomo Eliahu, the controlling owner of Eliahu, entered into an agreement whereby, subject to receiving various regulatory approvals, he is to acquire (on his own and/or through corporations under his control) control of Migdal, which is an insurance corporation that has, and/or companies under its control have, holdings in the Bank directly or indirectly.

Further to a report received from Eliahu, the Bank published, in an immediate report on 21 October 2012, details of the trust deed and irrevocable authorization whereby, on completion of the Migdal transaction, the direct holdings in the Bank will be put in trust or will be subject to trust, *inter alia*, subject to the completion of the Migdal transaction ("the trust deed"). In addition, further to a report received from Eliahu, the Bank published, in an Immediate Report on 24 October 2012 the permit received by Mr. Shlomo Eliahu and Ms. Chaya Eliahu from the Bank of Israel to hold means of control in the Bank of up to 13.49% of any type of means of control, including the direct holdings in the Bank the holdings of Migdal ("the Permit").

In accordance with paragraph 5 of the permit, during the two trust periods as detailed below, the direct holdings in the Bank do not confer a right to participate in General Meetings of the Bank and a right to vote therein, and do not confer a right to propose candidates to serve as directors of the Bank, and other rights granted to holders by virtue of their holdings of the relevant means of control, apart from the right to dividends to be distributed, to the extent they are distributed, by the Bank, and the right to consideration for the sale of the direct holdings in the Bank. In light of the above, the votes of other shareholders at the general meetings of the Bank will be affected, such that they will actually be relatively higher.

It is further provided in the permit and in the trust deed that, during the course of the first trust period – up until the end of a three-year period from the date of completing the Migdal transaction, the direct holdings in the Bank will be sold on the stock exchange or to one or more unrelated third parties, subject to the receipt of a permit from the Governor of the Bank of Israel, if required. As long as all of the direct holdings in the Bank have not been sold by that date, they will be sold in this way by the trustee by the end of the second trust period – one year after the end of the first trust period.

On 29 October 2012, on completion of the Migdal transaction, the transaction was finalized between the Bank and Eliahu to grant credit of NIS 2 billion to Eliahu for financing part of the transaction for purchasing controlling shares in Migdal.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

A. Balances on consolidated basis

	31 December 2012												
	Interested parties (f)							Related parties held by the Bank					
	Controlling owners		Key management personnel (a)		Others (b)		Interested party at time of transaction	Unconsolidated subsidiaries		Companies included on equity basis		Others (c)	
	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)
	NIS millions												
Assets:													
Securities (e)	-	-	-	-	**594**	**594**	-	-	-	-	-	-	-
Credit to the public	**2,016**	**2,016**	**29**	**29**	-	-	-	-	-	**319**	**369**	**1,800**	**2,523**
Investments in companies included on equity basis (e)	-	-	-	-	-	-	-	-	-	**2,222**	**2,303**	-	-
Other assets	-	**4**	-	**1**	**19**	**56**	-	-	-	**18**	**40**	**45**	**142**
Liabilities:													
Deposits of the public	**31**	**718**	**62**	**146**	**1,072**	**1,072**	**3**	**8**	**8**	**1,551**	**1,776**	**666**	**1,329**
Deposits from banks	-	-	-	-	**261**	**261**	-	-	-	**37**	**37**	-	-
Bonds and notes	-	**11**	**2**	**2**	**2,292**	**2,292**	-	-	-	**2**	**2**	-	-
Other liabilities	-	**15**	**1**	**1**	**227**	**227**	-	-	-	**122**	**122**	**76**	**93**
Credit risk in off-balance sheet items (g)	-	**2,046**	**18**	**19**	**152**	**283**	-	-	-	**31**	**46**	**676**	**685**

(a) Including their close relatives as defined in IAS 24.

(b) Corporations in which a person or a corporation included in one of the groups on the interested parties, controls them or has joint control in them, has significant influence or holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.

(c) Parties meeting the definition of a related party according to IAS 24 that were not included in other columns, and a party on whose business the activity of the Bank and its consolidated companies is significantly dependent.

(d) Based on end-of-month balances.

(e) For details, see Note 3 - Securities and Note 6 - Investments in companies included on equity basis.

(f) At 31 December 2012, interested parties and parties related to the equity of the Bank held NIS 185,510,497 par value of shares in the Bank.

(g) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of single borrower debt limitations.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

A. Balances on consolidated basis (cont'd)

	31 December 2011												
	Interested parties (f)							Related parties held by the Bank					
	Shareholders		Directors and CEO (a)		Others (f)		Interested party at time of transaction	Unconsolidated subsidiaries		Companies included on equity basis		Others (c)	
	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)
	NIS millions												
Assets:													
Securities (e)	-	-	-	-	-	-	-	-	-	-	-	9	10
Credit to the public	-	-	1	1	-	-	20	-	-	155	160	3,193	3,876
Allowance for credit losses	-	-	-	-	-	-	-	-	-	(1)	(1)	(15)	(58)
Credit to the public, net	-	-	1	1	-	-	20	-	-	154	159	3,179	3,818
Investments in companies included on equity basis (e)	-	-	-	-	-	-	-	-	-	2,270	2,350	-	-
Other assets	-	-	-	-	3	9	-	-	-	29	29	85	85
Liabilities:													
Deposits of the public	97	101	5	6	18	18	6	-	-	1,573	1,573	843	2,950
Deposits from banks	-	-	-	-	-	400	-	-	-	31	31	-	-
Bonds and notes	-	-	1	1	-	-	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	25	25	-	-	-	178	178	90	113
Credit risk in off-balance sheet items (g)	-	-	2	2	40	40	1	-	-	145	156	1,284	1,564

(a) Including their close relatives as defined in IAS 24.
(b) Corporations in which a person or a corporation included in one of the groups on the interested parties, controls them or has joint control in them, has significant influence or holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.
(c) Parties meeting the definition of a related party according to IAS 24 that were not included in other columns, and a party on whose business the activity of the Bank and its consolidated companies is significantly dependent.
(d) Based on end-of-month balances.
(e) For details, see Note 3 - Securities and Note 6 - Investments in companies included on equity basis.
(f) At 31 December 2012, interested parties and parties related to the equity of the Bank held NIS 141,733,088 par value of shares in the Bank.
(g) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of single borrower debt limitations.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

B. Condensed results of operations with interested and related parties

2012

	Interested parties					Related parties held by the banking corporation	
	Shareholders						
	Controlling owners	Key management personnel (a)	Others (b)	Interested party at time of transaction	Subsidiaries (unconsolidated)	Companies included on equity basis or companies held under joint control	Others
	NIS millions						
Net interest income (d)	**15**	**(1)**	**(18)**	**-**	**-**	**2**	**83**
Non-interest income	**(27)**	**-**	**(184)**	**-**	**-**	**(25)**	**69**
Of which: management fees and services	**3**	**-**	**6**	**-**	**-**	**-**	**12**
Operating and other expenses (e)	**-**	**(72)**	**62**	**-**	**-**	**(16)**	**5**
Total	**(12)**	**(73)**	**(140)**	**-**	**-**	**(39)**	**157**

2011

	Interested parties					Related parties held by the banking corporation	
	Shareholders						
	Controlling owners	Key management personnel (a)	Others (b)	Interested party at time of transaction	Subsidiaries (unconsolidated)	Companies included on equity basis or companies held under joint control	Others
	NIS millions						
Net interest income (d)	(5)	-	(11)	-	-	(13)	101
Expenses in respect of credit losses	-	-	-		-	-	(1)
Non-interest income	-	-	55	-	-	4	21
Of which: management fees and services	-	-	-	-	-	-	-
Operating and other expenses (e)	-	(60)	(1)	-	-	(73)	(14)
Total	(5)	(60)	43	-	-	(82)	107

2010

	Interested parties					Related parties held by the banking corporation	
	Shareholders						
	Controlling owners	Key management personnel (a)	Others (b)	Interested party at time of transaction	Subsidiaries (unconsolidated)	Companies included on equity basis or companies held under joint control	Others
	NIS millions						
Net interest income (d)	(2)	-	(6)	-	-	(11)	84
Non-interest income	-	-	65	-	-	11	(21)
Operating and other expenses (e)	-	(57)	-	-	-	(19)	(15)
Total	(2)	(57)	59	-	-	(19)	48

(a) Including their close relatives as defined in IAS 24.

