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

# Annual Report 2014

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.co.il.
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 2014

## Index

**Bank Leumi le-Israel B.M.**
# Members of the Board of Directors(*)(**)

**David Brodet, Chairman**

**David Avner(d)**

**Rami Avraham Guzman(b)**

**Prof. Arieh Gans(b)**

**Moshe Dovrat**

**Dr. Samer Haj Yehia (e)**

**Shai Shachnai Hermesh**

**Professor Haim Levy(e)(b)**

**Yoav Nardi**

**Adv. Haim Samet(a)**

**Nurit Segal**

**Zipporah Samet(a)(c)**

**Prof. Efraim Sadka(b)**

**Professor Yedidya Zvi Stern(b)**

**Prof. Gabriela Shalev(a)**

(a) External director pursuant to the Companies Law, 1999.
(b) External director pursuant to Proper Conduct of Banking Management Regulation no. 301
(c) On 25 July 2014, Ms. Samet ceased to serve as director in the Bank and was re-elected as external director pursuant to the Companies Law at the Annual General Meeting of the Bank held on 6 August 2014, for a period of three years with effect from 18 August 2014.
(d) On 25 July 2014, Mr. Avner ceased to serve as director in the Bank and was re-elected at the Annual General Meeting of the Bank held on 6 August 2014. He commenced his term of office on 18 August 2014.
(e) Elected at the Annual General Meeting held on 6 August 2014. The term of office of Professor H. Levy came into effect on 1 November 2014 and the term of office of Dr. Samer Haj Yehia commenced on 30 September 2014.

* Ms. Miri Katz served as director in the Bank until 25 July 2014. Mr. Amos Sapir served as director in the Bank until 31 October 2014.
** For information on changes which occurred in the composition of Board of Directors during the report period, see Chapter "Changes in the Board of Directors", below.

Further details on the Bank management are presented in the Periodic Report of the Bank for 2014 and on the Magna website of the Israel Securities Authority http://www.magna.isa.gov.il.

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

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

**Prof. Daniel Tsiddon**
Deputy Chief Executive Officer

**Yaacov (Kobi) Haber**
First Executive Vice President, Head of Corporate and Commercial Division

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

**Itai Ben-Zeev**
Executive Vice-President, Head of Capital Markets Division

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

**Tamar Yassur**
Executive Vice President, Head of Banking Division

**Dan Yerushalmi**
Executive Vice President, Head of Leumi Technologies Division

**Yoel Mintz**
Executive Vice President, Head of International Credit and Real Estate Division

**Ron Fainaro C.P.A. (Isr.)**
Executive Vice President, Head of Finance Division

**Hanan Friedman Adv,**
Executive Vice-President, Chief Legal Counsel, Head of Legal Division and Legal Risks Manager

**Shlomo Goldfarb, C.P.A. (Isr.)**
Executive Vice President, Chief Accounting Officer and Head of Accounting Division

---

**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

For information on changes that have occurred relating to the management of the Bank during 2014, see Chapter on Human Resources, Appointments and Retirements and Organizational Structure, below.

* Further details on the Bank management are presented in the Periodic Report of the Bank for 2014 and on the Magna website of the Israel Securities Authority http://www.magna.isa.gov.il.

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

# Directors' Report

The following is the sixty-fourth annual report of Bank Leumi le-Israel B.M. and the one hundred and thirteenth 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.

# 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 113 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 financial banking 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, and through overseas branches and representative offices.

The Group's policy, in Israel and overseas, is to provide its customers with comprehensive banking and financial solutions 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 a strategy to deal with these changes.

To implement its strategy, the Bank is organized into four 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; Retail Banking concentrates on providing banking services mainly to households, small businesses and wealthy customers who require investment solutions at high level of complexity within the framework of Private Banking; and the Capital Market and Financial Management Division coordinates the activities of all the dealing rooms and *nostro* rooms under one roof, with a view to improving and expanding the range of services to customers who are active in the capital and financial markets, including institutional customers.

Some of the financial services are provided by means of subsidiary companies that operate in various fields, such as: credit cards, retail, banking for hi-tech customers and underwriting.

Furthermore, the Group invests in non-banking corporations operating in the various fields inside and outside Israel. The management of the non-banking investment portfolio is mostly conducted through the subsidiary, Leumi Partners Ltd.

---

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.

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 and technology-based solutions (Fintech companies) that focus on areas of banking activity, mainly with retail customers.

The Israeli economy grew in real terms by some 2.9% in 2014, lower than in 2013, when it was 3.2%, which was partly affected by the Operation Protective Edge.

For further details, see the Chapter, Principal Developments in the Economy, below.

Total assets under management of the Group (both balance sheet and off-balance sheet*) amounted to NIS 1,222 billion as at 31 December 2014, compared with NIS 1,159 billion at the end of 2013, an increase of some 5.5%, resulting primarily from an increase in the scope of activity and an increase 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.

### Below are principal data:

| | As at 31 December | | | | |
|---|---|---|---|---|---|
| | **2014** | 2013 | 2012 | 2011 | 2010 |
| | NIS millions | | | | |
| Total assets | **396,134** | 374,540 (a) | 376,345 (a) | 365,854 | 328,322 |
| Credit to the public, net | **252,480** | 240,874 | 241,264 | 241,320 | 223,981 |
| Securities | **52,113** | 63,735 | 56,408 | 47,936 | 55,791 |
| Cash and deposits in banks | **60,615** | 44,351 | 54,621 | 53,044 | 30,052 |
| Investment in companies included on equity basis | **2,216** | 1,689 | 2,129 | 2,270 | 1,924 |
| Deposits of the public | **303,397** | 286,003 | 289,538 | 279,404 | 249,584 |
| Debentures, notes, and subordinated notes | **23,678** | 25,441 | 27,525 | 29,999 | 26,939 |
| Equity attributable to shareholders of the banking corporation | **28,093** | 26,129 (a) | 24,590 (a) | 23,374 | 23,293 |

(a) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R

### Below are principal data:

| | For the year ended 31 December | | | | |
|---|---|---|---|---|---|
| | **2014** | 2013 (a) | 2012 (a) | 2011 | 2010 |
| | NIS millions | | | | |
| Net interest income (b) | **7,363** | 7,357 | 7,408 | 7,107 | 6,972 |
| Expenses (income) in respect of credit losses | **472** | 268 | 1,236 | 734 | 584 |
| Total non-interest income | **5,173** | 5,517 | 4,774 | 4,175 | 4,767 |
| Of which: Commissions (b) | **4,167** | 4,188 | 4,199 | 4,116 | 4,129 |
| Total operating and other expenses | **9,311** | 8,892 | 9,120 | 8,341 | 7,961 |
| Of which: Salary expenses | **4,968** | 5,133 | 5,310 | 5,061 | 4,686 |
| Expenses relating to the arrangements with overseas suthorities | **1,026** | 236 | 396 | - | - |
| Profit before taxes | **2,753** | 3,714 | 1,826 | 2,207 | 3,194 |
| Provision for taxes | **1,281** | 1,397 | 800 | 418 | 1,241 |
| Net profit attributable to shareholders of the banking corporation | **1,502** | 1,982 | 922 | 1,891 | 2,334 |
| Net profit per share attributable to shareholders of the banking corporation (in NIS) | **1.02** | 1.35 | 0.63 | 1.28 | 1.58 |
| Total profit for the period attributable to shareholders of the banking corporation (c) | **1,888** | 1,493 | 1,579 | 1,659 | * |

(a) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R

(b) In 2014, Directive 310 was implemented for the first time, providing for the format of the statement of profit and loss for a banking corporation and the adoption of the generally accepted accounting principles in banks in the United States on the subject of the measurement of interest income which impacted net interest income and the item, commissions (see Note 1 to the financial statements).

(c) Pursuant to the directives of the Bank of Israel, the data for the total profit for the period attributable to shareholders of the banking corporation from 2011 should be presented.

**Below are principal financial ratios (in %):**

| | As at 31 December | | | | |
|---|---|---|---|---|---|
| | **2014** | 2013 (f) | 2012 (f) | 2011 | 2010 |
| Credit to the public, net, to total balance sheet | **63.7** | 64.3 | 64.1 | 66.0 | 68.2 |
| Securities to total balance sheet | **13.2** | 17.0 | 15.0 | 13.1 | 17.0 |
| Deposits of the public to total balance sheet | **76.6** | 76.4 | 76.9 | 76.4 | 76.0 |
| Deposits of the public to total credit net | **120.2** | 118.7 | 120.0 | 115.8 | 111.4 |
| Total equity to risk assets (a) (e) | **14.01** | 14.70 | 14.87 | 14.34 | 14.96 |
| Tier I capital to risk assets (e) | **9.21** | 9.32 | 8.55 | 8.07 | 8.43 |
| Equity (excluding non-controlling interests) to balance sheet | **7.1** | 7.0 | 6.5 | 6.4 | 7.1 |
| Net profit to average equity (excluding non-controlling interests) | **5.5** | 7.8 | 3.8 | 8.3 | 10.3 |
| Rate of provision for tax on the profit before taxes | **46.5** | 37.6 | 43.8 | 18.9 | 38.9 |
| Expenses in respect of credit losses to credit to the public, net | **0.19** | 0.11 | 0.51 | 0.30 | 0.26 |
| Of which: expenses in respect of collective allowance to credit to the public, net | **0.22** | 0.11 | 0.13 | 0.15 | 0.02 |
| Expenses in respect of credit losses to total risk of credit to the public | **0.14** | 0.07 | 0.34 | 0.20 | 0.17 |
| Interest income, net to total balance sheet | **1.86** | 1.96 | 1.97 | 1.94 | 2.12 |
| Total income to total assets (b) | **3.16** | 3.44 | 3.24 | 3.08 | 3.58 |
| Total income to total assets managed by the Group (b) (c) | **1.03** | 1.10 | 1.16 | 1.19 | 1.49 |
| Total operating and other expenses to total assets | **2.35** | 2.37 | 2.42 | 2.28 | 2.42 |
| Total operating and other expenses to total assets managed by the Group (c) | **0.76** | 0.76 | 0.87 | 0.88 | 1.01 |
| Net profit to total average assets (d) | **0.41** | 0.53 | 0.26 | 0.56 | 0.73 |
| Interest margin (g) | **1.98** | 1.87 | 1.87 | 2.12 | 2.58 |
| Operating and other expenses (without early retirement) to total income (b) | **74.3** | 68.5 | 72.2 | 73.9 | 67.8 |
| Non-interest income to operating and other expenses (without early retirement) | **55.6** | 62.6 | 54.3 | 50.1 | 59.9 |
| Non-interest income to total income (b) | **41.3** | 42.9 | 39.2 | 37.0 | 40.6 |

(a) Capital – with the addition of noncontrolling interests, net of investments in banking and financial non-consolidated subsidiaries 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.
(e) Since 2014, the capital liquidity ratio has been computed in accordance with the provisions of Basel III directives. Until 2013 (inclusive), this was computed in accordance with the provisions of the Basel II directives.
(f) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R.
(g) The interest gap in 2010 was computed according to the old format. The interest gap excludes the effect of derivatives and includes exchange rate differences.

Net profit attributable to the shareholders of the banking corporation (hereinafter: the "net profit") was significantly impacted in 2014 by expenses in respect of the investigations connected to foreign customers.

The summary of financial results as reported in the profit and loss statement and excluding the abovementioned effects is as follows:

| | Year | |
|---|---|---|
| | 2014 | 2013 |
| Reported net profit | 1,502 | 1,982 (a) |
| Reported return on capital | 5.5% | 7.8% (a) |
| Effect of provision in respect of arrangements with overseas authorities | 1,024 | 221 |
| Profit excluding the provision in respect of arrangements with overseas authorities | 2,526 | 2,203 |
| Return excluding the provision in respect of arrangements with overseas authorities | 9.3% | 8.7% |

(a) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R.

The factors which affected the improvement in **net profit in 2014**, excluding the negative impact of the provision in respect of arrangements with overseas authorities as detailed above, are a decrease of NIS 371 million (before the effect of tax) in total operating and other expenses and an improvement of NIS 335 million in the contribution of companies included on equity basis as a result of a decrease in the loss accrued in respect of the Israel Corporation. In 2014, a loss of NIS 8 million in respect of the Israel Corporation compared with a loss amounting to NIS 340 million which was recorded last year.

On the other hand, there was an increase in credit loss expenses amounting to NIS 204 million, primarily as a result of the initial implementation of the Bank of Israel directives relating to the "Collective allowance in respect of credit to private individuals" in respect of the balance as of 31 December 2014 and an increase in the expenses in respect of credit losses in the office in Romania due to the local regulatory requirements. In addition, noninterest income fell by NIS 332 million (before the effect of tax), as will be set forth in the Chapter, "Development of Income and Expenses, Noninterest Income", below.

The loss in the fourth quarter of 2014 amounted to NIS 111 million, compared to a profit of NIS 356 million in the corresponding period last year.

The loss in the fourth quarter of 2014 is mainly explained by an increase in expenses in respect of credit losses amounting to NIS 328 million and from a decrease in noninterest financial income amounting to NIS 162 million (before the effect of tax).

Net profit per share attributable to the shareholders of the banking corporation was NIS 1.02 in 2014, compared with NIS 1.35 in 2013, and a loss per share of NIS 0.07 in the fourth quarter of the year, compared with NIS 0.25 in the corresponding period last year.

Return on capital in 2014 was 5.5% compared with 7.8% in 2013.

Total profit after the effect of tax (in addition to the net profit, also including adjustments in respect of the presentation of available-for-sale securities at fair value and adjustments from the translation of financial statements) in 2014 amounted to NIS 1,888 million, compared to NIS 1,493 million in the corresponding period last year. The increase is primarily attributable to positive adjustments in respect of available-for-sale securities amounting to NIS 355 million before tax in 2014, compared with negative adjustments in respect of available-for-sale securities amounting to NIS 518 million in 2013.

For further details, see Chapter "Structure and Development of Assets and Liabilities", Chapter "Securities", below.

In the fourth quarter of 2014, the comprehensive income amounted to a loss of NIS 72 million, compared with a comprehensive income of NIS 337 million in the corresponding period last year.

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:

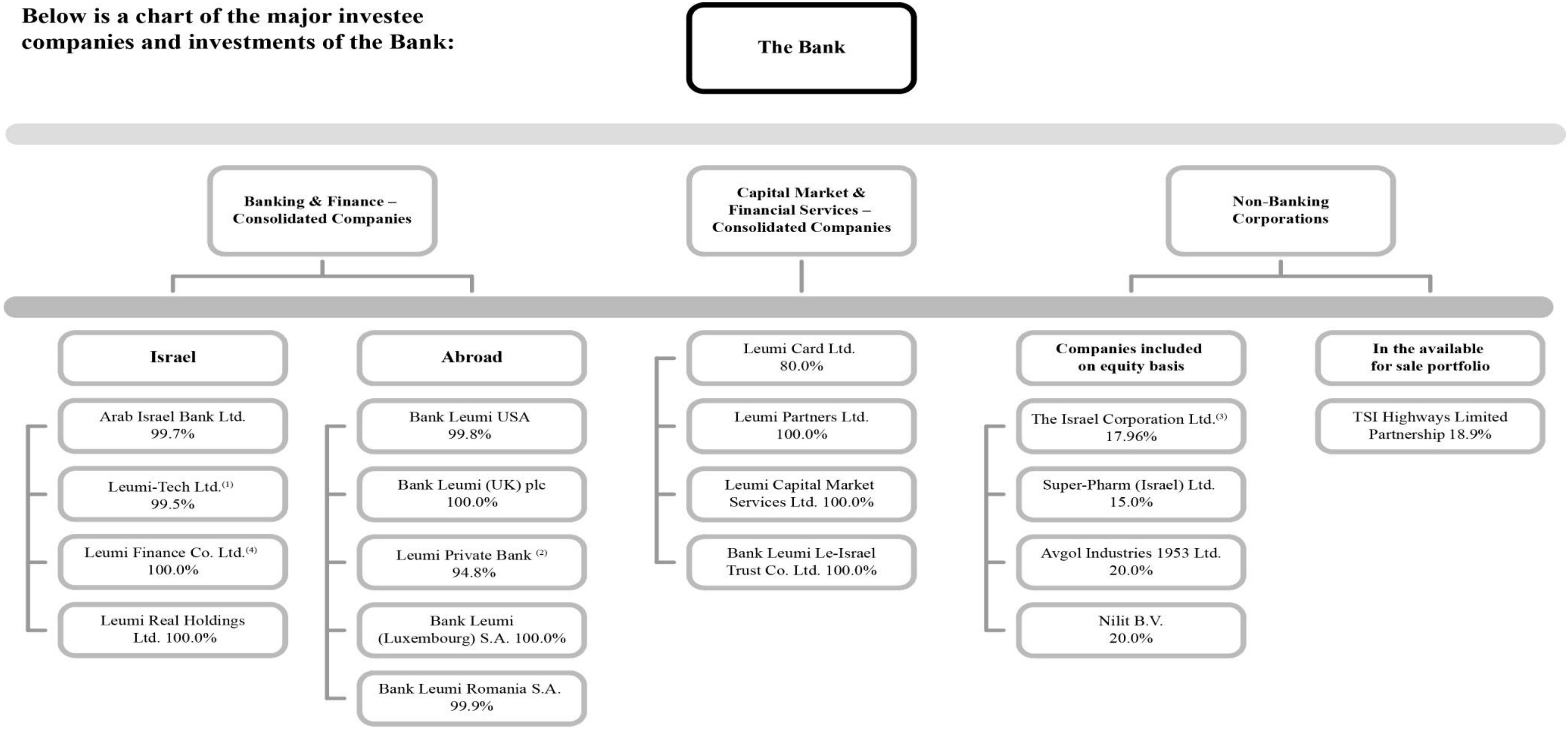
| | **2014** | | 2013 | |
|---|---|---|---|---|
| | Total investment | Contribution to net profit | Total investment | Contribution to net profit |
| | NIS billions | NIS millions | NIS billions | NIS millions |
| The Bank (b)(c) | **16.5** | **1,676** | 14.9 | 1,810 |
| Subsidiary companies in Israel (a) | **6.1** | **595** | 5.3 | 556 |
| Overseas subsidiary companies (b) | **4.1** | **(773)** | 4.6 | (52) |
| Companies included on equity basis | **1.4** | **4** | 1.3 | (332) |
| Total | **28.1** | **1,502** | 26.1 | 1,982 |

(a) Includes the profit and/or loss of companies included on equity basis of Leumi Partners Ltd.

(b) The provision in respect of the arrangements with overseas authorities was attributed to the Bank and the overseas subsidiaries in 2014. In 2013, the whole provision was recorded in the Bank in Israel.

(c) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R.

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




(1) Voting rights - 99.8%

(2) Voting rights - 98.6%. After the balance sheet date, the rate of holdings and voting rights is 99.84%. During 2014, agreements were signed for the sale of operations in Switzerland and an arrangement for participation with Bank Julius Baer.
For further information, see Chapter "Material agreements" below.

(3) Voting rights - 18.13% . In February 2015, the Bank sold 6.9% of the equity of the Israel Corporation. As a result of the sale of the company's shares, the shareholding percentage fell to 11.1%. For information regarding the waiver of the rights to appoint directors, see below Chapter "Operating segments, companies included on equity basis".

(4) The company was merged with and into Bank Leumi on 4 January 2015.

## Basel General (Table 1 – Basel):

**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, "Principal Investee Companies" 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, intangible assets (some NIS 189 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 and subordinated notes by the Bank in overseas companies. 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 exposures of any type *vis-à-vis* related companies. The maximum rate of exposure towards the Group (except for Bank Leumi Le-Israel and the subsidiary in Jersey) is 25% of the Bank's capital in the UK. The maximum rate of exposure towards Bank Leumi Le-Israel and Bank Leumi (Jersey) is 100% of the Bank's capital in the United Kingdom.

## 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 these reports.

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

## Merger between Leumi Finance Ltd. ("Leumi Finance")

On 11 November 2014, the Board of Directors of the Bank and the Board of Directors of Leumi Finance approved the merger of Leumi Finance with the Bank. See Immediate Reports dated 11 November 2014 (ref. no. 2014-01-192870 and 2014-01-192879).

On 4 January 2015, the merger was completed and the merger certificate was received from the Registrar of Companies according to which the Bank absorbed Leumi Finance.

See Immediate Report dated 4 January 2015 (Ref. no. 2015-01-002113).

The merger which was executed is a statutory merger, 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 (New Version), 1963 ("the Ordinance"), whereby Leumi Mortgage transferred its assets and liabilities to the Bank, such that on completion of the merger, Leumi Finance ceased to exist.

Until the date of the merger, Leumi Finance has operated in the area of raising sources of finance in Israel for the Bank, through public and private offerings of securities which did not confer the right to participate in Leumi Finance and were not convertible to shares – for example, debentures, deferred notes and deferred capital notes ("Leumi Finance liability notes").

There was no change in the terms of the liability notes as a result of the merger.

**Aim of the merger:**

The merger serves both a business and an economic purpose and its objects, *inter alia*, are to bring significant savings in operating expenses and costs.