(b) Corporations in which a person or a corporation included in one of the groups on the interested parties, controls them or has joint control in them, has significant influence or holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.

(c) Parties meeting the definition of a related party according to IAS 24 that were not included in other columns, and a party on whose business the activity of the Bank and its consolidated companies is significantly dependent.

(d) See details in paragraph D below.

(e) See details in paragraph C below.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

C. Remuneration and all other benefits to interested parties

	31.12.2012		31.12.2011		31.12.2010	
	Key management personnel		Key management personnel		Key management personnel	
	Total benefits	Number of recipients	Total benefits	Number of recipients	Total benefits	Number of recipients
	NIS millions		NIS millions		NIS millions	
Interested parties employed in the Bank or on its behalf (a) (b)	**57**	**24**	45	20	42	22
Directors not employed in the Bank or on its behalf (a)	**11**	**16**	12	18	11	17

(a) Does not include salary tax.

(b) Of which: short term employee benefits NIS 36 million, post retirement benefits NIS 20 million, other long term benefits NIS 1 million (2011 - short term employee benefits NIS 31 million, post retirement benefits NIS 9 million, other long term benefits NIS 5 million. 2010 - short term employee benefits NIS 25 million, post retirement benefits NIS 14 million, other long term benefits NIS 3 million).

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 amounted to NIS 2,901 thousand (2011 – NIS 3,001 thousand, 2010 – NIS 3,531 thousand).

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

D. Interest income, net, in transactions by the Bank and its consolidated companies with interested parties and related parties

	2012		2011 (a)		2010 (a)	
	Consolidated	Of which: companies included on equity basis	Consolidated	Of which: companies included on equity basis	Consolidated	Of which: companies included on equity basis
	NIS millions					
a) In respect of assets						
Credit to the public	**123**	**15**	135	7	101	9
b) In respect of liabilities						
Deposits of the public	**(24)**	**(12)**	(53)	(19)	(29)	(19)
Deposit from banks	**(1)**	**(1)**	(10)	(1)	(7)	(1)
Other liabilities	**(17)**	**-**	-	-	-	-
Total interest income, net	**81**	**2**	72	(13)	65	(11)

(a) Reclassified pursuant to the first-time implementation of the directives of the Supervisor of Banks on the format of the statement of profit and loss.

Note 20 – Interest Income and Expenses

	2012	2011(a)	2010(a)
	NIS millions		
A. Interest income (b)			
Credit to the public	**11,578**	12,137	10,662
Credit to governments	**21**	21	20
Deposits with banks	**95**	208	147
Deposits with Bank of Israel and cash	**515**	663	363
Interest income from securities borrowed or purchased under agreements to resell	**45**	47	23
Bonds (c)	**1,253**	1,207	1,274
Total interest income	**13,507**	14,283	12,489
B. Interest expenses (b)			
Deposits of the public	**(4,441)**	(5,185)	(3,709)
Deposits from governments	**(14)**	(22)	(29)
Deposits from banks	**(58)**	(126)	(65)
Debentures, bonds and subordinated notes	**(1,555)**	(1,813)	(1,695)
Interest expense from securities loaned or sold under agreements to repurchase	**(31)**	(30)	(19)
Total interest expenses	**(6,099)**	(7,176)	(5,517)
Total interest income, net	**7,408**	7,107	6,972
C. Details of the net effect of hedging derivative financial instruments on interest income and expenses (d)			
Interest income	**-**	(6)	(6)
Interest expenses	**(9)**	4	4
D. Details of interest income on accrual basis from bonds			
Available for sale	**966**	967	1,047
Held for trading	**287**	240	227
Total included in interest income	**1,253**	1,207	1,274

(a) Reclassified pursuant to the first-time implementation of the directives of the Supervisor of Banks on the format of the statement of profit and loss for a banking corporation, see Note 1.D.1.

(b) Including effective component of hedge relationships.

(c) Including interest in respect of mortgage-backed bonds (MBS) in the amount of NIS 68 million (2011 - NIS 63 million, 2010 - NIS 62 million).

(d) Details of the effect of hedging derivative instruments on sub-sections A. and B.

Note 21 – Non-interest Financing Income

	2012	2011(a)	2010(a)
	NIS millions		
A. Non-interest financing income from activities not for trading purposes			
A.1 From activities in derivative instruments			
Non-effective part of hedging relationships (b)	**6**	-	4
Net Income (expenses) in respect of ALM derivative instruments (c)	**(690)**	1,057	(1,801)
Total from activities in derivative instruments	**(684)**	1,057	(1,797)
A.2 From investment in bonds			
Gains on sale of debentures available for sale	**313**	315	271
Losses on sale of debentures available for sale	**(22)**	(50)	(9)
Total from investment in debentures	**291**	265	262
A.3 Exchange rate differentials, net	**597**	(1,482)	1,752
A.4 Gains (losses) on investment in shares			
Gains from sale of shares available for sale	**81**	86	71
Losses from sale of shares available for sale (d)	**(171)**	(312)	(30)
Gain from sale of shares in companies included on equity basis	**24**	-	181
Dividend from shares available for sale	**54**	74	174
Total from investment in shares	**(12)**	(152)	396
Total non-interest financing income in respect of activities not for trading purposes	**192**	(312)	613
B. Non-interest financing income from activities for trading purposes (e)			
Net income (expenses) in respect of other derivative instruments	**11**	7	15
Realized and unrealized profits from fair value adjustment of bonds for trading, net (f)	**229**	176	(154)
Realized and unrealized profits from fair value adjustment of shares for trading, net (g)	**10**	137	1
Dividend from shares held for trading	**2**	3	-
Total from investment in shares (h)	**252**	323	(138)

(a) Reclassified pursuant to the first-time implementation of the directives of the Supervisor of Banks on the format of the statement of profit and loss for a banking corporation, see Note 1.D.1.
(b) Excluding effective component of hedging 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 provision for impairment of NIS 160 million, (2011 - NIS (271) million, 2010 - NIS 1 million).
(e) Including exchange rate differences resulting from trading activity.
(f) Of which part of the profits (losses) of NIS 192 million (2011 and 2010 - NIS (36) million and NIS (19) million, respectively), relating to bonds held for trading still held as of balance sheet date.
(g) Of which part of the profits (losses) of NIS 12 million (2011 and 2010 - NIS (1) million and NIS (11) million, respectively), relating to shares held for trading still held as of balance sheet date.
(h) For interest income from investment in bonds held for trading, see Note 20.

Note 22 – Commissions

	2012	2011(a)	2010(a)
	NIS millions		
Ledger fees (d)	**868**	837	847
Conversion differences	**298**	287	293
Handling of credit	**358**	368	337
Commissions for distribution of financial products (b)	**185**	197	188
Foreign trade activities	**129**	126	127
Income from transactions in securities and certain derivative instruments	**835**	793	872
Credit cards	**864**	856	818
Management fees and commission on life insurance and home insurance	**42**	41	49
Net income from servicing credit portfolios	**37**	41	45
Management, operations, and custody for institutional entities (c)	**51**	53	55
Commissions on financing transactions	**425**	414	390
Other commissions	**107**	103	108
Total operating commissions	**4,199**	4,116	4,129

(a) Reclassified pursuant to the first-time implementation of the directives of the Supervisor of Banks on the format of the statement of profit and loss for a banking corporation, see Note 1.D.1.
(b) Mainly distribution fees of mutual funds.
(c) Mainly operations of provident funds.
(d) Reclassified.

Note 23 - Other Income

	2012	2011(a)	2010(a)
	NIS millions		
Profit from the realization of aasets received for settlement of loans	**1**	2	1
Profits from severance pay funds	**95**	-	70
Capital gain from sale of buildings and equipment	**6**	2	6
Capital loss from sale of buildings and equipment	**(4)**	-	-
Other, net (b)	**33**	44	86
Total other income	**131**	48	163

(a) Reclassified pursuant to the first-time implementation of the directives of the Supervisor of Banks on the format of the statement of profit and loss for a banking corporation, see Note 1.D.1.

(b) Reclassified.

Note 24 - Salaries and Related Expenses

	2012	2011(a)	2010(a)
	NIS millions		
Salaries	**3,025**	2,949	2,945
Early retirement (b)	**323**	-	-
Severance pay, provident fund, training fund, pension, vacation and long service bonus	**729**	682	652
Expense (income) deriving from share-based payment transactions	**-**	13	(24)
National Insurance and VAT on salaries	**655**	618	621
Other related expenses	**217**	199	188
Adjustment of provisions for related expenses as a result of changes in salaries in the current year	**341**	600	304
Total salaries and related expenses	**5,290**	5,061	4,686
Of which: salaries and related expenses abroad	**642**	590	519

(a) Reclassified pursuant to the first-time implementation of the directives of the Supervisor of Banks on the format of the statement of profit and loss for a banking corporation, see Note 1.D.1.

(b) Expenses related to early retirement of employees as part of the plan for structural change in the Bank.

Note 25 - Other Expenses

	2012	2011	2010
	NIS millions		
Marketing and advertising	**267**	283	260
Legal, audit and professional consultants	**321**	377	324
Communications - postage, telephone, delivery services, etc.	**171**	161	157
Computers (a)	**240**	222	218
Office expenses	**79**	84	82
Insurance	**21**	20	22
Training	**19**	27	27
Commissions	**162**	136	122
Loss in respect of assets received in settlement of loans	**12**	14	16
Other (b)	**676**(c)	250	376
Total other expenses	**1,968**	1,574	1,604

(a) The item includes outsourcing expenses and does not include the Bank's computer expenses as the Operations Division is a part of the Bank and its expenses are recorded and classified under the various expense headings.

(b) Regarding directors' fees of the Bank included in this item, see Note 19.D.

(c) Including expenses in respect of US customers, about NIS 400 million – see Note 18.K.

Note 26 – Provision for Taxes on Profit

A. Composition

	2012	2011	2010
	NIS millions		
Current taxes -			
In respect of current year	**1,400**	728	1,251
In respect of prior years	**46**	(2)	58
Total current taxes	**1,446**	726	1,309
Less: changes in deferred taxes	**(635)**	(308)	(68)
Provision for taxes on income	**811**	418	1,241
Of which: provision for taxes abroad	**74**	29	95
Deferred taxes			
Creation and reversal of temporary differences	**(586)**	18	(104)
Change in tax rate	**(49)**	(326)	36
Total deferred taxes	**(635)**	(308)	(68)

B. Reconciliation between the theoretical amount of tax applicable if the operating profit were liable for tax at the statutory rate of tax in Israel, and the provision for taxes on the operating profit appearing in the statement of profit and loss:

	2012	2011	2010
Statutory tax rate applying to a banking corporation	**35.53%**	34.48%	35.34%
	NIS millions		
Tax at the statutory tax rate	**656**	760	1,063
Tax (tax saving) resulting from:			
General and supplementary provisions for doubtful debts	**-**	-	(11)
Other non-deductible expenses	**171**	103	60
Income of foreign consolidated companies	**2**	(106)	116
Income of Israeli consolidated companies	**(25)**	(15)	(46)
Depreciation adjustment differences	**4**	15	(4)
Tax exempt and at preferred rates	**(17)**	(20)	(18)
Timing differences for which deferred taxes have not been recorded	**(12)**	2	(13)
Change in deferred taxes due to change in tax rates	**(49)**	(326)	36
Taxes in respect of prior years	**46**	(2)	58
Other	**35**	7	-
Provision for taxes on operating profit	**811**	418	1,241

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Note 26 – Provision for Taxes on Profit (cont'd)

On 14 July 2009, the Knesset approved the Improved Economic Efficiency Law (Legislative Amendments for Implementation of the Economic Plan for 2009 and 2010), 2009, which, inter alia, gradually reduces company tax rates to 18% for the year 2016 and thereafter. Pursuant to the said amendments, company tax rates applicable in 2010 and 2011 were 25% and 24%, respectively.

On 5 December 2011, the Knesset approved in first reading the Change in the Tax Burden Law (Legislative Amendments), 2011 (hereinafter – the Law). Pursuant to the Law, the reduction in tax, provided in the Improved Economic Efficiency Law, as aforesaid, was canceled, and the company tax rate from 2012 and thereafter is 25%.

On 30 August 2012, Value Added Tax Order (Tax Rate on Noninterest-Profit Organizations and Financial Institutions) (Amendment), 2012, was published in the Official Gazette (*Reshumot*), that updated the rate of value added tax in respect of profit tax and payroll tax to 17% from 1 September 2012. As a result of the said change, the statutory tax rate applicable to financial institutions increased in 2012 from a rate of 35.34% to a rate of 35.53%, and from 2013 onward wiol increase to a rate of 35.9%. In addition the rate of payroll tax, which applies to financial institutions, increased to 17% with respect to salary payable for work from September 2012 and thereafter, instead of 16% for the whole of 2012 and 15.5% for 2013 and thereafter.

Furthermore, on 13 August 2012, the Deficit Reduction and Change in Tax Burden Law (Legislative Amendment), 2012 (hereinafter: "the Law") was published. Pursuant to the Law, with effect from January 2013, the rate of National Insurance premiums collected from employers in respect of the part of the salary exceeding 60% of the average salary in the market increased from 5.9% to 6.5%. In addition, this rate will increase in January 2014 and January 2015 to 7% and 7.5%, respectively.

Current taxes for the periods reported in these financial statements are calculated in accordance with the tax rates stipulated in the laws mentioned above.

The balances of deferred taxes at 31 December 2012 were calculated at the tax rates as stipulated in the laws mentioned above, in accordance with the rate of tax expected at the date of reversal.

The effect of the change in the rate of tax on the financial statements at 31 December 2012 is reflected in an increase in the balance of the deferred tax asset of NIS 35 million, against the provision for taxes on income.

C. On 26 February 2008 the Amendment to the Income Tax (Adjustments for Inflation) Law, 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.

D. Final assessments have been issued to the Bank for all years up to and including the tax year 2007. The main consolidated companies have final assessments for the years up to and including 2008.

E. Amendment 11 to the Income Tax (Inflationary Adjustments) Law 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 for the years 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 of presentation of the securities in the financial statements of the financial institutions.

Note 26 – Provision for Taxes on Profit (cont'd)

Notwithstanding the limitation of the application of the Income Tax (Inflationary Adjustments) Law as described 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.

F. 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 some NIS 65 million (31 December 2011 – about NIS 139 million). Utilization of these amounts in the future will be possible if the consolidated companies for which the amounts are recorded have taxable income. Deferred taxes are not recognized in respect of these items since in the opinion of the Group, no taxable income is expected in the future against which tax benefits can be utilized.