**Approval of the Tax Authority – Replacement of the liability notes incidental of the merger**

On 26 November 2014, approval was received from the Tax Authority pursuant to which the replacement of Leumi Finance liability notes with the new liability notes ("the approval") will not be considered as a sale in the hands of the holders of the Leumi Finance liability notes pursuant to the provisions of the Ordinance and tax continuity will apply. According to the approval for the purpose of computing the gain on the initial sale of the new liability notes in the future, the original price and the purchase date will be determined for tax purposes, according to the original price and purchase date of Leumi Finance liability notes prior to the merger. In accordance with the terms of the approval, the Bank and Leumi Finance furnished the Tax Authority with notice of their consent to accept all of the terms of the approval, to the letter and without qualification.

**Ruling of the Tax Authority – Change in structure in Leumi Group**

On 9 December 2014, the ruling of the Tax Authority ("tax ruling") was given, confirming that the details of the merger plan, as conveyed in a request submitted to the Tax Authority, and subject to compliance with the terms provided in the Ordinance, comply with the conditions set forth in Section 103C of the Ordinance.

1. The main points of the tax ruling are as follows:

   1.1 The date of the merger was set at 31 December 2014 ("the merger date").

   1.2 No new rights in the Bank will be allocated to the shareholders therein because of the merger. Accordingly, on the sale of the Bank's shares, the cost of investment in the shares of Leumi Finance will not be added to the original price of the shares as aforesaid. The cost/investment amount will be canceled, and will not be permitted in any way for tax purposes, either directly or indirectly. In addition, the assets and liabilities transferred to the Bank will be subject to the provisions of Section 103E of the Ordinance, and no additional amount in excess of their original price will be attributed to them, as it was in Leumi Finance.

   1.3 No expense and/or loss whatsoever will be allowed in the hands of the Bank and/or a third party thereto due to the merger.

   1.4 Every expense and/or deduction accrued in Leumi Finance and in the Bank through the date of the merger and not allowed for tax purposes through this date ("the expenses"), and if they were allowed as a deduction, a loss would be incurred at the merger date, will be considered as a part of the losses of Leumi Finance and/or the Bank, as appropriate, through the merger date, and the provisions of Section 103H of the Ordinance will apply, all this, if they were allowed as a deduction for tax purposes within two years of the merger date. It was clarified that the provisions of this section do not contain anything to detract from the provisions of Section 103H of the Ordinance. In addition, it was clarified the tax ruling does not constitute the approval of the allowance of the expenses as stated in this section, an issue which will be examined by the assessing officer.

2. General clarifications

   2.1 If it becomes clear that the provisions of the terms set forth in Section 103C of the Ordinance are not fulfilled ("a breach"), the Bank and Leumi Finance will be liable to taxes and compulsory payments from which an exemption thereto was given, with the addition of linkage differences and interest from the merger date and through the date of payment, and all in accordance with the provisions of Section 103J of the Ordinance. In the case in question, an expert's valuation of Leumi Finance as of the merger date in accordance with the Income Tax Rules (Request for the Prior Approval for a Merger Plan), 1995, will be submitted to the assessing officer immediately prior to the date of the breach. The aforesaid valuation will require the approval and consent of the assessing officer.

   2.2 The tax ruling is contingent on the complete fulfillment of the other conditions stipulated in the Ordinance and the tax ruling, including the terms relating to the required period, as defined in Section 103 of the Ordinance, the effective date of which is the merger date. The tax ruling is contingent on full compliance with the conditions set forth in the Ordinance and the tax ruling, including the conditions relating to the required period, as defined in Section 103 of the Ordinance, which was effective on the date of the merger.

2.3 The Bank and Leumi Finance have undertaken to include a note on the fact of making a change of structure in their financial statements and in the tax reconciliations, and the terms of the tax ruling will be set forth therein. The note is presented from the first statements to be submitted following the receipt of the tax ruling.

2.4 The tax ruling does not constitute any approval of making an assessment and/or confirmation of the facts presented by the Bank and Leumi Finance. The facts presented as aforesaid can and will be examined by the assessing officer.

2.5 The tax ruling was given on the basis of the presentations and documents submitted in writing and verbally, including those set forth in the tax ruling, subject to the terms in Part Two of the Ordinance. The tax ruling will be retroactively cancelled if it becomes clear that the details and facts which were furnished pursuant to the request for the ruling are materially incorrect or incomplete, or if it becomes clear that material details set forth are not fulfilled or that the conditions stipulated by the manager in the tax ruling have not been fulfilled.

2.6 It is clarified that all expenses related, directly and indirectly, to this change in structure, including legal expenses, audit fees, the cost of experts, consultants and fees, will not be allowed as a deduction, directly and/or indirectly, for parties participating in the change in the structure outlined in the tax ruling and/or a party related thereto, as a deduction or as an expense pursuant to Section 17 of the Ordinance.

2.7 Leumi and Leumi Finance have undertaken, jointly and severally, to confirm in writing to the Mergers and Splits Department in the Tax Authority and to the Assessing Officer, within 30 days from the date of receiving the tax ruling that they agree to accept all of the terms of the tax ruling to the letter and without qualification. Such confirmations have been furnished as required.

## Leumi's Vision

### To lead enterprising and innovative banking for the customer

At the basis of the vision is the aspiration to devise a dynamic system, which combines the Bank's values with product and technological innovation – a system that will be, for our customers, a place in which they can find the best and most suitable solution for their financial requirements, and, in so doing, derive a fair profit, maintain the Bank's stability and create a balance between the needs of the employees and the expectations of the shareholders. As a financial group, with major influence over the business and public culture in Israel, Leumi considers its commitment to the community to be a social and ethical anchor, which it will continue to nurture.

### Central trends in the activity environment

The competitive and business environment in which the Bank operates is complex and is influenced by several 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.

For information on the macro-economic environment in Israel and around the world, see the chapter, "Principal Developments in the Economy in the Report of the Board of Directors", below.

### Increased regulation

The impact of regulation on the banking sector continues to expand in Israel and throughout the world, with the regulatory supervision focused on two main areas: regulation which is aimed to maintain the stability and reduce the extent of risk in their activity and regulation whose aim is to protect the consumer, to encourage competition and to bring an improvement in the services he receives.

Besides the local regulatory activities, the banks are also affected by global regulation. In light of the provisions of Basel III, the Bank of Israel tightened the capital adequacy requirements from the domestic banks. In addition, the enforcement of legislation of various countries on cross-border activity and activity *vis-à-vis* foreign residents continues to be increased, and within that, an agreement between the Ministry of Finance and the U.S. tax authorities came into force this year, according to which the banks and financial institutions in Israel are required to report on accounts of U.S. citizens pursuant to the Foreign Account Tax Compliance Act (FATCA) which was enacted in the United States.

In addition to the global effects, we are witness to several local legislative initiatives deriving mainly from the socioeconomic discourse and dealing with encouragement of competition and increased transparency in the banking system. One of the main local initiatives is the Zaken Committee for the Encouragement of Competition, which led to decisions whose implementation is of great significance to the banks' activity, such as the proposal for customer commission tracks, the approval for the opening and closing of accounts via the Internet, the issue of immediate debit cards (debit cards), a change in the definition of a small business, etc. A further major initiative which is expected to impact the market and the activities of the banks, is the Concentration Law, which is expected to lead to changes in ownership and control of financial and non-bank entities and in the banks' ability to invest in non-banks entities.

In addition to the restrictions regarding income, increased regulation creates material pressures for banks in terms of costs and inputs required for careful preparation and compliance with directives.

In addition, the regulations have an impact on competition and growth of the banking system in Israel, as they impose restrictions on the ability of banks to expand their activity through acquisitions and mergers or to enter into new areas of operation.

### The consumer environment

Economic, social and technological changes, with an emphasis on the increasing use of mobile phones and the wide sharing of information on social networks continue to increase consumer awareness and materially change consumption habits.

More so than in the past, the customer today expects banking to be fairer and more available and more accessible, simpler and more transparent. As mentioned above, the customer has high consumer awareness and is linked to other consumers, particularly through social networks. He is also more aware of his purchasing experience, a fact which gives him know-how and a large amount of bargaining power. The customer consumes information and services through a wide array of digital and physical channels and expects a uniform service experience using the various interfaces with the Bank. The digital channels are becoming an increasing focus of activity in the customer's interface with the Bank.

The strengthening of the impact of technological innovation may be seen in consumer trends, foremost of which is the use of mobile phones. The ever-increasing use of smart phones around the world, and in Israel, in particular, alters consumer habits, the mode of payment, the purchasing experience, the purchasing location, etc. The consumer is continually connected and expects to receive services and information in every place and at any time of day, in line with his choice and preferences.

Banks around the world invest many efforts in upgrading infrastructures that will allow for better familiarity with the customer, simplification of the interface with him, adaptation of value proposals to his needs and preferences and the use of crowd wisdom and gamification. At the same time, non-bank entities develop services which set a new standard in customer experience and direct competition with the banks in various areas.

**Competitive environment**

**Domestic banks**

In 2014, the trend of increase in the level of competition in all of the banking sectors of activity continued. The domestic banks continue to focus on households (*inter alia*, through consumer credit and mortgages) and in the small and medium business segments. They are taking steps to enroll new customers and increase the scope of activity, and focus efforts on developing innovative digital services, launching value proposals based on customer clubs, establishing new multi-channel service models and improving their operating efficiency.

**Non-bank competitors**

Loans by institutional entities – In recent years, there has been a clear trend of increasing loans of institutional entities to the business sector. These loans are characterized by large amounts, and are therefore, in most cases, designated for large corporations. In addition, as a part of the trend of institutional entities to grant direct loans, the trend of granting finance to infrastructure projects and to income-generating properties, and supporting the construction of residential projects (usually in cooperation with the commercial banks) has continued. Against the backdrop of the increase in the volume of activity of the institutional entities in granting loans, the Goldschmidt Committee for the review of the method of investing by institutional entities in private loans was set up, and, in the past year, it published its final conclusions. These conclusions have not yet been enacted in a final circular of the Finance Ministry. The committee's conclusions are likely to make it difficult for banks to assume the status of organizing a transaction, and *inter alia*, adversely affect the position of Israeli banks *vis-à-vis* foreign banks.

Technology-based players – In recent years, with the expansion in consumers' use of advanced technology (particularly mobile phones), the supply and quality of ventures/developments offering high-tech based financial services are becoming greater and greater (Fintech). Most of 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 (including peer-to-peer models), savings and financial management services.

Internet and social bank models – In recent years, the trend of setting up Internet banks, a large proportion of which are being established by the traditional banks themselves, has become widespread. These banks offer a basket of services in direct channels (with restricted access or no access at all to the branch) and are focused on retail customers who are interested in an advanced digital service experience, together with attractive price offers.

## Leumi's strategy

In order to realize Leumi's vision, and in accordance with the changes in the business environment, the Leumi Group has managed a comprehensive process for focusing and refreshing the Group's strategic goals.

Leumi Group has defined four strategic goals:

1. Upgrading the service model and value proposals to the targeted segments.
2. Assimilation of an organizational customer-centered culture – focusing on training and motivating employees of the organization in line with the Group's core values and vision.
3. Improving efficiency and flexibility – focusing on the human resource, information technology and procurement.
4. Creation of a qualitative and innovative technological environment – focusing on strengthening business performance and the Bank's ability to respond rapidly to constant changes in the activity environment.

The digital revolution and the significant and frequent technological changes create new challenges for the Bank. Leumi views this challenge as an opportunity for a material change in the modus operandi. This change includes an improvement in relations with the customer, a shortening of response times, reduction in costs and continuing innovation. A review of European banking shows that 11 of the 20 largest banks launched a discrete digital banking channel. Most of the digital banks or digital banking channels which have been set up around the world in recent years have been established by existing banks. In other cases, independent platforms have been acquired by existing banks and they have become a new channel, alongside the traditional retail activity of that bank. Leumi views this experiment in Europe as proof that the technological challenge is, in fact, an opportunity.

Digital banking brings banking activity to the customer when it enables the customer to access his entire activity using digital means, 24 hours a day, seven days a week, and does not require a face-to-face meeting with a bank official. It prevents errors, minimizes operating risks, limits exposure to frauds and embezzlements and facilitates maximum management of liquidity. Digital banking relies on a "lean" and effective platform, which is also cheaper for the customer. Such banking enables the customer to manage his financial requirements quickly, comfortably, with immediate and constant availability, easily and with maximum personal customization.

Bank Leumi has decided to promote a digital channel as a separate sub-brand. Leumi intends to launch the digital channel in stages commencing the beginning of 2016. The digital channel will provide its customers isolated products and services and it will be established on the basis of advanced, flexible and separate technological systems and work processes that will help it to be effective, and hence, also cheaper for customers. Although the digital banking is expected to create a service revolution, the Bank estimates that the anticipated annual investments are not material from the Bank's perspective.

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.

Strategic planning, by its nature, involves a fair amount of uncertainty, with the realization of long-term strategic plans dependent on many variables, including: the state of the markets in Israel and abroad, the security situation and the ongoing effects of regulatory changes, the extent of whose long term effects cannot yet be defined with certainty.

The Group's targets have been adapted to the lines of business in which Leumi operates, which are outlined below. Each business line is specialized in a defined section of the market and its purpose is to create a relative advantage among its target population.

**Savings and efficiency**

In 2012, Leumi Group defined a three-year streamlining program which represents a central pillar in the work plan from this year and henceforth.

The aim of the program was to bring material savings in the Group's operating expenses and an improvement in its efficiency ratio on a continuing and long-term basis.

The program included steps in the area of human resources and in other material expenditure areas and the targets that were defined as part of the plan for 2012-2014 were fully attained. In the context of the plan:

- The number of employees in the workforce was reduced on the basis of 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, which enabled the transfer of back-office activity from the branches to the centers of expertise, as well as structural changes in the Bank's offices.
- The reduction in the workforce also made possible a reduction in the amount of space the Bank uses and in related expenses. As a result of the reduction, assets that became redundant were sold or the rentals were ended.
- Steps were taken to utilize areas effectively, including examining the location of the Bank's sites for optimizing business activity vis-à-vis the cost of rentals and municipal rates.
- A culture of savings and efficiency of operations was assimilated.

In January 2015, a new collective agreement was signed in the Bank, which will be in effect for four years, which reduces the liabilities in respect of employee rights which are recorded in the Bank's books and increases the Bank's capital.

For further information regarding the new collective agreement, see Note 15 to the financial statements.

The changes in the collective agreement, compared to the previous agreement, will generate a current saving in operating salary expense. The Bank estimates that, for the period of the agreement, this saving will increase each year, reaching an aggregate total for the four years of the agreement, of NIS 250 million.

As part of the strategic target of improving efficiency and flexibility, Leumi Group intends to reduce the number of positions in the Group over the next three years (2015-2017) by about 1,000. This reduction is based on the streamlining procedure in the whole Group, mainly, in the Bank, but also, in the subsidiaries in Israel and abroad.

Within the Bank, most of the reduction in positions will come from natural retirement, positions in respect of which the Bank does not expect to recruit new employees, as well as in a reduction of the number of positions of temporary employees (particularly as a result of the implementation of changes of branch strategy). In the rest of the Group, the reduction in positions will be based mainly on the closure and/or sale of some of the Bank's activity abroad and the continuation of streamlining in the Group's activity in Israel,

An estimate of the expected saving in respect of the streamlining in positions and a change in the mix will amount to some NIS 300 million in the next three years.

It should be emphasized that the Bank's assessment regarding the aggregate annual savings constitutes forward-looking information and represents solely the Bank's forecasts, the realization of which is not certain and is based on the Bank's assessments, correct as of the time of the report.

The Bank's forecasts, as aforesaid, may not be realized, in whole or in part, or may differ materially from the current forecasts due to various factors, including changes in the number of the workforce in the company and the mix of the employees, other changes in the collective agreement applicable to the Bank's employees, changes in macro variables and changes in regulations in the area of activity.

Some of the information in this chapter is "forward looking information". For the meaning of this term, see the Chapter, "Description of the Banking Corporation's Business and Forward-Looking Information", above.

## Control of the Bank

With effect from 24 March 2012, the Bank is defined, according to the provisions of the law, as a banking corporation without core control and there is no shareholder who is defined as a controlling shareholder in the Bank.

On 2 October 2014, the Bank was notified that Shlomo Eliahu Holdings Ltd. (Shlomo Eliahu), which held securities of the Bank and which, together with companies of the Migdal Holdings Insurance and Finance Group Ltd. ("Migdal"), are considered as interested parties in the Bank by virtue of their joint holdings, sold its entire holdings in the shares of the Bank. As a result of the abovementioned sale, Shlomo Eliahu and Migdal ceased to be interested parties in the Bank.

For further details, see immediate reports dated 2 October 2014 (Ref. no. 2014-01-169776, 2014-01-169191).
For updated information regarding the holdings of interested parties in the Bank, see Immediate Report on the Holdings Position of Interested Parties and Senior Office Holders, dated 5 February 2015 (ref no.15-01-026155).

### Annual General Meeting and the Election of Directors

On 6 August 2014, the Annual General Meeting of the Bank ("AGM") was held, with the following subjects, *inter alia*, on the agenda: (1) the election of two directors for a term of office on the Board of Directors of the Bank, (2) the election of one external director pursuant to Regulation 301 of the Supervisor of Banks; and (3) the election of one external director pursuant to the Companies Law.

At the Annual General Meeting, the following serving directors were re-elected, Ms. Zipporah Samet, as external director pursuant to the Companies Law for a period of three years, and Mr. David Avner. In addition, Professor Haim Levy, as external director pursuant to Regulation 301 of the Supervisor of Banks, and Dr. Samer Haj Yehia were elected as directors.

For further details, see the Chapter, "Board of Directors", below.

## Distribution of Dividends

During 2012-2014, the Bank did not distribute dividends.

For information regarding the distribution of dividends, see Note 13 to the financial statements.

## Lines of Business and Operating Segments

The Bank in Israel is organized into four 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 lines of business.

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 four major lines of business:**

**Retail banking** deals with private and small business customers and also includes the Mortgage Department and the Private Banking Department. The aim of 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 to expand the customer base in operating segments which have potential, and increase activity levels with customers by continually improving the level of service and adapting value proposals to the needs of the customer in accordance with his way of life.

**Private Banking** deals with wealthy private customers. Activity is conducted through specialist centers in Israel and the Bank's offices in the United States and in the United Kingdom.

In connection with the cooperation arrangement with Julius Baer and the sale of the activity in Switzerland, see chapter on "Significant Agreements", below.

**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 expanding the volume and range of activities with existing customers and by recruiting new customers, whilst providing a range of financial and banking services required 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 multi-national corporations, including entrepreneurial and contract companies involved in large projects in the area of real estate and infrastructure. Among other things, those managed in the Corporate Department and the Construction and Real Estate Department 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. The objectives of corporate banking are to provide the entire spectrum of customers with all necessary financial and banking 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.

**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 currencies, interest rates, derivatives and securities. Financial management includes the development of financial and investment products, management of the Bank's assets and liabilities (Assets and Liabilities Management - ALM) and in the management of investments in financial assets. The division also manages the relationship with overseas financial institutions and is responsible for providing services to customers in Israel active in the capital and money markets, including institutional customers. The management of non-bank investments is conducted through Leumi Partners.

## 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 large companies and international corporations for their operations in Israel and abroad, and the provision of banking and financial services to the construction and real estate industry.

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 with large financial asset portfolios.

6. Financial Management and Capital Markets the *nostro* activities and dealing rooms and the provision of services to institutional customers 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 as well as activities derived from products, such as mortgages, credit cards, capital market and real estate.

For further details, see the chapter, "Operating segments, action in products and Profit Centers in the Group" 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:**

| Segment | Total approved facilities | Business turnover of borrower |
|---|---|---|
| Corporate Banking (a) | above NIS 120 million | above NIS 400 million |
| Commercial Banking (b) | 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 |

(a) The corporate banking segment will also handle customers with a facility of more than NIS 80 million, where their overall obligo in the banking system exceeds NIS 250 million. In addition, customers of Construction and Real Estate Department whose approved facilities exceeds NIS 80 million belong to this segment.

(b) Including start-ups at every level of credit facility and business turnover.

**Private Customers:**

| 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 Banking | up to NIS 6 million (a) | up to US$ 0.5 million |

(a) The interested parties of companies managed in the Commercial Department are dealt with in the Commercial Banking segment and sometimes even in higher amounts.

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 approved facilities and business turnover with regard to corporate customers, and financial wealth. Criteria, such as the nature of a corporation’s business operations and the scope of its business, such as 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 – as far as possible – to the appropriate business line/operational segment, according to the customers’ characteristics and activities. Nevertheless, it should be noted that the segmental attribution is sometimes also determined in coordination with the customer according to his request and the financial results in respect of the customer are recorded in the segment in which the customer's account actually operates.

b. The banking subsidiaries have been attributed to the operating segments as follows:

- The Arab Israel Bank Ltd. – to households, small businesses, commercial banking and financial management.
- Leumi USA – to commercial banking, private banking and financial management.
- Leumi Private Bank (Switzerland) and Luxembourg – to private banking.

  In connection with a cooperation arrangement with Julius Baer and the sale of the activity in Switzerland, see Chapter on "Significant Agreements," below.
- Leumi UK – to households, small businesses, commercial banking, corporate banking and private banking.
- Leumi Romania – to households, small businesses, commercial banking and private banking.

The segment data provided here, on a consolidated basis, is the result of a summarizing the segments based on the various definitions within each of the Group’s organizations, which are not identical in size. The Bank generally constitutes some 80% of each segment.