Note 26 – Provision for Taxes on Profit (cont'd)

G. a. Components of deferred tax assets and the deferred tax reserve are as follows:

	31 December 2012	31 December 2011	**31 December 2012**	31 December 2011
	NIS millions		Average tax rate in percent	
Deferred tax assets				
From allowance for credit	**1,020**	916	**37%**	36%
unutilized vacations and long service bonuses	**325**	312	**36%**	35%
From excess of provision for severance pay and	**1,586**	1,373	**36%**	35%
From interest not credited to	**70**	74	**39%**	38%
From tax deductions carried	**70**	61	**40%**	32%
From activity abroad	**3**	-	**36%**	-
From adjustment of depreciable non-monetary	**23**	32	**17%**	20%
Other – from non-monetary assets	**66**	54	**22%**	23%
Total	**3,163**	2,822		
Deferred tax reserve				
Surplus reserves over funds for severancy pay and pensions	**-**	(2)	**-**	30%
From securities	**(135)**	(91)	**32%**	37%
From investments in investee companies	**(191)**	(168)	**15%**	10%
From adjustment of depreciable non-monetary assets	**(279)**	(209)	**35%**	31%
Other – from monetary assets	**(22)**	(26)	**36%**	34%
Other – from non-monetary assets	**(82)**	(48)	**27%**	28%
Total	**(709)**	(544)		
Deferred taxes receivable, net	**2,454**	2,278		
Deferred taxes included: (a)				
In "Other assets"	**2,598**	2,396		
In "Other liabilities"	**(144)**	(118)		
Deferred tax assets, net	**2,454**	2,278		

(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.

Note 26 – Provision for Taxes on Profit (cont'd)

b. Movement in deferred tax assets and liabilities relating to the following items:

For the period ended 31 December 2012

	Allowance for credit losses	Provision for vacation and bonuses	Surplus of funds over reserve for severance pay and pension	Interest not charged to annual income	Dedictions carried forward for tax purposes	Foreign operation	Securities	Investments in investee companies	Adjustment of depreciable non-monetary assets	Other monetary items	Other non-monetary items	Total
	(NIS millions)											
Balance of deferred tax asset (liability) at 1 January 2012	916	312	1,371	74	61	-	(91)	(168)	(177)	(26)	6	2,278
Changes charged to profit and loss	82	6	184	(4)	9	9	316	(9)	(7)	4	(22)	568
Changes charged to equity	5	-	-	-	-	(6)	(354)	-	(43)	-	-	(398)
Effect of the change in the rate of tax	17	7	31	-	-	-	(6)	(14)	-	-	-	35
Business combinations	-	-	-	-	-	-	-	-	(29)	-	-	(29)
Balance of deferred tax asset (liability) at 31 December 2012	1,020	325	1,586	70	70	3	(135)	(191)	(256)	(22)	(16)	2,454
												-
Deferred tax asset	1,020	325	1,586	70	70	3	-	-	23	-	66	3,163
Balances available for offsetting												(565)
Deferred tax asset at 31 December 2012												2,598
												-
Deferred tax liability	-	-	-	-	-	-	(135)	(191)	(279)	(22)	(82)	(709)
Balances available for offsetting												(565)
Deferred tax liability at 31 December 2012												(144)

For the period ended 31 December 2011

	Allowance for credit losses	Provision for vacation and bonuses	Surplus of funds over reserve for severance pay and pension	Interest not charged to annual income	Dedictions carried forward for tax purposes	Foreign operation	Securities	Investments in investee companies	Adjustment of depreciable non-monetary assets	Other monetary items	Other non-monetary items	Total
	(NIS millions)											
Balance of deferred tax asset (liability) at 1 January 2011	203	257	987	79	55	7	(179)	(162)	(111)	(26)	(16)	1,094
Changes charged to profit and loss	64	(2)	208	(5)	6	(7)	(248)	(6)	(66)	-	32	(24)
Changes charged to equity	546	-	-	-	-	-	336	-	-	-	-	882
Effect of the change in the rate of tax	103	57	176	-	-	-	-	-	-	-	(10)	326
Balance of deferred tax asset (liability) at 31 December 2011	916	312	1,371	74	61	-	(91)	(168)	(177)	(26)	6	2,278
Deferred tax asset	916	312	1,373	74	61	-	-	-	32	-	54	2,822
Balances available for offsetting												(426)
Deferred tax asset at 31 December 2011												2,396
Deferred tax liability	-	-	(2)	-	-	-	(91)	(168)	(209)	(26)	(48)	(544)
Balances available for offsetting												(426)
Deferred tax liability at 31 December 2011												(118)

Note 26 – Provision for Taxes on Profit (cont'd)

c. Taxes on income recognized directly in equity:

	2012			2011			2010		
	Before tax	**Tax expense (benefit)**	**Net of tax**	Before tax	Tax expense (benefit)	Net of tax	Before tax	Tax expense (benefit)	Net of tax
	(NIS millions)								
Translation adjustments of financial statements	**-**	**6**	**(6)**	-	-	-	-	-	-
Profits (losses) net in respect of net hedges of investments in foreign currency	**4**	**1**	**3**	-	-	-	-	-	-
Financial assets available for sale	**1,067**	**354**	**713**	(1,023)	(336)	(687)	235	76	159
Other comprehensive income in respect of companies included on equity basis	**(20)**	**(2)**	**(18)**	70	7	63	(97)	(11)	(86)
Share-based payments	**-**	**-**	**-**	-	-	-	-	30	(30)
Effect of the Impaired Debts Directive	**-**	**-**	**-**	(1,960)	(584)	(1,376)	-	-	-
Implementation of IAS 12	**-**	**43**	**(43)**	-	-	-	-	-	-
Total recognized in equity	**1,051**	**402**	**649**	(2,913)	(913)	(2,000)	138	95	43

Note 26 – Provision for Taxes on Profit (cont'd)

H. Deferred taxes have been calculated at the statutory tax rate applying to the companies at the time of utilization.

I. Changes in deferred taxes amounting to NIS (398) million derive mainly from recording deferred tax in respect of an amendment to opening balances and securities available for sale which were charged to separate items in shareholders' equity (2011 – NIS 882 million).

J. 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, 2012 is about US$ 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 – Operating Segments and Geographic Areas

Description of Operating Segments

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.

* This includes other activities of the Group, none of which constitutes a profit segment under the directives of the Supervisor of Banks.

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, capital market, and real estate.

Note 27 – Operating Segments and Geographic Areas (cont'd)

Allocation to a specific operational segment is carried out according to quantitative criteria and additional criteria, such as: size of the *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, and the financial results in respect of the customer are recorded in the segment in which his account is actually operated.

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.

Note 27 – Operating 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.

Credit Loss Expenses, including the collective allowance, 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.

Non-interest Income

All non-interest income (non-interest financing income, commissions and other 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

Expenses are attributed to the lines of business (divisions of the Bank) in accordance with the sectoral association of the customers dealt with by those lines of business.

In a few cases, where the line of business deals with a number of operating segments, the expenses of the lines of business are attributed to the relevant segments and products on the basis of the pricing of multi-dimensional transactions.

Pricing is a system in which the cost of transaction is calculated taking into account the type of transaction, the type of customer executing it and the channel in which the transaction was carried out.

Measuring the return on capital

As part of the intensification of measurement of the performance of units and its adjustment to the unique risk characteristics for each unit, measurement is made of the rate of return on risk-adjusted capital (RORAC) of operating segments and their contribution to the Group's profit (economic value added - EVA), taking into account the cost of capital according to the multi-year return approved by the Board of Directors. The allocation of capital to risk components among the segments was done in accordance with the various risk characteristics inherent in each segment, in accordance with Basel II.

Note 27 – Operating Segments and Geographic Areas (cont'd)

From 2010, the allocation of First Pillar capital (in respect of credit, market and operational risks) is according to Basel II – the standardized - credit risks - approach on the basis of weighted risk assets in the units, operational and market risks (as of 31 December 2011) according to the standardized measurement method.

Second Pillar Capital is allocated to the units divided into its various components according to models designed by the Bank.

Until the end of 2009, risk capital was allocated to the various sectors according to its relative share of each segment in the total weighted risk assets of Leumi Group in accordance with the provisions of Basel I.

The profit of the operating segments is adjusted for the risk capital in each segment. The risk-adjusted return adjusted was calculated as a ratio of the adjusted profit to the average shareholders' equity allocated to the sector, which constitutes a part of the risk capital allocated (Tier 1 capital, Tier 2 capital and the balance of the capital in respect of extreme scenarios and retained earnings).

For each segment, the profit is calculated, taking into account the cost of Tier 1 and Tier 2 risk capital allocated to each segment. At the Group level, the value added for the shares (EVA) is the net profit, amended as aforesaid, less the cost of the shareholders' equity, according to the required long-term return over the shareholders' equity, as determined by the Board of Directors.

Note 27 – Operating Segments and Geographic Areas (cont'd)

A. Information on operating segments

for the year ended 31 December 2012

	Households Segment	Small Business Segment	Corporate Segment	Commercial Segment	Private Banking Segment	Financial Management Segment	Other	Total consol-idated
	NIS millions							
Interest income, net:								
From outside entities -	**1,884**	**1,097**	**2,744**	**1,620**	**(122)**	**184**	**1**	**7,408**
Intersegmental -	**915**	**(173)**	**(1,196)**	**(229)**	**472**	**198**	**13**	**-**
Non-interest income:								
From outside entities -	**1,622**	**551**	**613**	**523**	**611**	**834**	**20**	**4,774**
Intersegmental -	**230**	**(44)**	**24**	**39**	**51**	**(245)**	**(55)**	**-**
Total income	**4,651**	**1,431**	**2,185**	**1,953**	**1,012**	**971**	**(21)**	**12,182**
Credit loss expenses	**71**	**84**	**933**	**176**	**1**	**(29)**	**-**	**1,236**
Operating and other expenses	**3,872**	**858**	**651**	**1,083**	**898**	**1,806**	**(68)**	**9,100**
Profit (loss) before taxes	**708**	**489**	**601**	**694**	**113**	**(806)**	**47**	**1,846**
Provision for (benefit from) taxes	**236**	**167**	**204**	**248**	**32**	**(248)**	**172**	**811**
Profit (loss)	**472**	**322**	**397**	**446**	**81**	**(558)**	**(125)**	**1,035**
Group equity in after-tax operating profits of companies included on equity basis, net of tax effect	**2**	**-**	**-**	**-**	**-**	**(69)**	**-**	**(67)**
Net profit (loss)								
Before attribution to non-controlling interests	**474**	**322**	**397**	**446**	**81**	**(627)**	**(125)**	**968**
Attributable to non-controlling interests	**(27)**	**(3)**	**(5)**	**(2)**	**-**	**-**	**-**	**(37)**
Attributable to shareholders of the banking coporation	**447**	**319**	**392**	**444**	**81**	**(627)**	**(125)**	**931**
Return on capital (percentage profit on relative share of equity of the segment in risk assets)	**9.6%**	**21.1%**	**4.3%**	**10.3%**	**8.3%**	**(18.3%)**	**(29.9%)**	**3.8%**

Note 27 – Operating Segments and Geographic Areas (cont'd)

A. Information on operating segments

for the year ended 31 December 2012 (cont'd)

	Households Segment	Small Business Segment	Corporate Segment	Commercial Segment	Private Banking Segment	Financial Management Segment	Other	Total consol-idated
	NIS millions							
Average balance of assets	**87,317**	**20,788**	**76,624**	**51,196**	**13,315**	**111,951**	**6,188**	**367,379**
Including: investments in companies included on equity basis	**2**	**-**	**-**	**-**	**-**	**2,201**	**-**	**2,203**
Average balance of liabilities	**134,850**	**20,236**	**30,303**	**50,505**	**39,536**	**65,539**	**1,793**	**342,762**
Average balance of risk assets	**62,105**	**18,409**	**104,161**	**54,607**	**10,835**	**30,977**	**5,876**	**286,970**
Average balance of assets of mutual funds and training funds	**53,968**	**2,175**	**2,087**	**3,947**	**6,668**	**195**	**-**	**69,040**
Average balance of securities	**49,165**	**4,753**	**56,944**	**42,919**	**77,003**	**195,156**	**-**	**425,940**
Average balance of other assets under management	**5,134**	**226**	**226**	**685**	**227**	**-**	**8**	**6,506**
Interest income, net:	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Margin on credit-granting activities	**1,677**	**739**	**1,484**	**1,070**	**97**	**7,211**	**14**	**12,292**
Margin on deposit-taking activities	**1,122**	**185**	**64**	**321**	**253**	**(6,829)**	**-**	**(4,884)**
Total interest income, net	**2,799**	**924**	**1,548**	**1,391**	**350**	**382**	**14**	**7,408**

Note 27 – Operating Segments and Geographic Areas (cont'd)

A. Information on operating segments

for the year ended 31 December 2011 (a)

	Households Segment	Small Business Segment	Corporate Segment	Commercial Segment	Private Banking Segment	Financial Management Segment	Other	Total consol-idated
	NIS millions							
Interest income, net:								
From outside entities -	1,614	1,098	2,802	1,595	(81)	79	-	7,107
Intersegmental -	987	(190)	(1,351)	(245)	493	292	14	-
Non-interest income:								
From outside entities -	1,811	548	506	1,046	473	(281)	72	4,175
Intersegmental -	126	(52)	140	(461)	22	330	(105)	-
Total income	4,538	1,404	2,097	1,935	907	420	(19)	11,282
Credit loss expenses	69	89	312	218	(31)	77	-	734
Operating and other expenses	3,904	829	631	1,047	688	1,317	(75)	8,341
Profit (loss) before taxes	565	486	1,154	670	250	(974)	56	2,207
Provision for (benefit from) taxes	173	168	390	229	75	(421)	(196)	418
Profit (loss)	392	318	764	441	175	(553)	252	1,789
Group equity in after-tax operating profits of companies included on equity basis, net of tax effect	-	-	-	-	-	148	-	148
Net profit (loss)								
Before attribution to non-controlling interests	392	318	764	441	175	(405)	252	1,937
Attributable to non-controlling interests	(28)	(2)	(4)	(1)	(2)	(9)	-	(46)
Attributable to shareholders of the banking coporation	364	316	760	440	173	(414)	252	1,891
Return on capital (percentage profit on relative share of equity of the segment in risk assets)	8.7%	22.7%	9.3%	11.4%	22.0%	(10.1%)	70.1%	8.3%

(a) Reclassified pursuant to initial implementation of the directive of the Supervisor of Banks regarding the format of the statement of profit and loss of a banking corporation. See Note 1.D.1.

Note 27 – Operating Segments and Geographic Areas (cont'd)

A. Information on operating segments

for the year ended 31 December 2011 (a) (cont'd)

	Households Segment	Small Business Segment	Corporate Segment	Commercial Segment	Private Banking Segment	Financial Management Segment	Other	Total consol-idated
	NIS millions							
Average balance of assets	80,419	19,465	77,596	49,894	11,248	97,642	5,551	341,815
Including: investments in companies included on equity basis	5	-	-	-	-	2,142	-	2,147
Average balance of liabilities	128,256	19,030	35,180	44,043	37,393	53,447	1,197	318,546
Average balance of risk assets	57,268	17,651	99,423	51,073	9,424	38,168	5,444	278,451
Average balance of assets of mutual funds and training funds	53,540	2,199	1,281	4,240	6,390	261	-	67,911
Average balance of securities	50,806	5,702	82,702	40,831	68,071	179,121	-	427,233
Average balance of other assets under management	5,897	244	221	702	224	-	5	7,293
Interest income, net:								
Margin on credit-granting activities	1,443	716	1,387	1,037	107	7,990	16	12,696
Margin on deposit-taking activities	1,158	192	64	313	305	(7,619)	(2)	(5,589)
Total interest income, net	2,601	908	1,451	1,350	412	371	14	7,107

(a) Reclassified pursuant to initial implementation of the directive of the Supervisor of Banks regarding the format of the statement of profit and loss of a banking corporation. See Note 1.D.1.