**Financial measurement system**

**The way in which income and expenses are attributed by operating 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.

**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. Using the method described above, the profit centers bear credit risks but do not bear market risks.

The profit and loss statement of each of the segments also takes 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**

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 (divisions and departments in 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 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 and Others segment.

For further details regarding operating segments, see the chapter, "Operating segments, activities in products and profit centers in the Group", below and Note 27 to the financial statements.

**Measuring the return on capital**

In intensifying the measurement of the units' performance and its adaptation for the unique characteristics of risk, the rate of return on risk-adjusted capital (RORAC) of operational segments is presented according to the standardized approach. In addition, the internal measurement for the risk-adjusted return in accordance with the advanced approach is also taken into account. The allocation of capital to risk components among the segments is carried out in accordance with the various risk characteristics inherent in each segment, in accordance with Basel principles.

The allocation of First Pillar capital (in respect of credit, market and operational risks) is according to the Basel First Pillar principles. 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. 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 the balance of the capital).

### Evaluating the performance of the units

The Balanced Score Card (BSC) 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 risk-adjusted return, savings and efficiency and capital management), aspects of compliance, and customer satisfaction, processes, capabilities and infrastructures.

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.

This system of measurement is discussed each year by the Remuneration Committee and in the Board of Directors and receives its approval, since it is, *inter alia*, a basis for evaluation and remuneration in the context of the focus, which was implemented in 2012-2014, on the subject of savings and streamlining and the measurement of relevant targets for this subject in the BSC, was enhanced.

## Capital Resources and Capital Adequacy

Capital attributable to the Shareholders of the Banking Corporation as at 31 December 2014 amounted to NIS 28,093 million, compared with NIS 26,129 million at the end of 2013, an increase of 7.5%. The increase in shareholders' equity mainly derives from the profit for the year and from an increase in the adjustment fund of available-for-sale securities.

Shareholders' equity to total assets as at 31 December 2014 reached 7.1%, compared to 7.0% as at 31 December 2013.

**Implementation of the Basel III directives**

On 30 May 2013, the Supervisor of Banks issued final directives for the implementation of Basel III in Israel, by an amendment of Proper Conduct of Banking Business Regulation 201-211. These directives came into force on 1 January 2014.

According to the directives, the capital components in the Group for the purpose of calculating capital adequacy are attributed to two tiers:

a. Tier 1, including Tier 1 shareholders' equity and additional Tier 1 capital;

b. Tier 2 capital.

The sum of these tiers is called "Capital basis for capital adequacy" or "Regulatory capital" or "Overall capital".

**Tier 1 capital including Tier 1 Shareholders' equity and additional Tier 1 capital:**

**Tier 1 shareholders' equity** includes the capital attributable to the shareholders of the banking corporation, with the addition of the part of the rights not conferring control of capital of consolidated subsidiaries (minority interests) and deducting goodwill, intangible and other assets and regulatory adjustments and other deductions, all as set forth in Proper Conduct of Banking Business Management Regulation No. 202 "Measurement and Capital Adequacy – Regulatory Capital" and subject to the transitional provisions of Proper Conduct of Banking Business Management Regulation No. 299 "Measurement and Capital Adequacy – Regulatory Capital – Transitional Provisions".

**Additional Tier 1 capital** which comprises capital instruments complying with the criteria determined in Proper Conduct of Banking Business Management Regulation No. 202. There are no capital instruments in this tier in the Leumi Group. Any additional Tier 1 capital instruments that are issued in the future will be required to comply with all the criteria set forth in Proper Conduct of Banking Business Management Regulation No. 202.

**Tier 2 capital:**

In the Basel III directives, the distinction between Upper Tier 2 and Lower Tier 2 is cancelled.

Tier 2 capital includes mainly capital instruments and the balance of a collective allowance for credit losses before the effect of the related tax, up to a ceiling of 1.25% of total credit risk assets.

With regard to capital instruments which were included in Tier 2 capital on 31 December 2013, the transitional provisions and the asset recognition ceiling which was computed to 1 January 2014, according to 80% of the balance of instruments as of 31 December 2014, were determined, and at the beginning of each successive year, this ceiling is lowered by 10%. The capital instruments which were part of Tier 2 at 31 December 2013 include compound capital instruments which were, till now, classified to upper Tier 2 capital, and deferred notes, which were classified to lower Tier 2.

A description of the main features of regulatory capital instruments which have been issued is presented in the Bank's website: /http://leumi.co.il/home01/32587 in Chapter regarding >Financial information and meetings> Additional regulatory disclosures.

If any Tier 2 capital instruments are issued in the future, they will be required to comply with the criteria set forth in Proper Conduct of Banking Business Management Regulation No. 202.

For further information in connection with the capital adequacy ratio, see Note 13 in the financial statements.

### Capital adequacy target

The capital adequacy ratios are calculated as the ratio of capital to weighted risk assets. The Tier 1 shareholders' equity ratio is calculated as the ratio of Tier 1 share ratio to weighted risk assets, and the overall capital ratio is calculations as the ratio of the amount of overall capital to weighted risk assets.

The capital adequacy targets prescribed by the Bank of Israel are as follows:
Pursuant to Proper Conduct of Banking Business Regulation 201, "Measurement and Capital Adequacy – Introduction, Incidence and Calculation of Requirements", all banking corporations will be required to comply with a minimum Tier 1 capital ratio of 9% with effect from 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 Tier 1 capital ratio of 10%, with effect from 1 January 2017. This additional provision applies to Leumi. Compliance with these targets will be achieved gradually. In addition, all banking corporations in Israel will be required to maintain a minimum overall capital ratio of 12.5% from 1 January 2015. A large banking corporation will be required to maintain a minimum overall capital ratio of 13.5% by 1 January 2017. Leumi is subject to this additional directive.

On 28 September 2014, the Supervisor of Banks published a circular for an amendment to Proper Conduct of Banking Business Management Regulation no. 329 "Restrictions on the Grant of Housing Loans". Pursuant to the amended directive, the banking corporation will be required to increase Tier 1 shareholders' equity target at a rate expressing 1% of the balance of housing loans. The date for commencing compliance with the capital target determined is 1 January 2017, and banking corporations are to increase the capital target in fixed quarterly rates from 1 January 2015 until 1 January 2017. The effect of the amendments to the regulation on Leumi Group at the final effective date is 0.3% of the capital adequacy ratio, with the effect being spread in accordance with the regulation over eight quarters.

### Capital adequacy targets prescribed by the Bank:

Capital planning in Leumi Group reflects a forward-looking vision of the risk appetite and the capital adequacy required as a consequence. The Group policy approved by the Board of Directors is to strengthen a higher level of capital adequacy than the minimum threshold that will be periodically specified by the Bank of Israel and higher than the rate required for covering risks as estimated in the ICAAP process. In addition, targets that the Group wishes to meet in the event of a stress scenario have been defined.

In future years, implementation of the regulations regarding employee rights is the factor which is expected to have a most significant effect on Leumi's Tier 1 shareholders' equity, mainly due to the fact that the measurement of the liability is in accordance with market interest rates which are at a historic low.

In addition, a decrease in overall capital is expected, as a result of the amortization of capital instruments attributed to Tier 2 capital which were issued prior to the effective date of the directives for the implementation of Basel III and a lowering of the ceiling of the amount recognized to capital of these capital instruments.

The Bank is prepared to meet the targets outlined above which correspond to the requirements of the Supervisor of Banks as included in the regulations, maintaining a planning margin For the purpose of complying with the capital adequacy targets, the Bank will be required to control and prioritize the rate of growth in its risk assets and take steps to increase its capital base – such as the realization of investments and, if necessary, will also consider the issue of share capital and other capital instruments eligible for inclusion in the capital base.

For information regarding the effect of the initial implementation of the standards relating to employee rights, see Critical Accounting Policy, Obligations regarding Employee Rights, below.
For the effect of the transitional provisions on the calculation of capital adequacy according to Basel III, see Note 13A.

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", below.

**Leverage ratio**

On 30 October 2014, the Supervisor of Banks published a directive regarding the disclosure of the leverage ratio, which adopts the instruction of the Basel Committee from January 2014, to add a simple leverage ratio, which is not based on risk which will act as a supplementary and reliable measurement to the risk-based capital requirements.

The leverage ratio is intended to restrict the accumulation of leverage in the banking sector in order to prevent leverage reduction processes which are liable to impair the financial system and the economy, as well as strengthen the risk-based requirements, through a simple non-risk-based measurement.

The disclosure of the leverage ratio will commence on 1 April 2015.

As part of preparations for implementing the requirement, pursuant to a Bank of Israel instruction of 9 November 2014, a survey of the quantitative effect for the assessment of the leverage ratio as of 30 September 2014 was reported to the Bank of Israel.

Pursuant to Proper Conduct of Banking Management Regulation no. 218, which was published on 11 March 2015, all banking corporations will be required to comply with a minimum leverage ratio of not less than 5% on a consolidated basis. In addition, a banking corporation whose total balance sheet assets on a consolidated basis constitutes 20% or more of the total balance sheet assets in the banking system will be required to comply with a leverage ratio of not less than 6%. This directive applies to Leumi.

The requirement will be in effect from 1 January 2018, as follows:

a. A banking corporation which, on the date of publication of the directive, complies with the abovementioned leverage ratio requirement must not fall below the threshold as provided in the directive.

b. A banking corporation which, on the date of the publication of the directive, does not comply with the abovementioned leverage ratio requirement, must increase the ratio in fixed quarterly rates, by 1 January 2018.

According to the survey reported to the Bank of Israel, Leumi complies with the requirement.

## Structure of capital componen5ts for the purpose of computing the capital ratio (Table 2 – Basel):

| | Basel III | Basel II |
|---|---|---|
| | **31 December 2014** | 31 December 2013 |
| | NIS millions | |
| **Tier 1 shareholders' equity:** | | |
| Share capital | **7,059** | 7,059 |
| Premium | **1,129** | 1,129 |
| Retained earnings | **19,559** | 17,982 (a) |
| Unrealized profits (losses) from fair value adjustments of available-for-sale securities | **396** | - |
| Adjustments from translation of financial statements of companies included on equity basis | **(69)** | (242) |
| Capital reserves in respect of share-based payments and loans to employees for the purchase of shares of the Bank | **(29)** | (30) |
| Other capital reserves | **48** | 50 |
| Non-controlling interests in capital | **303** | 340 |
| Amounts deducted from Tier 1 shareholders' equity, including goodwill, and other intangible assets, deferred taxes, unrealized profits (losses) resulting from changes in the fair value of liabilities resulting from changes in the the Bank's own credit risk | **(266)** | - |
| Amounts deducted from Tier 1 capital, including goodwill, investments and other intangible assets | **-** | (321) |
| Total Tier 1 shareholders' equity after deductions | **28,130** | 25,967 |
| **Tier 2 capital:** | **-** | - |
| Eligible capital instruments pursuant to the transitional provisions in Directive No. 299 | **11,635** | - |
| Non-innovative and innovative compound capital instruments | **-** | 6,149 |
| Subordinated notes | **-** | 8,395 |
| Noncontrolling interests in capital in subsidiaries pursuant to the transitional provisions in Directive No. 299 | **5** | - |
| Collective allowance for credit losses before the effect of related tax | **3,044** | - |
| 45% of the amount of net profits, before the effect of related tax in respect of adjustments to fair value of available-for-sale securities | **-** | 100 |
| General provision for doubtful debts | **-** | 428 |
| Amounts deducted from Tier 2 capital | **-** | (65) |
| Total Tier 2 capital | **14,684** | 15,007 |
| Total capital base for purposes of capital adequacy | **42,814** | 40,974 |

(a) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R

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

**Capital adequacy structure**

The ratio of First Pillar shareholders' equity to risk assets was 9.21%, compared with ratio of Tier 1 shareholders' equity according to Basel III as of 1 January 2014 of 9.09%. The ratio of total capital to risk assets was 14.01%, compared with a ratio of overall capital to risk assets according to Basel III as of 1 January 2014 of 14.08%.

**Capital adequacy - (Table 3 - Basel):**

| | Basel III | | Basel II | |
|---|---|---|---|---|
| | **31 December 2014** | | 31 December 2013 | |
| | Risk assets and capital requirements in respect of credit risk deriving from exposures to: | | | |
| | Risk assets | Capital require-ments (c) | Risk assets | Capital require-ments (c) |
| | NIS millions | | | |
| Sovereign debts | **856** | **107** | 788 | 71 |
| Debts of public sector entities | **2,564** | **321** | 2,242 | 202 |
| Debts of banking corporations | **5,455** | **682** | 4,372 | 393 |
| Debts of securities | **161** | **20** | 35 | 3 |
| Debts of corporations | **110,313** | **13,789** | 104,523 | 9,407 |
| Debts collateralized by commercial real estate | **48,529** | **6,066** | 45,191 | 4,067 |
| Retail exposures to individuals | **30,488** | **3,811** | 26,639 | 2,398 |
| Loans to small businesses | **10,662** | **1,333** | 10,657 | 959 |
| Housing loans | **42,457** | **5,307** | 38,375 | 3,454 |
| Securitization | **723** | **90** | 831 | 75 |
| Other assets | **19,728** | **2,466** | 14,075 (e) | 1,267 |
| Risk assets and capital requirements in respect of CVA risk (a) | **2,405** | **301** | - | - |
| Total in respect of credit risk (a) | **274,341** | **34,293** | 247,728 | 22,296 |
| Risk assets and capital requirements in respect of market risk (a) | **10,839** | **1,355** | 10,510 | 946 |
| Risk assets and capital requirements in respect of operational risk (b) | **20,317** | **2,540** | 20,426 | 1,838 |
| Total risk assets and capital requirements (d) | **305,497** | **38,188** | 278,664 | 25,080 |
| Total capital base for capital adequacy | **42,814** | | 40,974 (e) | |
| Total capital ratio | **14.01%** | | 14.70% (e) | |
| Tier 1 shareholders' equity ratio | **9.21%** | | 9.32% (e) | |

(a) Weighted risk assets according to the standardized approach, First Pillar only.
(b) According to the standardized approach.
(c) The capital requirements have been computed at 12.5% according to the minimum required ratio with effect from 1 January 2015. In 2013, capital requirements have been computed at 9% according to the minimum required ratio until the end of 2013.
(d) Additional capital buffers were calculated in respect of the Second Pillar.
(e) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R.

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

| | Basel III | Basel II |
|---|---|---|
| | **31 December 2014** | 31 December 2013 |
| | % | |
| Leumi – on consolidated basis | **14.01** | 14.70 (b) |
| Arab-Israel Bank | **13.36** | 12.50 |
| Leumi Card | **17.36** | 16.00 |
| Bank Leumi USA (a) | **14.23** | 14.54 |
| Bank Leumi UK | **18.91** | 16.39 |
| Bank Leumi Switzerland | **24.00** | 44.91 |

For further details in connection with the capital components, the risk assets and the capital ratio of significant banking subsidiaries, see Note 13 of the financial statements.

(a) The office in the United States will begin to report in accordance with the Basel III principles with effect only from 1 January 2015. The capital adequacy reported for this period is according to Basel I.

(b) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R.

# C. Other information

## Principal Developments in the Economy[(a)]

### General

In 2014, the GDP of the Israeli economy grew by 2.8% in real terms, compared with a growth rate of 3.2% in 2013. In the fourth quarter of the year, there was a significant recovery in economic activity and GDP expanded by 6.8% in annual terms, compared with the third quarter, in which the rate of growth had substantially slowed due to Operation Protective Edge.

The consumer price index fell in 2014 by 0.2%. The Bank of Israel interest rate fell during this period by 0.75 percentage points, from 1.0% at the end of 2013 to 0.25% at the end of 2014. The low inflationary environment, which is under the price stability target, enables the monetary policy to operate, by means of interest, to support the growth of the market which remains in economic slowdown. In the interest decision for March 2015, the interest rate was lowered to 0.1%. At the same time, the Bank of Israel announced a reduction in the margin around its interest rate in the credit window and the deposit window for commercial banks from ±0.25% to ±0.1. In the interest decision for April 2015, the interest rate remained unchanged.

In 2014, there was a 12.0% devaluation in the rate of the Israeli shekel against the dollar, but an appreciation of the shekel against the euro, which was prominent in the second half of the year, particularly against a background of a significant strengthening of the dollar against the euro around the world.

The capital market was characterized in 2014 by increases in the prices of shares and debentures. The principal arrangement was the effect of low interest rates on the prices of assets in the market, both in Israel and in the impact of markets around the world. The index of shares and convertible securities increased during this period by 11.5%, while the unlinked fixed-interest government debenture index was prominent with an increase of 8.2%.

On 8 July 2014, Operation "Protective Edge" began and lasted 50 days. The period of fighting caused economic damage in the various areas of the country, and in various sectors of the economy, mainly those connected to private consumption and tourism. The Bank of Israel noted, as part of a macroeconomic forecast of the Research Division on 29 December 2014, that it estimated that the campaign reduced economic growth in 2014 by 0.3%.

During the operation, the Supervisor of Banks published a number of reliefs for the public managing their accounts on the confrontation line, for individuals and businesses operating within 0-40 kilometers of the Gaza Strip and to soldiers on reserve duty. The Bank granted reliefs in various areas, *inter alia*, on deviations from credit facilities, activity by means of Internet banking, telephone instructions and charges according to authorization. In addition, the Bank offered designated products for retail customers on the confrontation line.

On 3 September 2014, the Supervisor of Banks published "return to normal routine" directives, including the gradual phasing-out of the reliefs. Accordingly, the Bank canceled the reliefs for customers living in the emergency region. In addition, the reliefs regarding the restriction of accounts and bounced cheques were ended, in accordance with the time-tables dictated in the directives.

### The global economy

In January 2015, the International Monetary Fund revised its estimate of the expected development of growth in the world for 2014. In the advanced countries, there was no change in the estimates, compared with that made in October 2014, though this is a result of differences in the economic development of the various countries. The growth rate in the U.S. economy was revised upwards (by 0.2%), while in the Euro Area, there was no change in the estimate for the development of economic activity in the past year. According to the Fund’s revised forecasts, growth in the United States and the Euro Area in 2014 amounted to 2.4% (compared with 2.2% in a previous estimate) and 0.8% (0.8% in a previous estimate), respectively. The forecast for growth of global output in 2015 was revised downward by 0.3%, even though there was an upward revision in the United States of 0.5%.

---

(a) The sources of the data for review and for the graphs – publications of the Central Statistical Bureau, the Bank of Israel, the Finance Ministry and the Tel Aviv Stock Exchange.

**The State Budget and its Financing**

During 2014, the Government's budget deficit amounted to some NIS 29.9 billion, about 2.8% of GDP. This is in comparison to the planned deficit of NIS 31.1 billion. This was in spite of the impact of the Operation Protective Edge, which led to growth in excess of what was planned, in security operation expenses and an impairment of income due to an adverse impact on economic activity in the market. Government expenditure (excluding interest payments) rose in this period by 3.5%, while tax collected increased by 5.9%, compared with 2013.

The decision on early elections led to a postponement of the approval of the 2015 State Budget.

**Proposed Value Added Tax Law (Tax Benefit in a Transaction to Purchase a Beneficiary Residential Apartment), 2014 – "Zero-Rate VAT" program**

On 7 July, 2014, the Knesset approved in a first reading the proposed Value Added Tax Law (Tax Benefit in Transaction to Purchase a Beneficiary Residential Apartment), 2014. The proposed law provides that the benefit will apply to purchasers who acquire a new apartment from a contractor, with effect from September 2014. Pursuant to the proposal, eligible for the benefit is a resident of Israel who is a parent to at least one child in his/her custody, or who is 35 years or older and does not own an apartment, and has not owned an apartment since 1995. The benefit will be in effect for those who have served in the army and national or civil service in the purchase of an apartment at a cost of NIS 1.6 million, while for those who have not served in the army or in national service, the benefit will apply in the purchase of an apartment at a cost of up to NIS 950 thousand.

The proposed law was approved by the Finance Committee on 12 November 2014 and was scheduled to be passed to the Knesset plenum for a vote at a second and third reading. However, due to the advancement of elections, it was not brought for the approval of the plenum.

**"Target Price" Program**

The Israel Lands Council has prepared a program for the publication of tenders using the "Target Price" method. Under the program, 66,000 residential units will be offered, until 2019, at prices which will be 20% lower than their market value. According to an announcement of the Housing and Construction Ministry of 19 October 2014, the tenders will be published with the approval of the "Zero-Rate VAT" program. On 21 December 2014, the Government made a decision whereby, owing to the dissolution of the Knesset before the completion of the legislative proceedings relating to the Zero-Rate VAT Law (Tax Benefit in a Transaction to Purchase a Beneficiary Residential Apartment), 2014, it was decided to continue with the implementation of the government decision which approved the program, *mutatis mutandis*. The main points of the program which are presented above remain unchanged.

**The housing market**

In 2014, the number of new apartments sold as part of a private initiative building program fell by 1.5% compared with 2013. This decrease may be explained by waiting for the approval of a proposed law and government initiatives (the target price program and the "Zero-Rate VAT" program) with implications for the taxation of residential apartments and attempts to limit their price. These factors raised expectations among households that there would be a certain fall in house prices. In the fourth quarter (in particular, in December 2014), because of the failure to approve the Zero VAT Law and the advancement of the elections, there was substantial increase in the sale of new apartments.

**Foreign trade and capital transactions**

Israel's aggregate trade deficit in 2014 amounted to some US$ 13.8 billion, a fall of 3.4% compared with the deficit for 2013. The reduction in the trade deficit is due to the effect of a reduction in the value of imports of energy products, compared with a more moderate increase in exports. Excluding the effect of the import of energy products, the trade deficit grew.

Foreign currency capital transactions in 2014 amounted to foreign currency capital inflows higher than capital outflows. Direct investments in Israel, via the banking system, amounted to US$ 8.3 billion, while financial investments amounted to US$ 8.4 billion. However, investments by Israeli residents abroad (direct investments through Israeli banks and the financial investments) amounted to US$ 8.3 billion, most of which consisted of financial investments.

**Exchange Rate and Foreign Currency Reserves**

The exchange rate of the shekel fell in value against the dollar in 2014 by some 12.0%, with an appreciation in the first half of the year of some 1.0%, and a 13.1% depreciation in the second half. Against the euro, there was an appreciation of 1.2% in 2014. The strengthening of the dollar versus the shekel was influenced mainly by the strengthening of the dollar around the world (13.4% against the euro), and possibly by the effect of falling interest rates in Israel to a low point, as well as a reduction in the hedging of institutional investments abroad.

Foreign currency balances in the Bank of Israel at the end of December 2014 amounted to some US$ 86.1 billion. This compared with US$ 81.8 billion at the end of December 2013.

During 2014, foreign currency purchases by the Bank of Israel, part of a program of purchases to offset the effect of gas production on the exchange rate, totaled US$ 3.5 billion.

**Inflation and Monetary Policy**

The Israeli consumer price index fell in 2014 by 0.2%, a rate which is under the lower limit of the Government's target range of the price stability of 1% to 3%. The main contributory factors for the decrease were the food items (a fall of 2.5%) and fruit and vegetables (a fall of 9.3%). On the other hand, the housing component, which increased by 3.1%, contributed to the increase in the index. Notable among those items which resulted in the negative inflation were the decrease in the world prices of goods, food and oil, alongside local factors, such as competition and government initiatives to reduce food prices. The strengthening of the shekel in most of the months of the year also contributed to the fall in prices in some of the index components.

The Bank of Israel interest rate in December 2014 was 0.25%. During the past year, the interest rate fell from 1.0% in December 2013 to 0.75% in March 2014, and stayed at this level in June 2014. In the interest decision for August, interest was reduced to 0.50%, while in the September decision, the rate was lowered further to 0.25%, a rate which, as mentioned above, was retained in December 2014. The reasons for the reduction were the need to lend support to economic activity, particularly in light of weak economic activity around the world and Operation Protective Edge, as well as the low inflationary environment, approaching the lower limit of the price stability target. In the interest rate decision for March 2015, on 23 February 2015, the interest rate was lowered to 0.10% and was kept at this level for April 2015. The Monetary Committee held that, in view of the strengthening in the rate of appreciation (which offset most of the devaluation in the shekel which occurred through the end of 2014), and its potential effects on activity and inflation, the reduction to a level of 0.1% is the most appropriate measure at the time, in order to support the attainment of the policy targets.

**Capital market**

The shares and convertible securities index rose by some 11.5% during 2014, following an increase of some 15.3% in 2013. The rising prices are explained, *inter alia*, by the repercussions of an expansive monetary policy in Israel and around the world on the capital markets of several countries, including Israel.

Average daily trading volumes of shares and convertible securities increased in 2014 by some 3.5%, compared with the average for 2013, and amounted to some NIS 1,213 million on a daily average. This results from a reduction in trading volume in July and August during Operation Protective Edge, although in the months following the end of operation, trading volumes went back up.

The Government bond market was characterized by price increases during the past year. The price of index-linked Government bonds rose by 5.8%, despite falls in short-term bond prices as the effect of a decrease in the inflationary environment. Unlinked Government bonds increased at a higher rate of some 7.2% (the fixed interest bond indices rose by some 8.2%, while the variable interest (*Gilon*) bond index increased by only 1.0%). The background to this is, as aforesaid, the decline in the inflationary environment in Israel and around the world, which led to a drop in the Bank of Israel interest rate to a record low and to a decrease in comparison to the redemption of long-term bonds on world markets.

In the index-linked non-government debenture market (corporate bonds) in 2014, there were moderate price increases of some 1.0%, following price increases of some 9.5% in 2013.

**Financial Assets held by the Public**

The value of the portfolio of financial assets held by the public increased in 2014 by 7.2%, reaching NIS 3,180 billion at the end of December 2014. This increase in the value of the portfolio derived from an increase in all of its components, with prominent factors being the increase in foreign currency-linked components and shares abroad, which were affected, *inter alia*, by the devaluation of the exchange rate of the shekel against the dollar. The weight of shares (in Israel and abroad) in the financial assets portfolio of the Israeli public reached some 24.2% at the end of December 2014, compared with some 24.1% in December 2013.

**Bank Credit**

Bank credit in the economy granted to the private sector, including corporate credit and household credit, (before allowances for credit losses) increased in 2014 by 3.5%. This was a consequence of a decrease in credit extended to the corporate sector of 0.9% and a significant increase in credit extended to the household sector. The development of the components of housing credit indicated an increase in housing credit of 7.0%, with non-housing credit (consumer credit) expanding by 10.4%.

The table below shows the credit ratings of Israel and of the Bank on 24 March 2015:

| | Rating agency | Long-term rating | Outlook | Short-term rating |
|---|---|---|---|---|
| State of Israel | Moody's | A1 | stable | P-1 |
| | S&P | A+ | stable | A-1 |
| | Fitch | A | stable | F1 |
| Leumi: Foreign currency | Moody's | A2 | negative | P-1 |
| | S&P | A- | stable | A-2 |
| | Fitch | A- | stable | F1 |
| Leumi: Local currency | S&P Ma'alot | AAA | stable | - |
| | Midroog | Aaa | stable | P-1 |

On 1 May 2014, Fitch Credit Rating Agency raised the short-term credit rating of Bank Leumi to F-1 and affirmed the Bank's long-term credit rating at A-, with a stable outlook.

On 7 October 2014, S&P Credit Rating Agency raised the Bank's long-term credit rating in foreign currency to A- and S&P Maalot raised the Bank's long-term credit rating in local currency to AAA.

On 20 October 2014, Moody's Credit Rating Agency affirmed the Bank's rating and changed the outlook to negative from stable. The reason for this was general to the Israeli banking system, based on Moody's expectation of future regulatory measures relating to Government support of the banks in a crisis and not for a specific reason related to Leumi.

**Developments in Leumi Share Price**

In 2014, the price of Leumi shares fell from 1,418 points to 1,338 points, a decrease of 5.6%. During this period, the Bank's market value fell from NIS 20.9 billion to NIS 19.7 billion.

The price of a share in Leumi on 24 March 2015 was 1,432 points and reflects an increase of 7.0% from 31 December 2014. In this period, the market value of the Bank increased to a level of NIS 21.1 billion.

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

| | December 31 | | | | |
|---|---|---|---|---|---|
| | **2014** | 2013 | 2012 | 2011 | 2010 |
| | NIS | | | | |
| Exchange rate: | | | | | |
| U.S. dollar | **3.889** | 3.471 | 3.733 | 3.821 | 3.549 |
| Euro | **4.725** | 4.782 | 4.921 | 4.938 | 4.738 |
| Pound sterling | **6.064** | 5.742 | 6.037 | 5.892 | 5.493 |
| Swiss franc | **3.929** | 3.897 | 4.077 | 4.062 | 3.788 |
| | | | | | |
| Consumer price index: | (points) | | | | |
| For November (the "known" index) | **107.4** | 107.5 | 105.5 | 104.0 | 101.4 |
| Index for December | **107.4** | 107.6 | 105.7 | 104.0 | 101.8 |

Rates of change were as follows:

| | December 31 | | | | |
|---|---|---|---|---|---|
| | **2014** | 2013 | 2012 | 2011 | 2010 |
| | in % | | | | |
| Rate of change: | | | | | |
| U.S. dollar | **12.0** | (7.0) | (2.3) | 7.7 | (6.0) |
| Euro | **(1.2)** | (2.8) | (0.3) | 4.2 | (12.9) |
| Pound sterling | **5.6** | (4.9) | 2.5 | 7.3 | (10.1) |
| Swiss franc | **0.8** | (4.4) | 0.4 | 7.2 | 3.3 |
| | | | | | |
| Consumer price index: | | | | | |
| For November (the "known" index) | **(0.1)** | 1.9 | 1.4 | 2.6 | 2.3 |
| Index for December | **(0.2)** | 1.8 | 1.6 | 2.2 | 2.7 |

## Regulation, General Environment and the Effect of External Factors on Activities

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

## Legislation and Regulation affecting the Banking System

### Details regarding regulations enacted in the period -

Prohibition of Money Laundering and Obligation of Identification and Record Keeping of Banking Corporations for the Prevention of Money Laundering and the Financing of Terrorism, 2014

On 2 February 2014, an amendment to the Prohibition of Money Laundering Order applicable to banks was published in *Reshumot*. The amendment to the order includes new regulations in the area of the prohibition of money laundering and the financing of terrorism, for example, the addition of requirements in connection with the examination and recording of names of parties for transactions of transfers between countries, anchoring the duty of knowing the customer and the addition of regulations and requirements relating to this duty, the addition of a duty of retaining documents for a longer period at the request of the Supervisor of Banks and the addition of a reference to the list of countries at risk published by the Head of the Prohibition of Money Laundering and Financing of Terrorism Authority. In addition, the definition of "unusual activity", necessitating a report to the Prohibition of Money Laundering Authority, was amended. Pursuant to the amended definition, "an unusual activity refers to activity which, in light of the information in the hands of the banking corporation, there are concerns that it is connected to the activity which is prohibited according to the Prohibition of Money Laundering Law or according to the Prohibition of the Financing of Terrorism Law".

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

On 10 July, 2014, Amendment no. 19 to the Banking Law (Service to the Customer) came into force. Pursuant to the amendment to the law, a banking corporation may not make a loan available for immediate repayment and will not initiate legal proceedings against the customer due to failure to comply with the terms of a loan, (except a credit facility) including the failure to repay the loan in whole or in part, unless it has furnished the customer with a written notice, 21 working days before taking the action regarding the loan in a way that the banking corporation customarily furnishes notices to that customer, and by personal delivery to the customer's address registered with the banking corporation. The said notice must include various details as set forth in the proposed law. However, a banking corporation will not be obliged to furnish a notice as aforesaid if its delivery raises a tangible concern of 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 which require immediate action regarding the loan.

The amendment to the law also applies to loans made by the banking corporation before its inception.

Concurrently with the abovementioned amendment, on 23 April 2014, the Banking Supervision Department published an amendment to Proper Conduct of Banking Management Regulation no. 453, regarding "Third part guarantees in favor of a banking corporation". This amendment comes to adapt the provision in the abovementioned law in all matters related to the sending of a notice to guarantors. The amendment to Regulation 453 mitigates compared to the requirements of the law, since notices can be sent by mail (personal delivery is not required). In addition, the details that must be specified in the notice are reduced in comparison to those required according to the law.

**Banking Order (Early Repayment Commission), 2014**

On 27 August 2014, an amendment to the Banking Order (Early Repayment Commission), 2002 was published. Pursuant to the amendment, the formula for early repayment in loans for the purchase of housing apartments or in security for housing was revised, such that the calculation of the commission will take into account, *inter alia*, the average interest on the market at the date of extending the loan.

In addition, the abovementioned order includes further amendments, including – an amendment to the definition of "average interest" such that the Supervisor of Banks will be able to determine, if necessary, and with the approval of the Finance Committee – another interest calculation; the bank's charge on granting a full exemption from commission for the failure to give early notice in the event of the death of the borrower; an increase in the maximum number of days for the giving of early notice – from 30 days to 45 days prior to early repayment date; a determination that it is possible to furnish the bank with early notice not just by mail or personal delivery, but also by fax or any other means of communication that the bank suggests, at the customer's request; the addition of a requirement to outline, on an explanatory page sent to the borrower, the rates of amortization to which he is entitled by virtue of the order and the loan agreement, and the details of forging the connection with the banking corporation for giving early notice; a limitation of the period for furnishing an update page to the borrower for a period of 60 days from the date of making the repayment.

**Deposit and loan fund**

On 19 November 2014, regulations were published by virtue of the Arrangement of the Investment Consulting Profession, in Investment Marketing and Investment Portfolio Management, 1995, and regulations by virtue of the Joint Investments in Trust Law, 1994, pursuant to which a legal framework was determined for marketing a new monetary fund of the deposit and loan fund ("Kapam") type. The purpose of the Kapam is to be an effective alternative for a bank deposit, and it will also be able to be sold to the public through an intermediary who is not a holder of a consulting license.

**Securities Law (Amendment no. 53) (Electronic Voting System), 2013**

On 17 June 2015, the Electronic Voting System, which was established by the Israel Securities Authority, will commence operations. On this date, the system will begin to operate in relation to shares, options and participation units in traded partnerships, and after completion of the legislative process, it will also operate in relation to debentures. The activation of the system is regulated by the Securities Law (Amendment no. 53) (Electronic Voting System), 2013, the Companies Regulations (Voting in Writing and Position Notices) (Amendment) 2014, the Securities Regulations (Voting in Writing and Proof of Ownership of Options for the Purpose of Voting at Meetings of Holders of Options), 2014 and the amendment to the Partnership Ordinance (No. 5), 2015 (which were published in *Reshumot* on 31 October 2013, 2 June 2014, 17 December 2104 and 23 February 2015, respectively), and the Rules of Access and Recording in the Electronic Voting System pursuant to the Securities Law. By means of this system, investors in securities will be able to vote at meetings via the Internet, without the need to obtain confirmation of ownership of a security from a stock exchange member, such that the system will take care of this automatically. For the purpose of its activity, the Electronic Voting System will need an interface vis-à-vis members of the stock exchange for receiving details of the holders of securities who are entitled to vote at a specific meeting. In addition, members of the stock exchange will be required to supply potential voters with the information and details they require in order to vote, including information regarding the relevant meeting and identification codes for exercising the vote by means of the system.

## Proposed laws published during the report period

### Proposed Law for the Remuneration of Office-Holders in Financial Corporation (Special Approval and Disallowance of Expense for Tax Purposes due to Exceptional Remuneration), 2014

On 28 July 2014, the abovementioned proposed law was passed in its first reading. The proposal establishes limits on the remuneration of office-holders or other employees in financial entities, including banking corporations, when the amount of remuneration exceeds NIS 3.5 million per annum. Among other things, the proposal stipulates a strict procedure for approving remuneration exceeding NIS 3.5 million a year. In addition, the proposal provides that the cost of the salary to the office-holder or other employee, in excess of the NIS 3.5 million ceiling will not be allowed as a deduction from taxable income of a financial entity.

### Memorandum of Antitrust Law (Amendment no. 16 – Determination of Cross Commission), 2014

On 10 August 2014, a memorandum of the Antitrust Law (Amendment no. 16 – Determination of Cross Commission), 2014 was published. Pursuant to the amendment to the law, the Antitrust Commissioner ("the Commissioner") will be empowered to determine the rate of cross-commission of debit card transactions. This replaces the existing legal arrangement (approval of restrictive arrangement in the Antitrust Court). The Commissioner will be able to determine a cross-commission at various rates, including a cross-commission at zero rate, where he believes that various transactions have features which justify this.

In addition, the amendment to the law establishes criminal liability and the possibility of the imposition of a sanction in respect of the payment or collection of a cross-commission with a rate different from that set by the Commissioner, and that the legal supervision by the Commissioner in exercising the aforementioned power, including an appeal on the Commissioner's decision in determining the rate of cross-commission, will be undertaken through the Court for Administrative Affairs.

## Proposed laws published after the report period

### Electronic Cheque Clearing Law Memorandum, 2014

On 4 January 2015, the Justice Ministry published the Electronic Clearing Law Memorandum. The memorandum deals with the regulation of electronic cheque clearing in the banking system without the physical presentation of the cheques, including regulating the treatment of a cheque which has been declined for a customer. regulating the acceptability of the computerized cheque in a legal proceeding, authorization to determine rules on the matter of electronic clearing and on the matter of retaining the physical cheque, as well as determining that the scope of the bank's authority vis-à-vis its customer in accordance with any law will not change as a result of a change in the method of clearing.

### Reduction of Use of Cash Law Memorandum, 2015

In January 2015, the Ministry of Justice published the Reduction of the Use of Cash Law Memorandum, which adopts the recommendations of the Committee to Examine the Reduction of the Use of Cash in the Israeli economy – the Locker Committee. According to the memorandum, restrictions will be placed on the type and amount of the transactions in which cash may be used, and restrictions on the use and endorsement of cheques. This includes a prohibition on the issue and receipt of cheques on which the name of the payee or the endorsee is not marked, a prohibition on the endorsement of cheques without a note of the name and identity number of the endorser on the back of the cheque, a provision that a banking corporation and the Postal Bank will not redeem a cheque on which the name of the payee is not noted and a cheque in excess of NIS 10,000 on which the names of the endorsers or their identity numbers are not noted, a cheque which has been endorsed more than once and its amount exceeds NIS 10,000.

It is further proposed that the law will come into effect after the conditions ensuring the transaction of an immediate debit card are fulfilled, available to bank customers in a similar manner to a deferred debit card or to a credit card, whether by means of its marketing on the same card or its marketing as another debit card, which will not be subject to an online banking transaction commission. In addition, an immediate debit card will be issued by the Postal Bank for any person requesting, alongside the possibility of opening an appropriate bank account for this purpose.

## Legislation and regulation in pension consulting

### Uniform structure for transfer of data and information

In order to streamline the work processes in the pension savings market and remove technological blocks and encourage the existence of a competitive market, the Capital Market, Insurance and Savings Division in the Ministry of Finance ("Capital Market Division") has begun to regulate the processes of transferring information and monies between the various factors in the pension saving market. Within this framework, the Capital Market Division has published a circular on "Uniform structure for transferring information and data in the pension savings market" which provides a structure of a "uniform registry" for the use of the various factors in the pension savings market when transferring information and monies between them. Since its initial publication, the provisions of the circular have been updated by the Capital Market Division and a number of clarifications to the provisions of the circular have been published.

### Distribution commissions and brokerage fees

On 12 June 2014, the Capital Market Division published a revised version of the draft of the Supervisory Regulations on Pension Services (Provident Fund) (Distribution Commissions), 2014, which were forwarded for the approval of the Knesset Finance Committee. The draft regulations update the rate of distribution commission which will be paid to the pension consultant in respect of distribution of a pension product, such that this commission will be at an annual rate of 0.2% of the total amounts accrued to the credit of a customer in a pension product as well as from a rate of 1.6% of the current deposits made for that product. The amount of the commission is limited to the lower of the maximum rate of distribution commission as aforesaid in each component and 40% of the amount of management fees actually collected. The change does not apply with regard to the distribution committee paid in respect of distribution of training funds (whose rate is 0.25% per annum of the total amounts standing to the credit of the customer in the fund).

On 16 September 2014, the Capital Market Division published a draft of the Supervision of Financial Services (Insurance) (Brokerage) Regulations, including provisions regarding the payment of brokerage fees to more than one license holder, according to which brokerage (including distribution commission paid to a pension consultant) for a product in respect of which a new license holder was appointment by the customer, will be paid only to the new license holder.

### Explanatory document

On 16 June 2014, the Capital Market Division published a second draft of the "explanatory document" circular which is intended to establish a focused and uniform structure for the explanatory document and is expected to replace a number of circulars dealing with an explanatory document furnished to a customer when marketing or consulting regarding an pension product and other documents which a license holder is required to transfer to the customer during a marketing or pension consulting transaction.

### Power of attorney to a license holder

In order to prepare the entities operating in the area of pension savings to transfer information and enter into transactions by means of automated and uniform forms, the Capital Market Division has provided as part of a "power of attorney to a license holder" a uniform structure to the power of attorney form. Using this form, a customer can authorize a license holder to receive information regarding the pension savings which is managed for him and execute transactions in the product. On 18 June 2014, and 24 November 2014, the Capital Market Division published drafts to update the provisions of the circular which included additional methods for verifying the power of attorney by a license holder and an update was made regarding the content of the power of attorney so that the form will also refer to the insurance products from the risk of death and an insurance plan from loss of ability to work which are not included in the pension product. The update is expected to come into force on 1 July 2015.

### Significant provisions of the Supervisor of Banks published in the report period

### Proper Conduct of Banking Management Regulation no. 414 – Disclosure of the Cost of Services in Securities

On 2 April, 2014, the Banking Supervision Department published Proper Conduct of Banking Business Management Regulation No. 414 concerning the disclosure of the cost of services in securities. The regulation requires banking corporations to disclose to their customers who are charged commissions in respect of transactions for the purchase, sale or redemption of Israeli or foreign securities, or a commission fee for managing a securities deposit, comparative information regarding the rates of commissions paid by other customers of the banking corporation who hold deposits with a similar value to that of the deposit held by the customer. The said comparative information to be furnished to the customer should be presented in the context of a biannual report to the customer, along with detailed information on the commission on the purchase, sale or redemption of securities, and a commission fee for managing a securities deposit, which the customer is actually charged. The comparative information to be furnished to the customer will also be published on the banking corporation's website. The regulation applies to individuals and small businesses.