Note 27 – Operating Segments and Geographic Areas (cont'd)

A. Information on operating segments

for the year ended 31 December 2010 (a)

	Households Segment	Small Business Segment	Corporate Segment	Commercial Segment	Private Banking Segment	Financial Management Segment	Other	Total consol-idated
	NIS millions							
Interest income, net:								
From outside entities -	1,508	1,007	2,483	1,621	(149)	498	4	6,972
Intersegmental -	675	(157)	(686)	(319)	525	(38)	-	-
Non-interest income:								
From outside entities -	1,673	555	(340)	526	546	1,736	71	4,767
Intersegmental -	330	(61)	943	35	(54)	(1,192)	(1)	-
Total income	4,186	1,344	2,400	1,863	868	1,004	74	11,739
Credit loss expenses	169	147	(71)	341	8	(6)	(4)	584
Operating and other expenses	3,703	795	616	1,035	725	1,072	15	7,961
Profit before taxes	314	402	1,855	487	135	(62)	63	3,194
Provision for (benefit from) taxes	109	144	655	183	44	32	74	1,241
Profit (loss) after taxes	205	258	1,200	304	91	(94)	(11)	1,953
Group equity in after-tax operating profits (losses) of companies included on equity basis, net of tax effect	-	-	-	-	-	420	-	420
Net profit								
Before attribution to non-controlling interests	205	258	1,200	304	91	326	(11)	2,373
Attributable to non-controlling interests	(28)	(1)	(2)	(1)	(4)	(3)	-	(39)
Attributable to shareholders of the banking coporation	177	257	1,198	303	87	323	(11)	2,334
Return on capital (percentage profit on relative share of equity of the segment in risk assets)	4.4%	18.9%	14.3%	8.1%	12.7%	7.9%	(2.5%)	10.3%

(a) Reclassified pursuant to initial implementation of the directive of the Supervisor of Banks regarding the format of the statement of profit and loss of a banking corporation. See Note 1D.1.

Note 27 – Operating Segments and Geographic Areas (cont'd)

A. Information on operating segments

for the year ended 31 December 2010 (a) (cont'd)

	Households Segment	Small Business Segment	Corporate Segment	Commercial Segment	Private Banking Segment	Financial Management Segment	Other	Total consol-idated
	NIS millions							
Average balance of assets	71,397	18,460	73,946	46,667	10,797	99,175	5,009	325,451
Including: investments in companies included on equity basis	8	-	-	-	-	1,944	-	1,952
Average balance of liabilities	123,480	16,929	33,291	38,418	39,429	49,272	1,601	302,420
Average balance of risk assets	52,946	17,125	92,380	48,391	9,174	37,775	4,892	262,683
Average balance of assets of mutual		-						
funds and training funds	49,162	2,027	1,098	3,541	5,358	402	-	61,588
Average balance of securities	50,421	5,236	86,063	39,332	67,046	139,587	-	387,685
Average balance of other assets		-						
under management	6,607	301	201	563	253	-	118	8,043
Interest income, net:		-						
Margin on credit-granting activities	1,325	730	1,752	1,074	105	5,912	4	10,902
Margin on deposit-taking activities	858	120	45	228	271	(5,452)	-	(3,930)
Total interest income, net	2,183	850	1,797	1,302	376	460	4	6,972

(a) Reclassified pursuant to initial implementation of the directive of the Supervisor of Banks regarding the format of the statement of profit and loss of a banking corporation. See Note 1.D.1.

Note 27 – Operating Segments and Geographic Areas (cont'd)

B. Information on activity by geographic area (a)

31 December 2012	Israel	U.S.A.	U.K.	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consoli-dated
	NIS millions								
Total income (b)	**10,600**	**702**	**407**	**343**	**24**	**72**	**34**	**1,582**	**12,182**
Net profit attributable to shareholders of the banking corporation	**785**	**90**	**42**	**(18)**	**14**	**8**	**10**	**146**	**931**
Total assets	**336,069**	**20,103**	**9,732**	**7,379**	**989**	**1,280**	**608**	**40,091**	**376,160**
Credit to the public, net	**214,668**	**13,985**	**7,846**	**2,998**	**453**	**860**	**454**	**26,596**	**241,264**
Deposits of the public	**256,216**	**16,336**	**7,332**	**6,484**	**2,010**	**680**	**480**	**33,322**	**289,538**

31 December 2011 (c)	Israel	U.S.A.	U.K.	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consoli-dated
	NIS millions								
Total income (b)	9,695	866	490	227	(71)	112	(37)	1,587	11,282
Net profit attributable to shareholders of the banking corporation	1,490	213	102	53	22	(21)	32	401	1,891
Total assets	325,272	21,765	9,051	4,259	779	1,230	3,498	40,582	365,854
Credit to the public, net	214,356	14,785	7,696	2,312	336	812	1,023	26,964	241,320
Deposits of the public	245,948	16,783	5,683	4,960	2,069	726	3,235	33,456	279,404

31 December 2010 (c)	Israel	U.S.A.	U.K.	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consoli-dated
	NIS millions								
Total income (b)	10,539	528	126	264	192	1	89	1,200	11,739
Net profit attributable to shareholders of the banking corporation	2,613	(94)	(29)	34	(4)	(181)	(5)	(279)	2,334

(a) The classification was done based on the location of the office.
(b) Interest income net and non-interest income.
(c) Reclassified pursuant to initial implementation of the directive of the Supervisor of Banks regarding the format of the statement of profit and loss of a banking corporation. See Note 1.D.1.

Note 28 - Earmarked Deposits, Credit and Deposits from Earmarked Deposits

	31 December 2012	31 December 2011
	NIS millions	
Credit and deposits from earmarked deposits		
Total credit to the public	**158**	220
Earmarked deposits		
Deposits of the public	**6**	8
Deposits from banks	**13**	24
Deposits from the Government	**173**	278
Total	**192**	310

Note 29 - Condensed Financial Statements of the Bank

A. Balance sheet of the Bank as at 31 December 2012

	31 December 2012	31 December 2011
	NIS millions	
Assets		
Cash and deposits with banks	**49,438**	93,879
Securities	**49,475**	41,253
Securities borrowed or purchased under agreements to repurchase	**1,435**	1,225
Credit to the public	**211,255**	154,385
Allowance for credit losses	**(3,333)**	(2,777)
Credit to the public, net	**207,922**	151,608
Credit to governments	**426**	440
Investments in investee companies	**13,513**	16,870
Buildings and equipment	**3,248**	3,154
Assets in respect of derivative instruments	**11,308**	11,348
Other assets	**3,544**	2,943
Total assets	**340,309**	322,720

Liabilities and equity capital		
Deposits of the public	**274,482**	257,530
Deposits from banks	**7,066**	9,589
Deposits from governments	**260**	373
Securities loaned or sold under agreements to resell	**951**	385
Subordinated notes	**6,822**	7,719
Liabilities in respect of derivative instruments	**12,632**	11,860
Other liabilities	**13,175**	11,890
Total liabilities	**315,388**	299,346
Equity attributable to shareholders of the banking corporation	**24,921**	23,374
Total liabilities and equity	**340,309**	322,720

Note 29 - Condensed Financial Statements of the Bank (cont'd)