The regulation came into force on 1 January 2015. The initial disclosure of the information to the customer and its publication on the website became effective on 1 February 2015, with the data being based on data received during the months of July – December 2014.

**Proper Conduct of Banking Business Management Regulation No. 422 – Opening and Managing a Current Account in a Credit Balance**

On 26 May 2014, the Banking Supervision Department published Regulation no. 422 regarding opening and managing a current account in a credit balance. The directive specifies those cases in which a banking corporation is obliged to address a customer's request to open a current account with a credit balance.

In addition, the directive defines those services and means of payment which a banking corporation will be obliged, as a rule, to place at the disposal of its customers, including, making payments by way of direct debit, using an immediate debit card, using a cash withdrawal card, information retrieval service via a service kiosk in a branch and access to the account via the Bank's website and requires a customer who has submitted a request to open an account and has been declined in writing, to be furnished with a decision regarding the refusal within five business days of the date of submitting the request. The directive will come into force gradually.

**Proper Conduct of Banking Business Management Regulation No. 355 – Management of Business Continuity**

On 26 May 2014, the Banking Supervision Department published Regulation no. 355 regarding the management of business continuity. In the provisions of Proper Conduct of Banking Management Regulation no. 355, banking corporations were required to prepare for countrywide and other reference scenarios which could cause them significant damage. In addition, individual consideration was given to the existence of alternative sites to the Bank's main offices, including a disaster recovery site intended for recovering information and data systems. Pursuant to the amendment, a section was added, prescribing guiding principles for minimum protection of the various critical sites for withstanding countrywide and other reference scenarios.

**Amendment to Proper Conduct of Banking Business Management Regulation 403 – Non-banking Benefits to Customers**

On 6 July 2014, the Banking Supervision Department published an amendment to Proper Conduct of Banking Business Management Regulation 403 – Non-banking Benefits to Customers. Pursuant to the amendment, Proper Conduct of Banking Business Management Regulation 470 regarding debit cards was also amended.

According to the amendment, it is provided that, as a rule, banks and credit card companies are not authorized to provide a non-banking benefit by way of opening and managing a current account, or by way of providing other banking services, including the placement of a deposit, extending or utilizing credit, opening and managing an investment portfolio, investment advice or pension consulting, clearing and discounting.

However, the directive permits the provision of a non-banking benefit by way of submitting a request on the part of a customer for the issue, holding and use of a debit card, on opening a current account, and in other cases set forth in the directive, all providing these non-banking conditions will not be conditional on a commitment with the banking corporation for any periods of time, or a requirement for their recovery.

In addition, the directive provides that on publishing a non-banking benefit, the banking corporation must present material information in connection with the benefit. In addition, if the banking corporation has chosen to present in its announcement the price of a product or a service after the benefit, it will also be required to present the price before the benefit, where such exists. In addition, the banking corporation is required to publish the full details of the non-banking benefit on its website.

**Proper Conduct of Banking Business Management Regulation 312 – Transactions of a Banking Corporation with Related Persons**

On 10 July 2014, the Banking Supervision Department published an amendment to Proper Conduct of Banking Business Management Regulation 312 on Transactions of a Banking Corporation with Related Persons and an indirect amendment for the purpose of adjustment, to Proper Conduct of Banking Business

Management Regulation 301. As part of the amendment, the definition of "related person" was expanded, *inter alia*, to entities holding more than 5% of the means of control in a banking corporation, to office-holders in those entities, their relatives and corporations under their control, and to a shareholder in a banking corporation without a controlling core who proposed a candidate for office as director in a banking corporation, his relatives and corporations under their control, as long as whoever is proposed on his behalf serves as director, and to anyone holding 10% and more of any class of the means of control in a corporation controlled by the banking corporation or relative of a holder as aforesaid. In addition, individual limits were imposed on the obligations of related persons, as well as an overall restriction, and an update in relation to transactions which must be brought for approval in the Audit Committee or the Transactions with Related Persons Committee. The amendment provides provisions for regulating the obligations of anyone who became related persons, as far as they exceed the limits provided.

**Proper Conduct of Banking Business Management Regulation 418 – Opening accounts via the Internet and circular regarding the types of accounts and conditions providing the customer's signature on the agreement is not required**

On 15 July 2014, the Banking Supervision Department published a directive permitting the opening of an account on the Internet for an individual Israeli resident, who is over the age of 18, providing the account will have no beneficiaries other than the account-holders. After opening the account, no addition or change to the account-holders will be permitted. The account will be marked and identified in the bank's automated system as an account which was opened online for the purposes of monitoring risks.

The identification of the customer, pursuant to the directive, will be done using non-original documents, and the "Know Your Customer" procedure will be carried out by means of video-conferencing. In addition, the directive sets forth quantitative and other limits which will apply to activity in the account. The aforesaid restrictions on the online account, set out in the directive, will be removed only after completion of the full identification of the customer.

As a complementary step, on 5 January 2015, the Banking Supervision Department published a circular regarding "types of accounts and conditions providing the customer's signature on the agreement is not required". The circular details the agreement on which the signature of the customer is not required, providing the customer is able to confirm in an appropriate place on the banking corporation's website that he has been afforded the opportunity required to review an agreement.

**Proper Conduct of Banking Business Management Regulation 329 – Restrictions on the Granting of Housing Loans and a letter from the Supervisor of Banks on this subject**

On 15 July 2014, the Banking Supervision Department published a new Proper Conduct of Banking Business Management Regulation no. 329 (hereinafter: "the Directive") incorporating a number of provisions which it published in recent years relating to various restrictions with regard to housing loans (*inter alia*, limits on the rate of financing, a limit on the part of a loan at variable interest, on the rate of repayment from income, on the period to final repayment, etc,) and redefines the term "rate of repayment from income", and a letter of the Banking Supervision Department regarding the Directive providing a limit on the amount of the loan which permits the receipt of mitigated risk weight for the purpose of weighting capital.

The Directive includes a new definition of "rate of repayment from income", in place of the existing definition in Directive no. 876 of the Supervision Reporting Regulations of the Bank of Israel – Banking Supervision Department. *Inter alia*, it is provided in the new definition that, in the computation of the rate of repayment from income, in addition to the income of the borrower, half of the monthly available income of a close family member of the borrower (hereinafter: "the relative") may be recognized, providing all of the following conditions are fulfilled: the relative acts as a guarantor for the loan, the bank has conducted a repayment capacity examination as carried out for the borrower himself, the relative himself pays from his bank account, at least, 20% of the monthly repayment amount.

On 25 January 2015, the Supervisor of Banks published an update to the directive in which it was provided that, notwithstanding the aforesaid, it will be possible to recognize in full the available monthly income of the borrower's spouse, meeting all of the abovementioned conditions, and residing with the borrower in the apartment, and it was further clarified that it will not possible to recognize more than half of the available monthly income of a of the relative who does not purchase an interest in the land, even if the relative has signed the loan agreement as a borrower.

In a letter from the Banking Supervision Department, a limit of NIS 5 million was set for the amount of the loan which permits the receipt of mitigated risk weight pursuant to clause 72 of Proper Conduct of Banking Business Management Regulation 203. For capital weighting purposes, it was determined that a loan whose amount exceeds NIS 5 million should be weighted by 100%.

It was also provided that the new topics defined in the Directive and in a letter of the Banking Supervision Department, mentioned above, will apply with regard to housing loans to which approval has been given in principle, from the earliest date possible, but no later than 1 October 2014 (hereinafter: "the effective date").

Notwithstanding the aforesaid, a banking corporation is entitled to provide approval in principle for a housing loan after the effective date, without the aforesaid applying thereto, on fulfilling the conditions set forth in the letter of the Banking Supervision Department.

On 28 September 2014, the Banking Supervision Department published an update of the provision (hereinafter: "provision update"), pursuant to which it was provided that the banking corporation is obliged to increase the Tier 1 shareholders' equity target, by a rate expressing 1% of the balance of housing loans. The effective date was set at 1 January 2017, with it being established that the capital target should be increased at fixed quarterly rates from 1 January 2015 to 1 January 2017.

With regard to the effect of the amendment to the directive on Leumi Group, see chapter on "Capital Means and Capital Adequacy" above.

In addition, it was determined in the provision update that, with effect from 1 January 2015, the banking corporations may reduce the risk weight for variable interest leveraged loans, as specified in a letter of the Supervisor of Banks on this subject dated 28 October 2010, from 100% to 75%.

**Proper Conduct of Banking Business Management Regulation 439 – Direct debits**

On 1 September 2014, the Banking Supervision Department published an amendment to Proper Conduct of Banking Business Management Regulation no. 439 regarding direct debits. The provision regulates the process for authorizations for debiting an account and their transfer from one bank to another. The main purpose of the amendment is to simplify the process of transferring authorizations for debiting an account from one bank to another and the process of establishing new authorizations. Among the changes included in the proposed amendment are:

The need for using an authorization letter signed by a customer and the bank retaining a copy thereof will be canceled and, in its place, a process of the transfer of details from the customer or the beneficiary will be anchored in all the means of communication established between the bank and the customer or between the bank and the beneficiary, respectively.

The bank is obliged to enable the customer to ensure the identity of the beneficiary by carrying out an examination of correspondence between the institution code and the name of the institution, in order to prevent errors in entering details of the request by the customer. The bank is obliged to send a written response on its decision at the customer's request to establish an authorization to debit an account, within five business days from the date on which the customer's request is received. In addition, a new process was established for transferring direct debits from one bank to another, based on the transfer of data from the old bank to the new bank, as set forth in the regulation.

The regulation will come into force on 1 October 2015.

**Proper Conduct of Banking Business Management Regulation no 308A – Dealing with customer complaints**

On 30 September 2014, the Banking Supervision Department published a directive on the subject of dealing with customer complaints. The directive requires a banking corporation to appoint a designated function to deal with customer complaints, and to place at its head, a Customer Ombudsman. The Ombudsman will be a member of senior management of the banking corporation or directly subject to the aforesaid member. The Ombudsman and his staff should have professional skills, education and experience appropriate to the position, and proper resources for handling customer complaints. The Ombudsman and his staff will not carry out any other duties, apart from dealing with customer enquiries which are not complaints.

In addition, the directive requires the formulation of policy for dealing with customer complaints and establishment of a service charter for the Ombudsman.

With effect from the inception of the directive, clarification of a complaint in the respondent banking corporation will be a prerequisite for submitting the complaint to the Banking Supervision Department (except in exceptional cases). The response of the banking corporation will be given within 45 days. In exceptional circumstances, the Ombudsman will have the authority to extend this period, giving notice to the complainant.

The regulation will come into force on 1 April 2015.

**Proper Conduct of Banking Business Management Regulation no 425 – On the matter of an annual report to customers of the banking corporations (Banking ID)**

On 23 November 2014, the Banking Supervision Department published a new proper conduct of banking management regulation on annual reports to customer of banking corporations (banking ID).

The directive regulates the duty of reporting of a banking corporation to its customers, individuals and small businesses, regarding all of the customer's assets and liabilities in the banking corporation, including the total income and expenses during the year, in respect of assets, liabilities and current activity in the account. Pursuant to the directive, the annual report is intended to improve the ability of the customers to monitor their activity in the account, and increase their ability to compare various banking products and services.

The periodic report is also intended to provide the customer with information regarding his credit rating, as determined in the banking corporation's rating model, so that potential lenders can assess the customer's financial position. However, the data with regard to credit rating will not be presented in the report until an express directive on the part of the Supervisor of Banks is received.

The directive deals with the furnishing of two reports to the customer – one, in a shortened format and other, more detailed, and includes guidelines relating to the information channels through which the information is made available to the customer.

The regulation will come into force on 28 February 2016, in relation to data for 2015.

**Amendment to Proper Conduct of Banking Business Management Regulation no. 325 – Management of credit facilities in current bank accounts**

On 25 November 2014, the Banking Supervision Department an amendment to Proper Conduct of Banking Business Management Regulation no. 325, which discusses the management of credit facilities in current bank accounts. In the context of the amendment, the amount of overdraft which is permitted pursuant to paragraph 8 to the directive, which, until today, stood at NIS 1,000, was increased to NIS 2,000, when it involves "credit to individual persons", and to NIS 5,000, when it involves" commercial credit". In addition, it is provided that a banking corporation will not be required to determine a new credit facility in advance and in writing, if the duration of the overdraft approved does not exceed one working day.

**Amendment to Proper Conduct of Banking Business Management Regulation no. 432 – Transfer of Activity and Closure of a Customer's Account**

On 21 December 2014, the Banking Supervision Department published an update of Proper Conduct of Banking Business Management Regulation no. 432. The directive regulates the Bank's conduct vis-à-vis a customer who requests the closure and transfer of his account, including the ways of communication between the bank and the customer, the response and duration of treatment required of the bank vis-à-vis the customer.

The amendment to the directive is brought to streamline and shorten the process of closing the account and the transition from bank to bank, by a change in the processes of dealing with the customer's request, and the provision of a possibility for a customer to apply to the bank through a variety of channels.

In addition, the amendment has instructions for furnishing a customer with information regarding all of the customer's assets and liabilities in the banking corporation, including the total of the income and expenses during the year, in respect of assets, liabilities and current activity in the account, in the format required under Regulation 425.

The directive will come into force on 1 July 2015, except for the provision relating to the furnishing of information pursuant to Regulation 425, which will come into effect from 28 February 2016.

**Amendment to Accounting Rules (Service to the Customer) (Disclosure and Furnishing of Documents), 1992**

On 7 October 2014, the Banking Supervision Department published an amendment to the Banking Rules (Service to the Customer) (Disclosure and Furnishing of Documents), 1992. The amendment included three topics: 1. An expansion of the duty of publication: Every notice, which, until now, the Bank was obliged to publish on a board in the branch, should also be publicized on the Bank's website. 2. When opening an account for the purpose of a business, the Bank is obliged to forward an explanatory note to the customer in a separate document, setting out the significance of the term "small business" for the purposes of the service tariff-list, and 3. A customer who wishes to join a commissions track will receive from the Bank written information on the amounts of the commissions for the services included in the track, which were collected from him in the quarter preceding that date of submitting the request to join.

On 30 December 2014, the Banking Supervision Department published a further amendment to the Banking Rules (Service to the Customer) (Disclosure and Furnishing of Documents), 1992. The amendment outlines the types of agreements to be published to be by the bank on its website and compels the bank to publish on its site the exchange rates on deposits and current account balances, changes in the cost of credit to its customers, and with regard to the date of sending noting notices. In addition, the amendment authorizes the Supervisor of Banks to determine the types of accounts and conditions which will not be subject to the customer's signature.

**Provisions of the Supervisor of Banks published after the reporting period**

**Update of Proper Conduct of Banking Management Regulation no. 435 – Telephonic Instructions**

On 5 January 2015, the Supervisor of Banks published an amendment to Regulation no. 435, which discusses the topic of telephonic instructions.

According to the amendment, the customer can give his consent to enter into transactions according to a telephonic instruction, as well as by the Internet, and not only in the bank's branch.

**Duty of notifying the customer regarding interest gaps**

On 18 January 2015, the Banking Supervision Department published a letter regarding the duty of notifying the customer regarding interest gaps. The letter included directives which are directed to banking corporations, according to which:

a. Banking corporations must be meticulous on supplying information to the customer who has a debit balance and wishes to place money in a deposit, regarding the gap existing between the interest rates paid on the deposit and the interest rates collected in respect of the debit balance in the account, prior to making the placement of monies on deposit.

b. The banking corporations must contact their customers in writing who, as of the date of the Banking Supervision Department's letter, have a debit balance and at the same time, place monies in a deposit by means of a standing order, and to furnish them with the interest rate paid on the deposit, the interest rate collected in respect of the debit balance in the account, and the interest rate gap between the two, with the interest rate wholly updated to the date of sending the letter.

c. Initiated applications should not be made to customers who, at that date, have a debit balance, with a proposal to place monies in a deposit.

**Amendment to Banking Rules (Service to the Customer) (Commissions), 2008**

On 29 January 2015, Banking Supervision Department published an amendment to the Banking Rules (Service to the Customer) (Commissions), 2008. The amendment updates the Banking Rules (Service to the Customer) (Commissions) on various matters, including: changes in the definition of an account of a small business; expanding the options open to customers, joining a commission track option and a cancelation of the option; an addition of a chapter to the tariff-list detailing commissions to customers who receive clearing services from the banks on transactions by debit card; the cancelation of management fees in housing loans and collection fees due to non-housing loans, given prior to the application of these rules; the cancelation of the deferred payment commission on credit cards in respect of transactions entered into with effect from 1 February 2015; the collection of a commission totaling up to the amount of the clerk's commission in RTGS transfers in the amount of up to NIS 1 million.

The amendment will come into effect gradually, through 1 July 2015.

**Proper Conduct of Banking Management Regarding no. 361 – Management of Cyber-Protection**

On 16 March 2015, the Banking Supervision Department published a new Proper Conduct of Banking Management Regulation on the topic of the management of cyber protection. The directive establishes that consideration should be given to the management of cyber risks as part of the overall system of risk management in the banking corporation and set out a structured, but flexible, framework for managing cyber-risks, while allowing the banking corporation freedom in its execution. The main topics to which the directive refers include: details of the areas of authority of the Board of Directors and senior management on the topic, the appointment of a cyber protection manager, the exercise of periodic control over the area by the Internal Audit Department, the management of cyber risks in a coordinated manner with interfacing systems inside and outside the banking corporation, the determination of a list of principles for maintaining an effective and efficient cyber protection system, the definition of a company-wide cyber protection policy, the existence of an effective process for identifying and assessing cyber risks and the establishment of an effective control system vis-à-vis the cyber risks.

The amendment will come into effect gradually, through 1 September 2015.

**Bank of Israel Circular – Risk management deriving from cross-border activity of customers**

On 16 March 2015, the Banking Supervision Department published a circular regarding risk management deriving from cross-border activity of customers for banking corporations.

The circular provides that, in light of the increasing risks deriving from cross-border activity of customers, and pursuant to the provisions of paragraphs 4 – 6 of Proper Conduct of Banking Management Regulation no. 411, the board of directors and senior management of a banking corporation should examine and update the policy, procedures and controls of the banking corporation in relation to these risks, and ensure that the bank is prepared to deal with them, with an emphasis on the tax indebtedness outside the country in which the account was opened, whether the customer is resident in that country or not, in a risk-based approach.

The banking corporation is obliged to classify high-risk customers from cross-border activity according to various parameters, *inter alia*, the source of wealth and income of the customer and the source of the monies which are supposed to be deposited in the account, the amount and the type of activity in the account, the customer's country of residence, and to take the necessary steps to implement the policy: e.g., to obtain from the customer a declaration reporting on his income in accordance with the law applicable to him and the obligation to notify any change in the tax indebtedness and to establish procedures and scale of powers for approving the opening of an account.

The circular provides that the refusal to provide banking services will be considered a reasonable refusal for the purposes of the Banking Law (Service to the Customer), 1981, in the following cases: the opening of an account for a customer who does not cooperate with the banking corporation, in a way that was necessary to implement the Bank's policy and procedures for the purpose of cross-border risk, and therefore, the continuation of providing service in an existing account, such that it exposes the banking corporation to risk, which will be considered as cooperating with the customer for the purpose of bypassing foreign legislation, which applies to the customer.

The content of the circular is intended to be incorporated as part of Proper Conduct of Banking Management Regulation no. 411 – "Prevention of Money Laundering and the Financing of Terrorism and Identification of Customers". The circular is in effect from the date of its publication. In addition, the circular stipulates transitional provisions regarding existing accounts, according to which the banking corporation is obliged to complete the necessary actions with regard to existing accounts which it classifies as customers at high risk by 31 December 2015, and with regard to existing accounts by 31 December 2016.

For the Bank's preparedness regarding cross-border regulations, see Chapter "Exposure to Risk and Methods of Risk Management", below.

**Draft amendment to the Banking Rules (Service to the Customer) (Commissions), 2008 and draft Banking Order (Service to the Customer) Super of the Service or Warning Service, 2015**

On 9 March 2015, the Banking Supervision Department published a draft amendment to the Banking Rules (Service to the Customer) (Commissions), 2008 and draft Banking Order (Service to the Customer) Super of the Service or Warning Service, 2015. The draft includes amendments in various areas related to commissions, including, the announcement of a notices commission as a service which may be regulated and the determination of its maximum price of NIS 5, the cancelation of a depositor's debit commission on the return of a cheque, and the prohibition of the collection of debit card fees for a customer holding a credit card.

**Draft amendment to the Proper Conduct of Banking Management Regulation no. 470 regarding charge cards, a draft letter regarding the expansion of circulation of debit cards and a draft Banking Order (Service to the Customer) Supervision of a Service Provided by an Issuer to a Clearer in connection with Interchanging of Debit Card Transactions (Temporary Provision), 2015**

On 9 March 2015, the Banking Supervision Department published Draft amendment to the Proper Conduct of Banking Management Regulation no. 470 regarding charge cards, a draft letter regarding the expansion of circulation of debit cards and a draft Banking Order (Service to the Customer) Supervision of a Service Provided by an Issuer to a Clearer in connection with Interchanging of Debit Card Transactions (Temporary Provision), 2015.

Pursuant to the draft amendment to Regulation no. 470, a chapter on "Debit cards and rechargeable cards" was added, providing various provisions with regard to these cards, including provisions regarding the date of charging the customer in these transactions, provisions regarding the date of transferring the monies from the issuer to the clearer and from the clearer to the merchant, provision provisions regarding the frontal isolation of the cards, and provisions regarding the disclosure given to the customer for the transactions in these cards.

In the draft of the letter regarding the expansion of the circulation of debit cards, the Banking Supervision Department provided regulations regarding the increase of the circulation of the debit card, including rules about offering cards to new and existing customers. The draft of the Banking Order (Service to the Customer), Supervision of a Service Provided by an Issuer to a Clearer in connection with Interchanging of Debit Card Transactions (Temporary Provision), 2015 provides the maximum rate of commission, which may be collected for the service provided by an issuer to a clearer in connection with the interchange of debit card transactions must not exceeds 0.3% of the amount of transaction.

**Additional regulations**

**Consortium arrangements for granting credit**

On 30 December 2014, the Antitrust Authority published an updated letter to the managers of the banking corporations and institutional entities, setting out the conditions that if fulfilled, the Antitrust Authority does not intend to enforce the provisions of the Antitrust Law, 1988 ("the Law"), on a consortium for granting credit. The letter establishes that a transaction to grant shared credit, to which Bank Leumi and Bank Hapoalim are joined, will not require individual confirmation from the Antitrust Authority. Additional principal conditions included in the letter: formation on a credit consortium will be made after receiving written authorization from the customer on a separate form; the customer will be granted an option to negotiate the conditions of the provision of the credit with any of the parties joining the consortium, including through another person on his behalf; any information which is not required for joining will not be transferred among the parties in the specific consortium regarding which contacts are being made; the parties will maintain documentation which will include all of the data as detailed in the letter. The effective date of the letter is a year from the date of its publication.

**Report of the Committee to Examine Debt Arrangements in Israel (Endoren Committee)**

On 17 November 2014, the Report of the Committee to Examine Debt Arrangements in Israel was published. The report proposes a set of rules for dealing with companies in difficulties, through an outline of two stages. The outline is intended to increase the certainty among players in the market (bank and non-bank) and to create incentives to reach agreements, at an early date, before the company's situation becomes worse. In addition, the report included recommendations for the determined of joint principles for the institutional entities and guarantor the banking system with regard to the grant of loans for leveraged purchases, credit limits for a corporate group and the Promotion of Competition and the Reduction of Concentrations Law, 2013 and principles for the grant of loans according to the borrower's relevant characteristics. To the best of the Bank's knowledge, the Bank of Israel is taking steps to implement the committee's recommendations by updating the relevant banking standard procedures.

## International Regulations

### Foreign Account Tax Compliance Act – FATCA

In March 2010, the United States Congress enacted the Foreign Account Tax Compliance Act (FATCA), amending the Internal Revenue Code in the United States (the U.S. Income Tax Law) and bringing into effect a new reporting regime for foreign financial institutions operating outside the United States. The aim of the law is to compel foreign financial institutions to transfer information to the U.S. tax authorities regarding accounts held with them by U.S. customers, thus considerably expanding the disclosure and reporting requirements imposed on FFI in relation to these accounts. The law and the regulations by virtue thereof came into force on 1 July 2014.

Pursuant to the law and regulations, foreign financial institutions are obliged to enter into an agreement with the Internal Revenue Service (IRS), whereby the foreign financial institution will undertake, *inter alia*, to locate accounts of U.S. customers, report on them once a year to the IRS and deduct tax from customers who refuse to furnish the required information and documents. A foreign financial institution that does not comply with the provisions of the law will be charged a deduction of withholding tax at 30% in respect of all of its income from U.S. revenue sources.

The IRS has published a model for an inter-governmental agreement for implementing the FATCA, according to which financial institutions situated in a country which has signed an intergovernmental agreement, as aforesaid, will enjoy certain reliefs pursuant to the FATCA requirements. For the purpose of preparations for the implementation of the law in Leumi Group, in 2011, the Bank set up a steering committee in 2011, under whose direction the FATCA requirements in the Bank and in the relevant Group companies were implemented, and work procedure for dealing with U.S. customers were established. 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 prohibiting the giving of advice to customers on taxation matters, particularly U.S. tax, and assisting them in concealing their identity. In recent years, additional procedures have been issued regulating the area of identifying, locating and handling U.S. customers, as a complement to the procedures previously issued.

In April 2014, the Supervisor of Banks issued "Directives for the Preparedness for the Implementation of the FATCA Regulations", pursuant to which the banks were instructed, as follows: "to appoint a responsible official and set up a designated working team to coordinate the implementation of the directives, directly subject to a member of management", to update the management and the board of directors on the rate of progress of preparedness and to provide appropriate policy and procedures. In addition, the directives included the possibility of "refusal to grant certain banking services" in cases of non-cooperation on the part of the customer in the manner required for implementation of the FATCA regulations.

In July 2014, the governments of Israel and the United States announced that they had signed an Inter-Governmental Agreement (IGA) for improving international tax enforcement and the implementation of the FATCA regulations. The agreement regulates the transfer of information to the IRS through the Israeli Tax Authority, which will receive the information from the financial institutions in Israel. The information to be forwarded will include details regarding financial accounts held in Israel by U.S. customers.

It should be noted that the Bank and Leumi Group companies were prepared for the FATCA requirements, when these came into effective on 1 July 2014. It should also be noted that, pursuant to the Deferred Prosecution Agreement (DPA), with the United States Department of Justice (DOJ),, Leumi took upon itself to implement the FATCA requirements at standards higher than in the Inter-Governmental Agreement.

### Standard of automatic Exchange of Financial Account Information – OECD

The OECD organization has published a standard for the implementation of uniform reporting to replace automatic information regarding financial accounts between countries (hereinafter "the standard"). This standard is constructed in the spirit of the U.S. FATCA and is intended to increase transparency and supervision of tax reporting for residents of the OECD countries. The model was approved in principle by the G-20 Committee in September 2013. On 21 July 2014, the OECD published a guide for implementation of the standard.

The reporting standard is composed of two parts:

1. The Common Reporting Standard (CRS) model, which imposes a duty of identification and reporting on financial institutions with regard to reportable financial accounts held by them. The model prescribes the financial institutions which are required to report, the types of account that required to be reported, the type of information to be furnished and the procedures for examining fairness which the financial institutions are obliged to apply.
2. The Competent Authority Agreement (CAA) model – a model which constitutes the basis for the legal agreements to be signed between the various countries for the purpose of exchanging information to be received from the financial institutions.

As of date, more than 90 countries have undertaken to adopt the standard, with 60 countries having undertaken early adoption of the standard. (The commencement of the application for them will be 1 January 2016, and initial reporting in September 2017.) Israel is not among those opting for early adoption. In October 2014, the Ministry of Finance announced that "Israel will adopt the procedure of automatic exchange of information about financial accounts for tax purposes by the end of 2018".

For the purpose of implementing the standard, the Government is expected to prepare the necessary legislative amendments which will authorize the Ministry of Finance to sign the agreements with the other countries, to require the financial entities to transfer the information to tax authorities, and to transfer the information to the relevant countries.

Leumi has begun to study the subject towards its implementation in the future, *inter alia*, through the steering committee which was appointed to deal with this matter.

**Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA)**

The Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) is an American Federal Law which came into force on 21 July 2011 and implements a comprehensive reform of financial regulation, with various implications for Bank Leumi, the main points of which relate to over-the-counter (OTC) swap derivative transactions.

**European Market Infrastructure Regulation (EMIR)**

At the same time as the DFA, the European Union published the EMIR, which contains principles similar, but not identical, to DFA. The EMIR applies, *inter alia*, to European financial entities, similar duties to those applied under the DFA (clearing, reporting, and management of collateral).

The implementation regulations of EMIR have not yet been fully completed.

In order to prepare for the implementation of the DFA and EMIR in Leumi Group, the Bank has set up a steering committee to study and monitor the development of the relevant legislation under them and the requisite timetable.

Most of the duties by virtue of DFA and EMIR apply to the Bank indirectly because of its engagement with American and/or European financial institutions. In addition, from time to time, the Bank is requested by American and/or European counterparties to approve its attachment to various protocols of the International Swaps and Derivatives Association (ISDA), with the intention of guaranteeing that the counterparties fulfilling the duties under the DFA and the EMIR.

## Taxation

### Company tax

The company tax rate is 26.5%, with effect from 1 January 2014 (2013 – 25%).

The statutory rate of tax (including profit tax and salary tax), applicable to all financial institutions, for 2014 and thereafter, is 37.71% (2013 – 36.21%).

### Value added tax and national insurance

The rate of profit tax and payroll tax, which is imposed on financial institutions, is 18%, with effect from 2 June 2013.

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 from January 2013, the rate of national insurance contributions 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%. In addition, it was provided that this rate would increase to 7% and 7.5% in January 2014 and January 2015, respectively. However, on 27 January 2014, the Reliefs in the Capital Market and Encouragement of Activity Therein (Legislative Amendments), 2014, was published according to which the rate of insurance fees collected from employers in respect of the part of salary exceeding 60% of the average salary in the market, will be updated in January 2014, January 2015 and January 2016 to 6.75%, 7.25% and 7.5%, respectively.

## 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 estimates and assessments are generally based on economic forecasts, assessments regarding the various markets and past experience, while exercising discretion, which management believes to be reasonable at the time of signing of the financial statements.

The actual results relating to these items may differ from the estimates and/or the assumptions.

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**

The collective allowance for credit losses is applied to 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 Public Reporting Directive. The collective in respect of 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 rates of realization of the credit.

Pursuant to the Public Reporting Directive, which was updated in January 2015, the rates of collective allowance were determined by allocating according to the various market sectors, on the basis of the average historical rates of loss for doubtful debts in each market sector (rates of allowances/accounting write-offs). In addition, the Bank takes into account relevant environmental factors, including developments in sectoral conditions, macro-economic and sectoral data, changes in credit volume and mix, other factors, including credit concentrations, and expert assessments of the risks and risk management in the Bank. On the basis of the relevant environmental factors, as mentioned above, the Bank determines an increment in the rate of collective allowance in respect of each market segment, in excess of the average of past losses. In accordance with the said revision to the Public Reporting Directive, published by the Bank of Israel on 19 January 2015, this increment in excess of the average with regard to credit to private individuals which is not problematic – must not be less than 0.75%, with effect from December 2014.

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, *inter alia*, 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 (subject to a minimum rate determined by the Supervisor of Banks).

The Bank examines the accuracy of the collective allowance each quarter based, *inter alia*, on the assessment or risks inherent in the credit portfolio and an examination of the trends and developments in the main segments, and from a forward-looking standpoint, as far as can be assessed, implementing the principles of Proper Conduct of Banking Management Regulation no. 314 "Fair assessment of credit risks and fair measurement of debts".

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. This calculation acts as an indication with regard to the collective allowance, so that it is possible to ensure that the collective allowance is higher than the supplementary and general provision, at least compared to that required according to Bank of Israel directives.

**Individual allowance**

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 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 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 1 million 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, which the Bank implements 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 a process of dealing with customers defined as "sensitive customers". In the Corporate and Commercial Division and in the International Credit and Real Estate Division, which deal with the larger customers of the Bank and medium-sized business corporations, a quarterly credit review process is carried out, in which borrowers whose risk rating is higher than that requiring inclusion in the customer population defined 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 Credit Risk Management (CRM) Units in the Risk Management 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, *inter alia*, subjective assessments which have an implication for the classification of debts and on the credit loss allowance.

Pursuant to the revisions in the Proper Conduct of Banking Management Regulations which came into force during the year, the Risk Management Division is responsible for the fairness of the classifications and the allowances, with the Bank's Allowances Committee, headed by the President and Chief Executive Officer, each quarter, discussing the allowances required for the quarter and the recommendations for the classification of problem loans.

**Derivative instruments**

In accordance with the directives regarding financial reporting of the Supervisor of Banks, the Bank applies Financial Accounting Standard 133, FAS 138, FAS 149 and FAS 157, all 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 and a willing seller at the measurement date. Among other things, the standard requires for the purpose of the assessment of fair value to make maximum use of observable data and minimum use of unobservable data. Observable data represent information which is available in the market received from independent sources, while unobservable 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 observable or unobservable. 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 observable in a market or supported by observable market data.

Level 3 data: Unobservable data for the asset or the liability deriving from valuation models, where one or more of the significant figures are unobservable.

This hierarchy requires the use of observable market data, when this information exists. When this is possible, the Bank weighs relevant observable market information as part of its assessment. The scope and frequency 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 observable prices in those markets.

The level in the fair value scale to which the fair value measurement of the financial instrument belongs will be 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 reflects 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. but not solely limited to this risk.

In accordance with the transitional provisions, specific directives regarding the methodology and data to be 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 customer level, using a credit quality index based on internal models or on market data.

In May 2014, approval was received from the Banking Supervision Department to compute the adjustment at the customer level in the quarterly reports and in the 2014 Annual Report, similar to the computation made in 2013 without the use of a complex model, including various scenarios of potential exposure.

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 with regard to the determination of fair value, see Note 1H.

**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 (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-makers are active).

In non-tradable securities of companies in Israel, fair value is based on data received from the "Mirvach Hogen" company. The Bank has validated the model and ensured with a reasonable degree of security the accuracy of the fair value. Sometimes, for reasons of prudence, when there are indicators, the Bank adjusts the model and/or market price in order to establish a more accurate value.

For further details, see the chapter, "Structure and Development of Assets and Liabilities, Securities", see below.
For further details with regard to the determination of the fair value, see Note 1H.

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 if one or more of the following conditions are met:

1. A security that was sold before 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 section.
4. A debenture which, after its purchase, was classified as problematic by the Bank.
5. A debenture for which there was a credit failure that 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 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) and determined by the Supervisor of Banks. 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.

Quantitative sensitivity analysis of the effect of main assumptions in the calculation of the actuarial liability is as follows:

A decrease of 1.0% in the rate of capitalization of the abovementioned liabilities will result in an increase of NIS 2.1 billion in total liabilities. A decrease of 1.0% in the increase of salary will result in a reduction of NIS 613 million in total liabilities. An increase of 5.0% in the life expectancy will result in an increase of NIS 95 million in total liabilities. All 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.

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.

On 9 April 2014, the Banking Supervision Department published a circular regarding the adoption of United States accounting principles on the subject of employee rights. The circular updated the recognition, measurement and disclosure requirements on the subject of employee benefits in the Public Reporting Directives in accordance with accounting principles generally accepted in banks in the United States.

The circular provides that the amendments to the Public Reporting Directives will apply from 1 January 2015 when, on initial implementation, the Bank will retroactively amend the comparative figures for periods commencing 1 January 2013 and thereafter, in order to comply with the requirements of the principles, in accordance with the provisions of the circular.

On 11 January 2015, the Supervisor of Banks published a supplementary circular, which was published on 9 April 2014, which includes a format of disclosure on the subject of employee rights and on the subject of share-based payments. In addition, the circular updates other subjects, including: discount rates, transitional provisions, requirements for disclosure in the report of other comprehensive income, in the note on accumulated other comprehensive income and the requirements for disclosure in the report of the Board of Directors. It is noted in the circular that the Bank of Israel had come to the conclusion that Israel did not have a solid market for high-quality corporate debentures. Accordingly, the discount rate for employee benefits should be computed on the basis of the yield from government debentures in Israel with the addition of an average margin of international corporate debentures rated AA and above. For practical reasons, it was provided that the margin should be based on the margins of corporate debentures in the United States. A bank which believes that the changes in the margin obtained in a certain period are derived from irregular fluctuations in markets in such a way that the margins obtained thereby are not appropriate for use in discounting as aforesaid, should apply to receive a pre-ruling from the Banking Supervision Department. Examples of these situations may include, *inter alia*, changes in respect of which the margin obtained is higher than the margin on AA-rated (local) corporate debentures in Israel.

The Bank is required to retroactively amend the comparative figures for periods commencing 1 January 2013 and thereafter. As regards the accounting treatment of actuarial gains and losses arising from the changes in discount rates, it was provided as follows:

- The actuarial loss as of 1 January 2013 arising from the gap between the discount rate for computing reserves for covering index-linked employee rights provided according to the temporary provisions of the Public Reporting Directives (4%) and the discount rates at this date determined according to the new rules as explained above will be included in accumulated other comprehensive income.
- Actuarial gains recorded from 1 January 2013 and thereafter, as a result of current changes in the discount rates during the reporting year, will be recorded in accumulated other comprehensive income and will reduce the balance of the loss recorded as stated above until this balance is reduced to zero.
- Actuarial gains arising from current changes in discount rates during the reporting year after the recorded balance of the loss has been reduced to zero, as stated above, and actuarial losses, will be amortized using the straight-line method over the average period of service remaining of the employees who are expected to receive benefits under the plan.
- Other actuarial gains and losses (which do not arise as a result of a change in discount rates) as of 1 January 2013 and in the subsequent period. will be included within accumulated other comprehensive income and will be amortized on a straight-line basis over the average period of service of the employees who are expected to receive benefits under the plan.
- The effect of the initial implementation on other employee benefits, all of the changes in which are carried to the profit and loss on a current basis (such as a jubilee bonus) will be carried to retained earnings.

In addition, the circular updates the disclosure requirements regarding employee rights and share-based payments in accordance with generally accepted accounting principles in banks in the United States.

On 12 January 2015, an FAQ was published regarding employees, including examples of the treatment of common benefits in the banking system, in accordance with generally accepted accounting principles in banks in the United States.

The Bank estimates that the anticipated effect as of 1 January 2015 in respect of the new rules which is primarily attributable to the change in the discount rate is an increase in assets amounting to between NIS 0.9-1.1 billion, an increase in liabilities amounting to between NIS 2.4-2.8 billion and a reduction in shareholders' equity amounting to between NIS 1.5-1.7 billion after tax. The increase or decrease in the discount rate is likely to have a significant effect on the total liabilities in respect of employee rights, and therefore, on the shareholders' equity. In the first quarter of 2015, the yield derived from the capital markets fell, resulting in a further decrease in the discount rate, which, insofar as it continues until the end of March 2015, will be reflected in the report of 31 March 2015. This decrease, based on the data for the middle of March, is expected to reduce the shareholders' equity by a further amount of between NIS 0.8-1.1 billion after the effect of tax.

The computation of the capital requirements pursuant to the Basel III provisions will be made in accordance with the transitional provisions established in Proper Conduct of Banking Management Regulation no. 299, which provides that the balance of other comprehensive income or loss arising from adjustments in respect of employee benefits , and the amount carried directly to retained earnings as of 1 January 2013 in respect of the effect of initial adoption will not be brought into account immediately, but will be subject to the transitional provisions, so that their effect will be spread as follows: 40% from 1 January 2015, and a further 20% on 1 January of each year, until full implementation commencing 1 January 2018.

For disclosure of an estimate of the expected effect on the Tier 1 shareholders' equity ratio as of 31 December 2014, see Note 13A.
For further details, see Note 1Y.

**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 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 risks inherent in requests for the approval of class actions is complex, 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 decline in value.

Buildings offered for sale are presented at the lower of their book value or realization value as determined by assessors. The amount of the provision for impairment of assets offered for sale is affected by changes in the valuation of the asset.

The Bank classifies in this item the costs in respect of software assets purchased or cost which are capitalized as an asset in respect of programs developed internally for self-use.

Programs which have been purchased are measured at cost net of accumulated depreciation and losses from impairment.

Costs in connection with the development and adaptation of computer programs for self-use are capitalized only if the development costs may be reliably measured, the software is technically applicable, a future economic benefit is expected and the Bank has an intention and sufficient resources to complete the development and use the software. Capitalized costs include direct costs of materials, services and direct cost of labor. These costs are measured at cost, net of accumulated depreciation and losses from impairment. Other costs are charged to profit and loss as they arise.

Subsequent costs in respect of software are recognized as an asset, only when they increase the future economic benefits inherent in the asset for which they were incurred. All other costs are charged to the statement of profit and loss as they arise.

Depreciation is calculated on the basis of the cost, over the useful life, using the straight line method. Capitalized costs for investments are depreciated from the date of their operation according to an assessment of the period of their use, from the date on which the asset is ready for 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 amount. 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).

**Taxes 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.

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 balance sheet 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 investee companies.

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

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

**The net profit attributable to the shareholders of the banking corporation** (hereinafter "net profit") of Leumi Group in 2014 amounted to NIS 1,502 million, compared with NIS 1,982 million in 2013, – a decrease of 24.2%. Excluding the expenses relating to the arrangements with overseas authorities, the net profit for 2014 was NIS 2,526 million, compared with NIS 2,203 million in 2013, an increase of 14.7%.