B. Condensed Statement of Profit and Loss for the year ended 31 December 2012

	2012	2011 (a)	2010 (a)
	NIS millions		
Interest income	**10,859**	11,552	9,771
Interest expenses	**5,521**	6,201	4,501
Net interest income	**5,338**	5,351	5,270
Expenses in respect of credit losses	**1,069**	600	340 (b)
Net interest income after expenses in respect of credit losses	**4,269**	4,751	4,930
Non-interest income			
Non-interest financing income	**386**	(221)	251
Commissions	**2,769**	2,791	2,812
Other income	**110**	34	113
Total non-interest income	**3,265**	2,604	3,176
Operating and other expenses			
Salaries and related expenses	**4,104**	3,921	3,656
Maintenance and depreciation of buildings and equipment	**1,400**	1,313	1,201
Other expenses	**1,270**	964	950
Total operating and other expenses	**6,774**	6,198	5,807
Profit before taxes	**760**	1,157	2,299
Provision for taxes on profit	**430**	198	861
Profit after taxes	**330**	959	1,438
Bank's share in the profits, net of operating profit of investee companies after the effect of tax	**601**	932	896
Net profit	**931**	1,891	2,334

(a) Reclassified pursuant to initial implementation of the directive of the Supervisor of Banks regarding the format of the statement of profit and loss of a banking corporation. See Note 1.D.1.

(b) Comparative figures of expenses in respect of credit losses for 2010 have not been restated pursuant to the implementation of the new directives and are not comparable with figures of 2011 and 2012.

Note 29 - Condensed Financial Statements of the Bank (cont'd)

C. Statement of Cash Flows
for the year ending 31 December 2012

	2012	2011 (a)	2010 (a)
	NIS millions		
Cash flows from operating activities			
Net profit for the year	**931**	1,891	2,334
Adjustments:			
Bank's share in undistributed profits of investee companies including extraordinary profits less dividend received	**(497)**	(482)	(693)
Other, net (including provisions for doubtful debts and impairment of securities)	**12,797**	11,456	(5,732)
Net cash from operating activities	**13,231**	12,865	(4,091)
Cash flows from activities in assets			
Additional investments in shares of consolidated companies	**(66)**	(691)	-
Proceeds from sale of investments in investee companies	**(24,723)**	-	-
Other	**(5,987)**	7,807	(3,260)
Net cash from activities in assets	**(30,776)**	7,116	(3,260)
Cash flows from activities in liabilities and capital			
Issue of debentures and subordinated notes	**-**	-	2,375
Dividend paid to shareholders	**(2,554)**	(149)	(372)
Issue of shares to employees	**-**	(900)	(500)
Other	**-**	(40)	359
Net cash from activities in financing activities	**(2,554)**	(1,089)	1,862
Increase (decrease) in cash	**(20,099)**	18,892	(5,489)
Balance of cash at beginning of year	**65,684**	46,241	52,389
Effect of exchange rate changes on cash balances	**(125)**	551	(659)
Balance of cash at end of year	**45,460**	65,684	46,241

(a) Reclassified pursuant to initial implementation of the directive of the Supervisor of Banks regarding the format of the statement of profit and loss of a banking corporation. See Note 1.D.2.

Interest and taxes paid and/or received and dividends received

	For the year ended 31 December		
	2012	2011	2010
	NIS millions		
Interest received	**10,939**	10,649	9,186
Interest paid	**(5,798)**	(5,024)	(4,312)
Dividends received	**136**	480	233
Taxes paid on income	**(785)**	(670)	(579)

Note 29 - Condensed Financial Statements of the Bank (cont'd)

D. Information on the basis of historical nominal values for tax purposes

	31 December 2012	31 December 2011
	NIS millions	
Total assets	**338,602**	320,801
Total liabilities	**315,321**	299,300
Shareholders' equity	**23,281**	21,501
Net profit (a)	**1,087**	1,871

(a) Not including profits (losses) of companies included on equity basis, as required under generally accepted accounting principles in Israel.

CONDENSED FINANCIAL STATEMENTS OF PRINCIPAL CONSOLIDATED COMPANIES

Bank Leumi USA
Chairman of the Board: D. Brodet
General Manager: I. Eyal

Condensed Consolidated Balance Sheet as at 31 December 2012 (US$ millions)

	2012	2011		2012	2011
Assets			**Liabilities and equity**		
Cash and deposits with banks	**687**	873	Deposits	**4,546**	4,855
Securities	**698**	679	Other liabilities	**189**	218
Loans	**3,705**	3,827	Capital notes	**90**	90
Buildings and equipment	**22**	16			
Other assets	**253**	285	Capital resources	**540**	517
Total assets	**5,365**	5,680	Total liabilities and capital resources	**5,365**	5,680

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (US$ millions)

	2012	2011
Income from finance operations before allowance for credit losses	**133**	133
Expenses in respect of credit losses	**7**	9
Income from finance operations after allowance for credit losses	**126**	124
Operating and other income	**49**	43
Operating and other expenses	**137**	137
Operating profit before taxes	**38**	30
Provision for taxes	**14**	10
Net profit	**24**	20

Leumi Private Bank*
Chairperson of the Board: G. Maor
General Manager: A. Zaidenberg

Condensed Consolidated Balance Sheet as at 31 December 2012 (CHF millions)

	2012	2011		2012	2011
Assets			**Liabilities and equity**		
Cash and deposits with banks	**872**	236	Deposits from banks	**38**	94
Loans	**736**	569	Deposits and other accounts	**1,577**	813
Securities	**260**	237	Subordinated notes	**50**	50
Other assets	**34**	32	Capital resources and reserves	**237**	117
Total assets	**1,902**	1,074	Total liabilities and capital resources	**1,902**	1,074
Customer investments (off-balance sheet)	**5,565**	3,564			

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (CHF millions)

	2012	2011
Interest income, net	**17**	22
Operating and other income	**66**	33
Operating and other expenses	**82**	50
Operating profit before taxes	**1**	5
Provision for taxes	**1**	1
Net profit	**-**	4
Dividend paid	**-**	70

* Until 3 January 2012, the name of the Bank was Bank Leumi (Switzerland) Ltd.

Bank Leumi (UK) plc
Chairman of the Board: Y. Minz*
Chief Executive Officer: L. Weiss

Condensed Consolidated Balance Sheet as at 31 December 2012 (£ millions)

	2012	2011		**2012**	2011
Assets			**Liabilities and equity**		
Cash and deposits with banks	**201**	146	Deposits	**1,235**	985
Loans	**1,298**	1,304	Deposits from banks	**150**	350
Securities	**102**	70	Subordinated notes	**84**	73
Equipment and buildings	**6**	5	Other liabilities	**11**	12
Other assets	**7**	14	Capital resources	**134**	119
Total assets	**1,614**	1,539	Total liabilities and capital resources	**1,614**	1,539

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (£ millions)

	2012	2011
Income from finance operations before allowance for credit losses	**38**	28
Expenses (income) in respect of credit losses	**18**	(1)
Income from finance operations after allowance for credit losses	**20**	29
Operating and other income	**14**	15
Operating and other expenses	**28**	28
Operating profit before taxes	**6**	16
Provision for taxes on operating profit	**1**	4
Net profit	**5**	12

* Began serving as Chairman of the Board of Directors on 22 May 2012.

Bank Leumi (Luxembourg) S.A.
Chairman of the Board: Z. Itskovitch
General Manager: G. Karni

Condensed Consolidated Balance Sheet as at 31 December 2012 (€ millions)

	2012	2011		**2012**	2011
Assets			**Liabilities and equity**		
Cash and deposits with banks	**347**	478	Deposits of the public	**397**	413
Securities	**29**	58	Deposits from banks	**29**	153
Credit to the public	**92**	68	Other liabilities	**5**	6
Other assets	**5**	7	Total liabilities	**431**	572
			Shareholders' equity	**42**	39
Total assets	**473**	611	Total liabilities and shareholders' equity	**473**	611

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (€ millions)

	2012	2011
Net interest income	**6**	6
Operating and other income	**6**	6
Operating and other expenses	**8**	7
Net profit	**4**	5

Bank Leumi Romania S.A.