**The decrease in net profit in 2014, compared with 2013 is explained as follows:**

| | For the year ended 31 December | | | |
|---|---|---|---|---|
| | **2014** | 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Net income interest (a) | **7,363** | 7,357 | 6 | 0.1 |
| Expenses in respect of credit losses | **472** | 268 | 204 | 76.1 |
| Non-interest income (a) | **5,173** | 5,517 | (344) | (6.2) |
| Other operating expenses | **9,311** | 8,892 (b) | 419 | 4.7 |
| Profit before taxes | **2,753** | 3,714 | (961) | (25.9) |
| Provision for tax | **1,281** | 1,397 (b) | (116) | (8.3) |
| Profit after taxes | **1,472** | 2,317 | (845) | (36.5) |
| The Bank's share in profits (losses) of companies included on equity basis | **42** | (293) | 335 | + |
| Net profit attributed to non-controlling interests | **(12)** | (42) | 30 | 71.4 |
| Net profit attributed to shareholders in the banking corporation | **1,502** | 1,982 | (480) | (24.2) |

The loss of the Leumi Group in the fourth quarter of 2014 amounted to NIS 111 million, compared with a profit of NIS 356 million in the corresponding period last year.

| | For the three months ended 31 December | | | |
|---|---|---|---|---|
| | **2014** | 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Net income interest (a) | **1,802** | 1,810 | (8) | (0.4) |
| Expenses in respect of credit losses | **483** | 155 | 328 | + |
| Noninterest income (a) | **1,221** | 1,420 | (199) | (14.0) |
| Other operating expenses | **2,235** | 2,244 (b) | (9) | (0.4) |
| Profit before taxes | **305** | 831 | (526) | (63.3) |
| Provision for tax | **157** | 301 (b) | (144) | (47.8) |
| Profit after taxes | **148** | 530 | (382) | (72.1) |
| The Bank's share in profits (losses) of companies included on equity basis | **(252)** | (165) | (87) | (52.7) |
| Net loss (profit) attributed to non-controlling interests | **(7)** | (9) | 2 | 22.2 |
| Net profit attributed to shareholders in the banking corporation | **(111)** | 356 | (467) | - |

See notes on next page.

(1) The financial statements are prepared in reported values. The known consumer price index fell by 0.1% in 2014. The shekel depreciated in nominal terms by 12% against the U.S. dollar, and appreciated against the euro by 1.2%. The representative rate of exchange of the U.S. dollar on 31 December 2014 was NIS 3.889.
For further details see Note 1(E) to the financial statements.

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

| | **2014** | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter |
| | NIS millions | | | | | | | |
| Net income interest (a) | **1,802** | **1,899** | **1,905** | **1,757** | 1,810 | 1,946 | 1,839 | 1,762 |
| Expenses (income) in respect of credit losses | **483** | **56** | **(16)** | **(51)** | 155 | (44) | 84 | 73 |
| Non-interest income (a) | **1,221** | **1,328** | **1,250** | **1,374** | 1,420 | 1,382 | 1,246 | 1,469 |
| Other operating expenses (b) | **2,235** | **2,459** | **2,504** | **2,113** | 2,244 | 2,432 | 2,169 | 2,047 |
| Profit before taxes | **305** | **712** | **667** | **1,069** | 831 | 940 | 832 | 1,111 |
| Provision for tax (b) | **157** | **362** | **373** | **389** | 301 | 346 | 286 | 464 |
| Profit after taxes | **148** | **350** | **294** | **680** | 530 | 594 | 546 | 647 |
| The Bank's share in profits (losses) of companies included on equity basis | **(252)** | **345** | **(14)** | **(37)** | (165) | (17) | (54) | (57) |
| Net profit attributed to non-controlling interests | **(7)** | **(11)** | **17** | **(11)** | (9) | (12) | (10) | (11) |
| Net profit attributed to shareholders in the banking corporation | **(111)** | **684** | **297** | **632** | 356 | 565 | 482 | 579 |

(a) In 2014, Directive 310 was adopted for the first time on the format of the statement of profit and loss for banking corporation and the adoption of generally accepted accounting principles for banking corporations regarding the measurement of interest income which affected net interest income and the item, commissions, see Note 1 in the financial statements.

(b) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R

**Net interest income** of Leumi Group in 2014 amounted to NIS 7,363 million, compared with NIS 7,357 million in 2013, an increase of NIS 6 million, or 0.1%.

The increase in net interest income in 2014, compared with last year, was attributable to the initial implementation of a provision regarding the measurement of interest income amounting to NIS 188 million. On the other hand, the continuing decrease in interest rates reduced interest income. The decrease was partly offset by an increase in activity.

In the fourth quarter of 2014, net interest income amounted to NIS 1,802 million compared to NIS 1,810 million in the corresponding period in 2013, a decrease of 0.4%.

The ratio of net interest income to the average balance of income-bearing assets (net return on income-bearing assets) is 2.22%, compared with 2.24% in the corresponding period in 2013.

**The following shows the breakdown of net interest income by main operating segments:**

| | For the year ended 31 December | | | |
|---|---|---|---|---|
| | **2014** | 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Households | **2,627** | 2,647 | (20) | (0.8) |
| Small businesses | **1,040** | 948 | 92 | 9.7 |
| Corporate banking | **1,252** | 1,384 | (132) | (9.5) |
| Commercial banking | **1,463** | 1,374 | 89 | 6.5 |
| Private banking | **282** | 292 | (10) | (3.4) |
| Financial management | **687** | 700 | (13) | (1.9) |
| Other | **12** | 12 | - | - |
| Total | **7,363** | 7,357 | 6 | 0.1 |

**Total Interest Margin** in 2014 was 1.98%, compared with a margin of 1.87% in 2013.

The interest margins in activity in Israel by segment were as follows:

In the unlinked shekel sector, 2.49%, compared with 2.48% in the corresponding period last year. The interest margin in the foreign currency sector was 1.75%, compared to 1.55% in the corresponding period last year. In the index-linked segment, the interest margin was 0.42%, compared with 0.22% in the corresponding period last year.

For further information, see Management Review, Exhibit C and Note 20 to the financial statements.

**Expenses in respect of credit losses** of Leumi Group amounted to NIS 472 million in 2014, compared with NIS 268 million in 2013, an increase of 76.1%. In the Bank, expenses in respect of credit losses amounted to NIS 195 million in 2014, compared with NIS 27 million in 2013.

In the fourth quarter of 2014, expenses in respect of credit losses amounted to NIS 483 million, compared with NIS 155 million in the corresponding period last year.

The increase in credit loss expenses in the two abovementioned periods derives mainly from the initial implementation of the Bank of Israel directives in January 2015 relating to "collective allowance in respect of credit to private individuals". As a result of the implementation, NIS 208 million was charged as credit loss expenses in the fourth quarter of 2014.

In addition, the agency in Romania recorded NIS 52 million in credit loss expenses in the fourth quarter of 2014, as a result of the requirement of the Romanian Central Bank for the entire banking system in Romania to increase the level of allowances, mainly against the portfolio, which, according to the definition of the Romanian Central Bank, is classified as not generating interest income.

**Data on credit loss expenses (income) by quarter are as follows:**

| | **2014** | | | | | 2013 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Year 2014** | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter | Year 2013 | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter |
| | NIS millions | | | | | | | | | |
| Individual expense (income) in respect of credit losses | **(94)** | 157 | (60) | (114) | (77) | 11 | 59 | (80) | 39 | (7) |
| Collective expenses (income) in respect of credit losses | **566** | 326 | 116 | 98 | 26 | 257 | 96 | 36 | 45 | 80 |
| Total expense (income) in respect of credit losses | **472** | 483 | 56 | (16) | (51) | 268 | 155 | (44) | 84 | 73 |
| **Percentage ratios (in annual terms):** | | | | | | | | | | |
| Individual expenses (income) in respect of credit losses to total credit to the public, net | **(0.03)** | 0.25 | (0.10) | (0.19) | (0.12) | - | 0.10 | (0.13) | 0.07 | (0.01) |
| Collective expenses in respect of credit losses to total credit to the public, net | **0.22** | 0.52 | 0.19 | 0.16 | 0.04 | 0.11 | 0.16 | 0.06 | 0.07 | 0.13 |
| Total expenses (income) in respect of credit losses to total credit to the public, net | **0.19** | 0.77 | 0.09 | (0.03) | (0.08) | 0.11 | 0.26 | (0.07) | 0.14 | 0.12 |
| Individual expenses (income) in respect of credit losses to total credit risk to the public | **(0.02)** | 0.16 | (0.06) | (0.13) | (0.09) | - | 0.07 | (0.09) | 0.04 | (0.01) |
| Collective expenses in respect of credit losses to total credit risk to the public | **0.14** | 0.33 | 0.12 | 0.11 | 0.03 | 0.07 | 0.10 | 0.04 | 0.05 | 0.09 |
| Total expenses (income) in respect of credit losses to total credit risk to the public | **0.12** | 0.49 | 0.06 | (0.02) | (0.06) | 0.07 | 0.17 | (0.05) | 0.09 | 0.08 |

**The following table shows the balance of the allowance for credit losses on a collective basis:**

| | **31 December 2014** | 31 December 2013 |
|---|---|---|
| Credit loss allowance on a collective basis (NIS millions) | **3,041** | 2,702 |
| Balance of credit loss allowance on a collective basis to total credit to the public, net (%) | **1.20** | 1.12 |
| Balance of credit loss allowance on a collective basis to total credit risk to the public, net (%) | **0.78** | 0.72 |

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

| | **For the year ended 31 December** | | For the year ended 31 December | |
|---|---|---|---|---|
| | NIS millions | % (a) | NIS millions | % (a) |
| Households | **407** | **0.4** | 179 | 0.2 |
| Private banking | **14** | **0.2** | 9 | 0.1 |
| Small businesses | **182** | **0.8** | 112 | 0.5 |
| Corporate banking | **(489)** | **(0.8)** | (166) | (0.3) |
| Commercial banking | **153** | **0.3** | 186 | 0.4 |
| Financial management and other | **205** | **42.3** | (52) | (9.1) |
| Total | **472** | **0.19** | 268 | 0.11 |

(a) Percentage of total credit of the segment at the end of the period.

**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 | |
|---|---|---|
| | **2014** | 2013 |
| | NIS millions | |
| Industry | **(166)** | 93 |
| Construction and real estate | **(101)** | (21) |
| Trade | **140** | (9) |
| Hotel, food and catering services | **(47)** | 14 |
| Transportation and storage | **(35)** | (28) |
| Communications and computer services | **(60)** | 11 |
| Financial services | **272** | (115) |
| Other business services | **33** | 75 |
| Private individuals - housing loans | **24** | 53 |
| Private individuals – other | **356** | 182 |
| Others | **54** | 10 |
| Total public | **470** | 265 |
| Total banks | **2** | 3 |
| Total governments | **-** | - |
| Total | **472** | 268 |

**The following table shows the breakdown of expenses 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 | | | |
|---|---|---|---|---|
| | **2014** | 2013 | Change | |
| | NIS millions | | NIS millions | % |
| The Bank | **195** | 27 | 168 | + |
| Leumi Card | **25** | 10 | 15 | + |
| Arab Israel Bank | **17** | 9 | 8 | 88.9 |
| Leumi U.S.A. | **68** | 38 | 30 | 78.9 |
| Leumi U.K. | **100** | 182 | (82) | (45.1) |
| Leumi Romania | **67** | 1 | 66 | + |
| Others | **-** | 1 | (1) | (100.0) |
| Total expenses (income) in respect of credit losses | **472** | 268 | 204 | 76.1 |

**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:**

| | **2014** | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | % | | | | | | | | | | |
| Israeli banking system | **0.16** (a) | 0.25 | 0.42 | 0.39 | 0.41 | 0.75 | 0.72 | 0.28 | 0.52 | 0.69 | 0.88 |
| Leumi Group | **0.19** | 0.11 | 0.51 | 0.30 | 0.26 | 0.74 | 1.01 | 0.20 | 0.51 | 0.79 | 0.87 |

(a) Estimate of the banking system on the basis of data for the five largest banks.

## Problem credit risk

| | **31 December 2014** | | |
|---|---|---|---|
| | Balance sheet | Off-balance sheet | Total |
| | NIS millions | | |
| **1. Problem credit risk:** (a) | | | |
| Impaired credit risk | **4,816** | **375** | **5,191** |
| Subordinate credit risk | **2,331** | **637** | **2,968** |
| Credit risk under special supervision (b) | **3,060** | **529** | **3,589** |
| Total problem credit | **10,207** | **1,541** | **11,748** |
| Of which: Unimpaired debts in arrears 90 days or more (b) | **941** | **-** | **-** |
| **2. Non-performing assets:** | | | |
| Impaired debts | **4,411** | **-** | **-** |
| Assets received in respect of credit cleared | **15** | **-** | **-** |
| Total non-performing assets | **4,426** | **-** | **-** |

| | 31 December 2013 | | |
|---|---|---|---|
| | Balance sheet | Off-balance sheet | Total |
| | NIS millions | | |
| **1. Problem credit risk:** (a) | | | |
| Impaired credit risk | 5,782 | 333 | 6,115 |
| Subordinate credit risk | 1,832 | 187 | 2,019 |
| Credit risk under special supervision (b) | 3,260 | 795 | 4,055 |
| Total problem credit | 10,874 | 1,315 | 12,189 |
| Of which: Unimpaired debts in arrears 90 days or more (b) | 1,112 | - | - |
| **2. Non-performing assets:** | | | |
| Impaired debts | 5,217 | - | - |
| Assets received in respect of credit cleared | 101 | - | - |
| Total non-performing assets | 5,318 | - | - |

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.

(a) Credit risk impaired risk, subordinate or under special supervision.

(b) Including in respect of housing loans in respect of which there is an allowance according to the extent of 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:**

| | 31 December 2014 | 31 December 2013 |
|---|---|---|
| | % | |
| Balance of impaired credit to the public not accruing interest income as a percentage of the balance of credit to the public | **1.7** | 2.1 |
| 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 | **0.4** | 0.5 |
| 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 | **90.5** | 74.5 |
| Problem commercial credit risk in respect of the public as a percentage of total credit risk in respect of the public | **2.7** | 2.9 |
| Expenses in respect of credit losses as a percentage of the average balance of credit to the public | **0.2** | 0.1 |
| Net write-offs in respect of credit to the public as a percentage of the average balance of credit to the public | **0.1** | 0.2 |
| 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 | **7.6** | 13.2 |

**Noninterest income** of Leumi Group in 2014 amounted to NIS 5,173 million, compared with NIS 5,517 million in the corresponding period last year, a decrease of NIS 344 million, or 6.2%.

A large part (approximately NIS 200 million) of this decrease is attributable to the fact that there is an asymmetry in the treatment of exchange rate differences of deposits in foreign currency which financed shares in foreign currency. While the exchange rate differences on deposits are carried to noninterest income, exchange rate differences in respect of the shares are carried to other comprehensive income, adjustments in respect of the presentation of available-for-sale shares. In 2014, as a result of the depreciation of most currencies against the shekel, an expense was recorded in respect of the exchange rate differences on deposits in noninterest income, while the income on the shares is carried to other comprehensive income.

Noninterest income of the Bank in 2014 amounted to NIS 3,363 million, compared with NIS 3,910 million in the corresponding period last year, a decrease of NIS 547 million, or 14.0%.

In the fourth quarter of the year, non-interest income amounted to NIS 1,221 million, compared with NIS 1,420 million in the corresponding period last year, a decrease of NIS 199 million, or 14.0%.

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

| | For the three months ended | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Non-interest financial income | **76** | 238 | (162) | (68.1) |
| Commissions | **1,054** | 1,084 | (30) | (2.8) |
| Other income | **91** | 98 | (7) | (7.1) |
| Total | **1,221** | 1,420 | (199) | (14.0) |

| | For the year ended | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Non-interest financial income | **795** | 1,127 | (332) | (29.5) |
| Commissions | **4,167** | 4,188 | (21) | (0.5) |
| Other income | **211** | 202 | 9 | 4.5 |
| Total | **5,173** | 5,517 | (344) | (6.2) |

**The following shows the quarterly development of noninterest income:**

| | **2014** | 2013 | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **4th quarter** | 3rd quarter | 2nd quarter | 1st quarter | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter |
| | NIS millions | | | | | | | |
| Non-interest financial income | **76** | 224 | 172 | 323 | 238 | 266 | 212 | 411 |
| Commissions | **1,054** | 1,033 | 1,040 | 1,040 | 1,084 | 1,050 | 1,029 | 1,025 |
| Other income | **91** | 71 | 38 | 11 | 98 | 66 | 5 | 33 |
| Total | **1,221** | 1,328 | 1,250 | 1,374 | 1,420 | 1,382 | 1,246 | 1,469 |

**Details of non-interest financial income are as follows:**

| | For the year ended | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Net income (expenses) in respect of derivative instruments and net exchange rate differences | **(346)** | 204 | (550) | - |
| Profits from sale of available-for-sale debentures, net | **205** | 209 | (4) | (1.9) |
| Profits from investments in shares including dividends | **452** | 580 | (128) | (22.1) |
| Net profits in respect of loans sold | **28** | 99 | (71) | (71.7) |
| Adjustments of debentures and shares available for trade to fair value, net | **456** | 35 | 421 | + |
| Total | **795** | 1,127 | (332) | (29.5) |

| | For the three months ended | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Net income (expenses) in respect of derivative instruments and net exchange rate differences | **(163)** | 73 | (236) | - |
| Profits from sale of available-for-sale debentures, net | **78** | 52 | 26 | 50.0 |
| Profits from investments in shares including dividends | **89** | 20 | 69 | + |
| Net profits in respect of loans sold | **-** | 6 | (6) | - |
| Adjustments of debentures and shares available for trade to fair value, net | **72** | 87 | (15) | (17.2) |
| Total | **76** | 238 | (162) | (68.1) |

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

| | 2014 | 2013 | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **4th quarter** | 3rd quarter | 2nd quarter | 1st quarter | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter |
| | NIS millions | | | | | | | |
| Net income (expense) in respect of derivative instruments and net exchange rate differences | **(163)** | (180) | 26 | (29) | 73 | 14 | 55 | 62 |
| Profits from sale of available-for-sale debentures, net | **78** | 10 | 35 | 82 | 52 | 34 | 24 | 99 |
| Profits (losses) from investments in shares including dividends | **89** | 199 | 35 | 129 | 20 | 206 | 115 | 239 |
| Net profits in respect of loans sold | **-** | 28 | - | - | 6 | 16 | 34 | 43 |
| Realized and unrealized profits (losses) from adjustments of debentures and shares available for trade to fair value, net | **72** | 167 | 76 | 141 | 87 | (4) | (16) | (32) |
| Total | **76** | 224 | 172 | 323 | 238 | 266 | 212 | 411 |

**Noninterest income was affected as follows:**

In the first quarter of 2014, income on the sale of shares of Partner amounting to NIS 70 million before the effect of tax was recorded, compared to income from the sale of the shares of Migdal amounting to NIS 180 million, before the effect of tax, in the corresponding period last year.

In the second quarter of 2014, income mainly from profits from tradable debentures was recorded, compared to profit from the sale of shares in Caesar Stone amounting to NIS 86 million before the effect of tax, in the corresponding period last year.

In the third quarter of 2014, income from the sale of shares of Mobileye amounting to NIS 144 million before the effect of tax was recorded, compared to income from the sale of shares of Migdal amounting to NIS 163 million, before the effect of tax, in the corresponding period last year.

In the fourth quarter of 2014, there were expenses in respect of derivative instruments and an exchange rate difference resulting from the devaluation in exchange rates, in contrast to the corresponding period last year when there was income in respect of derivative instruments and exchange rate differences.

**The following table presents a breakdown of commissions:**

| | For the year ended | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Account management | **821** | 833 | (12) | (1.4) |
| Activity in certain securities and derivative instruments | **816** | 817 | (1) | (0.1) |
| Credit cards | **939** | 907 | 32 | 3.5 |
| Dealing with credit (a) | **196** | 332 | (136) | (41.0) |
| Commissions for distribution of financial products | **286** | 249 | 37 | 14.9 |
| Conversion differences | **318** | 289 | 29 | 10.0 |
| Commissions from financing transactions | **487** | 450 | 37 | 8.2 |
| Other commissions | **304** | 311 | (7) | (2.3) |
| Total commissions | **4,167** | 4,188 | (21) | (0.5) |

In 2014, Directive 310 was adopted for the first time on the format of the statement of profit and loss for a banking corporation and the adoption of generally accepted accounting principles for banking corporations regarding the measurement of interest income which led to an increase in net interest income amounting to NIS 188 million and to a decrease in the item, commissions, amounting to NIS 210 million. See Note 1D in the financial statements.

Income from commissions accounts for 44.8% of the operating and other expenses, compared with 47.1% in 2013.

**Details of other income are as follows:**

| | For the year ended | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Profits from severance pay fund | **71** | 129 | (58) | (45.0) |
| Other income | **140** | 73 | 67 | 91.8 |
| Total | **211** | 202 | 9 | 4.5 |

In the item, profits from severance pay fund, in the third quarter and fourth quarter of 2014, income of NIS 64 million and NIS 5 million, respectively, were recorded as a result of positive yields in the employee severance pay funds.

Other income derived from the sale of assets not used by the Bank, which were sold as part of the streamlining processes.

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

| | For the year ended | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Households | **1,820** | 1,806 | 14 | 0.8 |
| Small businesses | **508** | 546 | (38) | (7.0) |
| Corporate banking | **773** | 647 | 126 | 19.5 |
| Commercial banking | **571** | 575 | (4) | (0.7) |
| Private banking | **597** | 610 | (13) | (2.1) |
| Financial management | **812** | 1,307 | (495) | (37.9) |
| Other | **92** | 26 | 66 | + |
| Total | **5,173** | 5,517 | (344) | (6.2) |

The proportion of non-interest income from total income (i.e., net interest income and non-interest income) was 41.3%, compared with 42.9% in 2013.

**Total operating and other expenses** of Leumi Group in 2014 amounted to NIS 9,311 million, compared with NIS 8,892 million in 2013, an increase of 4.7%. Excluding the expenses relating to the arrangements with the overseas authorities, other and operating expenses fell from NIS 8,656 million in 2013 to NIS 8,285 million in 2014, a decrease of 4.3%.