Chairman of the Board: Z. Itskovitch**

Director and Executive President: L. Mitrache

Condensed Consolidated Balance Sheet as at 31 December 2012 (RON millions)*

	2012	2011		**2012**	2011
Assets			**Liabilitities and equity**		
Cash and deposits in banks	**161**	306	Deposits	**614**	636
Loans	**775**	726	Deposits from banks	**304**	281
Securities	**186**	83			-
Equipment and buildings	**19**	18	Other liabilities	**8**	10
Other assets	**9**	5	Capital resources	**224**	211
Total assets	**1,150**	1,138	Total liabilities and capital resources	**1,150**	1,138

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (RON millions)*

	2012	2011
Net interest income before expenses in respect of credit losses	**49**	69
Expenses in respect of credit losses	**5**	77
Net interest income (loss) after expenses in respect of credit losses	**44**	(8)
Operating and other income	**21**	17
Operating and other expenses	**55**	59
Operating loss	**10**	(50)
Income from taxes	**3**	-
Net profit	**13**	(50)

* 1 RON = NIS 1.1095.

** On 6 March 2013, Mr. Yoel Mintz was appointed Chairman of the company.

The Arab Israel Bank Ltd.
Chairman of the Board: Z. Nahari*
Chief Executive Officer: D. Gitter

Condensed Consolidated Balance Sheet as at 31 December 2012 (NIS millions)

	2012	2011		**2012**	2011
Assets			**Liabilities and equity**		
Cash and deposits with banks	**1,467**	1,336	Deposits of the public	**4,345**	3,892
Securities	**398**	571	Deposits from banks	**824**	1,056
Credit to the public	**4,147**	3,774	Subordinated notes	**157**	158
Allowance for credit losses	**(54)**	(50)	Other liabilities	**251**	231
Credit to the public, net	**4,093**	3,723			
Buildings and equipment	**69**	62	Total liabilities	**5,577**	5,338
Other assets	**78**	68	Equity	**527**	424
Total assets	**6,104**	5,761	Total liabilities and equity	**6,104**	5,761

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (NIS millions)

	2012	2011
Net interest income before expenses in respect of credit losses	**283**	265
Expenses in respect of credit losses	**15**	7
Net interest income after expenses in respect of credit losses	**268**	259
Operating and other income	**123**	114
Operating and other expenses	**233**	220
Operating profit before taxes	**159**	153
Provision for taxes on operating profit	**55**	44
Net profit	**103**	109

* Until 31 March 2012, Mr. S. Zussman served as Chairman of the Board of Directors.

Leumi Card Ltd.
Chairman of the Board: B. Lederman*
Chief Executive Officer: T. Yassur**

Condensed Consolidated Balance Sheet as at 31 December 2012 (NIS millions)

	2012	2011		2012	2011
Assets			**Liabilities and equity**		
Cash and deposits with banks	**42**	58	Credit from banking corporations	**1,596**	1,338
Receivables in respect of credit card activity	**8,780**	8,095	Payables in respect of credit card activity (b)	**6,010**	5,723
Allowance for the credit losses	**(72)**	(69)	Other liabilities (b)	**162**	161
Receivables in respect of credit card activity, net	**8,708**	8,026	Total liabilities	**7,768**	7,222
Investment in companies included on equity basis and others	**1**	4	Equity	**1,232**	1,092
Equipment	**190**	175			
Other assets	**59**	51			
Total assets	**9,000**	**8,314**	Total liabilities and equity	**9,000**	**8,314**

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (NIS millions)

	2012	2011 (a)
Income from credit card transactions	**795**	789
Net interest income	**156**	150
Other income	**3**	1
Expenses in respect of credit losses	**19**	15
Operating and other expenses (b)	**688**	683
Profit before taxes	**247**	242
Provision for taxes on profit	**69**	65
Profit after taxes	**178**	177
Company's equity in profits after the effect of taxes of companies included on equity basis	**2**	- (c)
Net profit	**180**	177

(a) Pursuant to first-time adoption of directives of the Supervisor of Banks.
(b) Reclassified.
(c) Amounts less than NIS 1million.

* As of 1 January 2013, Ms. Tamar Yassur was appointed Chairperson of the Board of Directors of the company.
** As of 1 January 2013, Mr. Haggai Heller was appointed CEO of the company.

Leumi Partners Ltd.
Chairman of the Board: D. Tsiddon*
Executive President: Y. Bloch

Condensed Consolidated Balance Sheet as at 31 December 2012 (NIS millions)

	2012	2011		**2012**	2011
Assets			**Liabilities and equity**		
Cash and deposits with banks	**68**	126			
Securities	**1,130**	1,076	Other liabilities	**22**	27
Investment in investee companies	**441**	410			
Fixed assets	**4**	4	Capital notes	**1,154**	1,150
Other assets	**3**	7	Shareholders' equity	**473**	446
Total assets	**1,646**	1,623	Total liabilities and shareholder's equity	**1,649**	1,623

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (NIS millions)

	2012	2011
Loss from financing operations	**(2)**	(5)
Operating and other income	**(42)**	(166)
Operating and other expenses	**33**	39
Operating loss before taxes	**(77)**	(210)
Benefit from taxes on operating profit	**(3)**	(46)
Net operating loss after taxes	**(75)**	(164)
Company’s equity in the net profit of companies included on equity basis	**32**	56
Net loss	**(43)**	(108)

* Began serving as Chairman of the Board of Directors on 1 July 2012.

Leumi Finance Company Ltd.
Chairman of the Board: M. Aisenthal
Executive President: O. Shlosman

Condensed Consolidated Balance Sheet as at 31 December 2012 (NIS millions) (a)

	2012	2011		**2012**	2011
Assets			**Liabilities and equity**		
Cash and deposits in banks	**20,851**	18,306	Debentures and subordinated notes	**20,693**	18,149
Other assets	**-**	1			
			Equity	**158**	158
Total assets	**20,851**	18,307	Total liabilities and equity	**20,851**	18,307

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (NIS millions)

	2012	2011
Net interest income	**25**	20
Operating and other expenses	**5**	2
Operating profit before taxes on income	**20**	18
Provision for taxes on income	**8**	6
Net profit	**12**	12
Dividend paid	**-**	11

(a) The financial statements have been prepared by the company in accordance with International Financial Reporting Standards (IFRS).

Leumi Leasing and Investments Ltd.
Chairman of the Board: E. Katzav
Executive President: I. Weizmann

Condensed Consolidated Balance Sheet as at 31 December 2012 (NIS millions)

	2012	2011		**2012**	2011
Assets			**Liabilities and equity**		
Cash and deposits in banks	**379**	119	Deposits from banks	**79**	168
			Other liabilities	**2**	4
Credit to the public	**658**	981	Total liabilities	**81**	171
Other assets	**12**	12	Shareholders' equity	**968**	941
Total assets	**1,049**	1,113	Total liabilities and shareholders' equity	**1,049**	1,113

Condensed Statement of Profit and Loss for the year ended 31 December 2012 (NIS millions)

	2012	2011
Net interest income before expenses in respect of credit losses	**46**	58
Other income	**2**	2
Impairment of investment	**-**	(1)
Operating income before expenses in respect of credit losses	**48**	59
Expenses in respect of credit losses	**2**	3
Operating income after expenses for credit losses	**46**	56
Operating expenses	**10**	11
Operating profit before taxes	**36**	45
Provision for taxes on operating profit	**9**	10
Net profit	**27**	35