Total operating and other expenses of the Bank in 2014 amounted to NIS 6,330 million, compared with NIS 6,872 in 2013, a decrease of 7.9%. Excluding the expenses relating to the arrangements with the overseas authorities, other and operating expenses in the Bank fell from NIS 6,636 million in 2013 to NIS 6,074 million in 2014, a decrease of 8.5%.

Operating and other expenses in the fourth quarter of 2014 amounted to NIS 2,235 million, compared with NIS 2,244 million in the corresponding period in 2013, a decrease of 0.4%.

**Salary expenses** in 2014 amounted to NIS 4,968 million, compared with NIS 5,133 million in 2013, a decrease of 3.2%.

The decrease in salary expenses derives, inter alia, from a decrease in the number of employees and from a decrease in the provision for the annual yield bonus, which was partly offset by an increase in salary pursuant to the previous collective agreement.

**The following table shows the quarterly development of salary expenses:**

| | 2014 | | | | | 2013 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Total for year** | **4th quarter** | 3rd quarter | 2nd quarter | 1st quarter | Total for year | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter |
| | NIS millions | | | | | | | | | |
| Salary and related expenses | **4,009** | 1,009 | 979 | 982 | 1,039 | 4,040 | 1,010 | 1,006 | 993 | 1,031 |
| Yield bonus | **104** (b) | (154) | 94 | 32 | 132 | 367 | 61 | 183 | 19 | 104 |
| Voluntary retirement, pension and severance pay expenses, net of fund profits (a) | **856** | 408 | 154 | 163 | 130 | 653 | 250 | 130 | 136 | 137 |
| Regulatory changes | **-** | - | - | - | - | 73 | 8 | 8 | 57 | - |
| Total salary expenses | **4,968** | 1,263 | 1,227 | 1,177 | 1,301 | 5,133 | 1,329 | 1,327 | 1,205 | 1,272 |

(a) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R
(b) Yield bonus in subsidiaries.

**The changes in salary expenses were affected as follows:**

In the first quarter of 2014, the total effect of an increase in employees' salaries was recorded in respect of the completion of reserves, which was partly offset by high returns on the provident and severance pay funds.

In the second quarter of 2014, there was 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 2014, there was 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 2014, there was a decrease in salary expenses, due to a decrease in the annual yield bonus, which was partly offset by an increase in pension expenses as a result of low profits in the provident funds and actuarial changes carried to profit and loss in overseas companies.

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

- The Bank's actuarial obligation for pension and long-service grants in the financial statements is 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.

  For information regarding the adoption of accounting principles in the U.S. regarding employee rights, see Note 1Y to the financial statements.

- As a result of an increase in salary tax from 17% to 18%, with effect from 2 June 2013, the Bank increased the pension liability in 2013 by NIS 53 million before tax.

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

Salary and related expenses (excluding early retirement expenses) account for some 53.4% of total operating expenses, compared with 56.9% in 2013.

**Operating and other expenses**, excluding salary, amounted to NIS 4,343 million in 2014, compared with NIS 3,759 million in 2013, an increase of 15.5%. The increase derives from an increase in other expenses amounting to NIS 669 million, mainly as a result of expenses of the arrangements with overseas authorities. In 2014, expenses in respect of the arrangements with overseas authorities amounting to NIS 1,026 million were recorded, compared with NIS 236 million in 2013.

Operating and other expenses, excluding salary, net of expenses in respect of arrangements with overseas authorities fell by NIS 206 million in 2014, from NIS 3,523 million in 2013 to NIS 3,317 million in 2014, a decrease of 5.8%. The decrease in operating and other expenses was attributable to a decrease in all of the following items – depreciation, building and equipment maintenance expenses and other expenses.

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[(a)]:**

| | 2014 | | | | | 2013 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Total for year** | **4th quarter** | 3rd quarter | 2nd quarter | 1st quarter | Total for year | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter |
| | NIS millions | | | | | | | | | |
| Depreciation | **726** | **187** | 177 | 181 | 181 | 768 | 179 | 179 | 225 | 185 |
| Maintenance expenses of buildings and equipment | **1,052** | **262** | 274 | 255 | 261 | 1,065 | 273 | 264 | 264 | 264 |
| Other expenses and amortization of intangible assets, excluding expenses related to the investigation in respect of overseas customers | **1,539** | **506** | 301 | 404 | 328 | 1,690 | 463 | 464 | 437 | 326 |
| Total operating and other expenses, excluding expenses related to the investigation in respect of overseas customers | **3,317** | **955** | 752 | 840 | 770 | 3,523 | 915 | 907 | 926 | 775 |
| Expenses related to the investigation in respect of overseas customers | **1,026** | **17** | 480 | 487 | 42 | 236 | - | 198 | 38 | - |
| Total operating and other expenses, including expenses related to the investigation in respect of overseas customers | **4,343** | **972** | 1,232 | 1,327 | 812 | 3,759 | 915 | 1,105 | 964 | 775 |

(a) Excluding salary

Operating expenses constitute 74.3% of total income, compared with 69.1% in 2013 and excluding expenses in respect of the arrangements with overseas authorities, constitute 66.1%, compared with 67.2% in 2013.

Total operating and other expenses (in annual terms) constitute 2.35% of the total balance sheet, compared with 2.37% for 2013. Operating and other expenses, excluding expenses in respect of the arrangements with overseas authorities, constitute 2.09% of the total balance sheet, compared to 2.31% for 2013.

**Profit before tax** of Leumi Group for 2014 amounted to NIS 2,753 million, compared with NIS 3,714 million in 2013, a decrease of 25.9%. The Bank's profit before tax amounted to NIS 2,800 million in 2014, compared to NIS 2,990 million in 2013, a decrease of 6.4%.

Profit before tax, excluding expenses in respect of the arrangements with overseas authorities, amounted to NIS 3,779 million in 2014, compared with NIS 3,950 million in 2013, a decrease of 4.3%.

In the fourth quarter of 2014, pre-tax profit of Leumi Group amounted to NIS 305 million, compared with NIS 831 million in the corresponding period last year.

**Provision for taxes on profit** of Leumi Group for 2014 amounted to NIS 1,281 million, compared with NIS 1,397 million in 2013. The rate of the provision in 2014 was some 46.5% of the pre-tax profit, compared with 37.6% in 2013, an increase of some 8.9 percentage points. The increase in the rate of tax provision is primarily attributable to an increase in disallowed expenses in respect of the arrangements with overseas authorities.

**The development of the provision for tax by quarter is as follows:**

In the first quarter of the year, the tax rate was 36.4%, compared to 41.8% in the corresponding quarter in 2013. The decrease in the rate of tax is mainly the result of positive exchange rate differences in respect of investments in foreign subsidiaries, compared to negative exchange rate differences in the corresponding period in 2013.

In the second quarter of the year, the tax rate was 55.9%, compared with 34.4% in the corresponding period last year, mainly due to an increase in unrecognized expenses in relation to the corresponding quarter last year.

In the third quarter, the tax rate was 50.8%, compared to 36.8% in the corresponding quarter in 2013, mainly as a result of an increase in disallowed expenses compared to the corresponding quarter last year.

In the fourth quarter, the tax rate reached 51.5%, compared with 36.2% in the corresponding period last year, mainly due to an increase in disallowed expenses, compared with the corresponding period last year.

**Profit after taxes** for 2014 amounted to NIS 1,472 million, compared with NIS 2,317 million in 2013, a decrease of 36.5%. The profit after taxes for the fourth quarter of 2014 amounted to NIS 148 million, compared with NIS 530 million in corresponding period last year.

**The Group share in the profit (loss) after taxes of companies included on equity basis** amounted to a profit of NIS 42 million in 2014, compared with a loss of NIS 293 million in 2013.

For further details, see the section below, "Sectors of Activity within the Group" in the Chapter, "Financial Management – Capital Market".

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

**1.** The Israel Corporation Ltd. – A loss of NIS 8 million in 2014, compared with a loss of NIS 340 million in 2013.

**2.** Companies included on equity basis of Leumi Partners Ltd. – a profit of NIS 34 million in 2014, compared with a profit of NIS 35 million in 2013.

**Net profit before attribution to holders of non-controlling interests** amounted to NIS 1,514 million in 2014, compared with a profit of NIS 2,024 million in 2013, a decrease of 25.2%. In the fourth quarter of 2014, there was a loss before attribution to holders of non-controlling interests amounting to NIS 104 million, compared with a profit of NIS 365 million in the corresponding period in 2013.

**Net profit attributable to holders of non-controlling interests** in 2014 amounted to NIS 12 million, compared to a profit of NIS 42 million in 2013.

**Net profit attributable to the shareholders of the banking corporation** for 2014 amounted to NIS 1,502 million, compared with a profit of NIS 1,982 million in 2013, a decrease of 24.2%. In the fourth quarter of 2014, there was a loss attributable to the shareholders of the banking corporation amounting to NIS 111 million, compared with a profit of NIS 356 million in the corresponding period in 2013.

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

| | **2014** | | | | | 2013 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Year 2014** | **4th quarter** | 3rd quarter | 2nd quarter | 1st quarter | Year 2013 | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter |
| | % | | | | | | | | | |
| Net profit attributable to the shareholders of the banking corporation | **5.5** | **(1.6)** | 10.5 | 4.5 | 9.9 | 7.8 | 5.6 | 9.2 | 7.9 | 9.7 |

**Total basic net profit per share attributable to the shareholders of the banking corporation** in 2014 was NIS 1.02 compared to NIS 1.35 in 2013.

**The following table presents a statement of total profit:**

| | For the year ended | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Net profit attributable to shareholders in the banking corporation | **1,502** | 1,982 (a) | (480) | (24) |
| Other comprehensive income (loss) before tax | **439** | (639) | 1,078 | + |
| Effect of tax attributable to other comprehensive income | **(53)** | 147 | (200) | - |
| Net of other comprehensive income (loss) attributable to noncontrolling interests | **-** | 3 | (3) | - |
| Total profit attributable to shareholders in the banking corporation | **1,888** | 1,493 | 395 | 26 |

(a) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R

| | For the three months ended | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | NIS millions | % |
| Net profit attributable to shareholders in the banking corporation | **(111)** | 356 (a) | (467) | - |
| Other comprehensive income (loss) before tax | **(39)** | (10) | (29) | - |
| Effect of tax attributable to other comprehensive income | **78** | (12) | 90 | + |
| Other comprehensive income (loss) attributable to noncontrolling interests | **-** | 3 | (3) | - |
| Total profit attributable to shareholders in the banking corporation | **(72)** | 337 | (409) | - |

(a) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R

## Structure and Development of Assets and Liabilities

**Total Assets** of the Leumi Group on 31 December 2014 amounted to NIS 396.1 billion, compared with NIS 374.5 billion at the end of 2013, an increase of 5.8%. The Bank's total assets on 31 December 2014 amounted to NIS 362.5 billion, compared with NIS 343.0 billion at the end of 2013, an increase of 5.7%.

Out of the Group's total assets, the value of assets denominated in or linked to foreign currency was some NIS 94.6 billion, some 23.9% of total assets. In 2014, the shekel was depreciated against the US dollar by 12% and the shekel appreciated against the euro by 1.2%. The change in the exchange rates of the shekel against foreign currencies contributed to an increase of 1.8% in the Group's total balance sheet, so that canceling the effect of the depreciation of the shekel, the total balance sheet was NIS 389.2 billion.

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 1,223 billion, compared with some NIS 1,159 billion at the end of 2013 (about US$ 314 billion and US$ 334 billion, respectively).

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

| | Consolidated | | | | The Bank | | | |
|---|---|---|---|---|---|---|---|---|
| | 31 December | | | | 31 December | | | |
| | **2014** | 2013 | Change | | **2014** | 2013 | Change | |
| | NIS millions | | NIS millions | % | NIS millions | | NIS millions | % |
| Total assets | **396,134** | 374,540 (a) | 21,594 | 5.8 | **362,532** | 342,954 (a) | 19,573 | 5.7 |
| Cash and deposits with banks | **60,615** | 44,351 | 16,264 | 36.7 | **57,276** | 40,413 | 16,863 | 41.7 |
| Securities | **52,113** | 63,735 | (11,622) | (18.2) | **43,669** | 57,203 | (13,534) | (23.7) |
| Credit to the public, net | **252,480** | 240,874 | 11,606 | 4.8 | **221,190** | 209,940 | 11,250 | 5.4 |
| Buildings and equipment | **3,729** | 3,638 | 91 | 2.5 | **3,094** | 3,131 | (37) | (1.2) |
| Deposits of the public | **303,397** | 286,003 | 17,394 | 6.1 | **287,378** | 273,186 | 14,192 | 5.2 |
| Deposits from banks | **4,556** | 4,310 | 246 | 5.7 | **8,889** | 7,522 | 1,367 | 18.2 |
| Debentures, notes and subordinated notes | **23,678** | 25,441 | (1,763) | (6.9) | **5,953** | 6,526 | (573) | (8.8) |
| Total equity | **28,433** | 26,129 (a) | 1,964 | 7.5 | **28,093** | 26,129 (a) | 1,964 | 7.5 |

(a) Restated as a result of a change in the accounting method for accruing employee rights, see Note 1R.

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

| | Consolidated | | | | The Bank | | | |
|---|---|---|---|---|---|---|---|---|
| | 31 December | | | | 31 December | | | |
| | **2014** | 2013 | Change | | **2014** | 2013 | Change | |
| | NIS millions | | NIS millions | % | NIS millions | | NIS millions | % |
| Documentary credits, net | **1,624** | 1,863 | (239) | (12.8) | **1,079** | 1,278 | (199) | (15.6) |
| Guarantees securing credit, net | **5,969** | 5,406 | 563 | 10.4 | **4,892** | 4,483 | 409 | 9.1 |
| Guarantess to apartment purchasers, net | **17,523** | 15,507 | 2,016 | 13.0 | **17,523** | 15,507 | 2,016 | 13.0 |
| Other guarantees and liabilities, net | **16,863** | 14,861 | 2,002 | 13.5 | **16,418** | 14,495 | 1,923 | 13.3 |
| Derivative instruments (a) | **664,316** | 539,651 | 124,665 | 23.1 | **653,890** | 530,833 | 123,057 | 23.2 |
| Options of all types | **149,837** | 130,980 | 18,857 | 14.4 | **149,673** | 130,321 | 19,352 | 14.8 |

(a) Including "forward" transactions, financial swap contracts, futures and credit derivative transactions.
For further details, see Note 18A and 18B 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:**

| | **31 December 2014** | 31 December 2013 | Change | |
|---|---|---|---|---|
| | NIS millions | | NIS millions | % |
| Securities portfolios (a) | **618,728** | 597,088 | 21,640 | 3.6 |
| Assets in respect of which operating services are provided: (a)(b)(c) | **-** | - | - | - |
| Mutual funds | **74,052** | 76,009 | (1,957) | (2.6) |
| Provident and pension funds | **67,895** | 70,170 | (2,275) | (3.2) |
| Supplementary training funds | **65,884** | 49,584 | 16,300 | 32.9 |

(a) 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.

(b) The Group in Israel does not manage mutual funds, provident funds or supplementary training funds.

(c) 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 total activity and an increase in market values in Israel and abroad.

## Deposits of the Public

Deposits of the public with the Group amounted to NIS 303.4 billion at the end of 2014, compared with NIS 286.0 billion at the end of 2013, an increase of 6.1%.

The depreciation of the shekel against most foreign currencies contributed to a 3.2% increase in total deposits of the public, so that, after canceling the effect of the depreciation of the shekel, the increase in deposits of the public was 2.9%.

Debentures, notes and subordinated notes, the balance of which was some NIS 23.7 billion as at the end of 2014, compared with NIS 25.4 billion at the end of 2013.

Deposits of the public, debentures and subordinated capital notes increased in 2014 by 5.0%, and together constitute 82.6% of total assets.

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

| | **31 December 2014** | | | | |
|---|---|---|---|---|---|
| | On demand | Short-term | Savings schemes | Earmarked deposits | Total |
| | NIS millions | | | | |
| **Israeli currency:** | | | | | |
| Unlinked | **71,240** | **95,238** | **-** | **1** | **166,479** |
| CPI-linked | **-** | **24,884** | **2,515** | **-** | **27,399** |
| **Foreign Currency:** | **-** | **-** | **-** | **-** | **-** |
| Including linked to foreign currency | **56,384** | **52,792** | **-** | **-** | **109,176** |
| Non-monetary | **-** | **343** | **-** | **-** | **343** |
| Total | **127,624** | **173,257** | **2,515** | **1** | **303,397** |

| | 31 December 2013 | | | | |
|---|---|---|---|---|---|
| | On demand | Short-term | Savings schemes | Earmarked deposits | Total |
| | NIS millions | | | | |
| **Israeli currency:** | | | | | |
| Unlinked | 57,731 | 97,092 | - | 2 | 154,825 |
| CPI-linked | - | 26,189 | 2,590 | - | 28,779 |
| **Foreign Currency:** | - | - | - | - | - |
| Including linked to foreign currency | 50,960 | 50,818 | - | - | 101,778 |
| Non-monetary | - | 621 | - | - | 621 |
| Total | 108,691 | 174,720 | 2,590 | 2 | 286,003 |

**Developments in the various types of deposits were as follows:**

- Unlinked shekel deposits of the public increased by NIS 11.7 billion, 7.5%, compared with 31 December 2013.
- Deposits of the public denominated in or linked to foreign currency rose by NIS 7.4 billion, 7.3%, compared with 31 December 2013, and after offsetting the effect of the changes in the exchange rate of the shekel, these deposits fell by 1.7%. Deposits of the public with the foreign subsidiaries in 2014 increased by some 5.7%, or about NIS 1.7 billion, a result of a depreciation of the shekel against most of the foreign currencies in which the subsidiaries operate.
- CPI-linked shekel deposits fell by NIS 1.4 million (4.8%) compared with 31 December 2013, mainly in term deposits.

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

| | **31 December 2014** | 31 December 2013 | |
|---|---|---|---|
| | NIS millions | | Change % |
| Households | **115,480** | 118,634 | (2.7) |
| Small businesses | **26,090** | 22,830 | 14.3 |
| Corporate banking | **27,754** | 22,816 | 21.6 |
| Commercial banking | **66,723** | 51,878 | 28.6 |
| Private banking | **34,830** | 34,794 | 0.1 |
| Financial management and other | **32,520** | 35,051 | (7.2) |
| Total | **303,397** | 286,003 | 6.1 |

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

| | **2014** | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | **4th quarter** | 3rd quarter | 2nd quarter | 1st quarter | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter |
| | NIS millions | | | | | | | |
| Households | **115,480** | 114,265 | 114,341 | 116,049 | 118,634 | 120,059 | 121,693 | 124,320 |
| Small businesses | **26,090** | 23,048 | 22,061 | 21,893 | 22,830 | 21,928 | 21,052 | 19,730 |
| Corporate banking | **27,754** | 23,961 | 21,745 | 21,080 | 22,816 | 22,088 | 20,822 | 21,452 |
| Commercial banking | **66,723** | 60,433 | 56,363 | 54,034 | 51,878 | 49,036 | 47,840 | 49,420 |
| Private banking | **34,830** | 33,573 | 33,110 | 35,460 | 34,794 | 35,698 | 35,767 | 36,529 |
| Financial management and capital markets (a) | **32,520** | 31,352 | 32,241 | 34,216 | 35,051 | 31,030 | 28,274 | 27,369 |
| Total | **303,397** | 286,632 | 279,861 | 282,732 | 286,003 | 279,839 | 275,448 | 278,820 |

(a) Includes mainly deposits of institutional bodies.

**Deposits from Governments** amounted to some NIS 467 million at the end of 2014, an increase of NIS 70 million, compared to 2013,

This item includes deposits of foreign governments in overseas offices which, at the end of 2014, amounted to NIS 344 million, compared with NIS 241 million at the end of 2013, and deposits from government sources which were extended to the banks in previous years mainly for restructuring debts of the kibbutzim, and also deposits for granting housing loans to eligible members of the public.

## Deposits with banks and deposits from banks

### A. Deposits with banks (central and commercial):

| | **31 December 2014** | | 31 December 2013 | |
|---|---|---|---|---|
| | Central banks | Commercial banks | Central banks | Commercial banks |
| | NIS millions | | | |
| Israeli currency: | | | | |
| Unlinked | **38,970** | **1,286** | 27,147 | 1,074 |
| CPI-linked | **-** | **263** | - | 272 |
| Foreign currency including linked to foreign currency | **5,343** | **12,681** | 5,901 | 7,967 |
| Total deposits with banks | **44,313** | **14,230** | 33,048 | 9,313 |

Total deposits with banks increased by 38.2%.

### B. Deposits from banks (central and commercial):

| | **31 December 2014** | | 31 December 2013 | |
|---|---|---|---|---|
| | Central banks | Commercial banks | Central banks | Commercial banks |
| | NIS millions | | | |
| Israeli currency: | | | | |
| Unlinked | **-** | **1,807** | - | 1,717 |
| CPI-linked | **-** | **91** | - | 117 |
| Foreign currency including linked to foreign currency | **-** | **2,658** | 32 | 2,444 |
| Total deposits with banks | **-** | **4,556** | 32 | 4,278 |

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 2014, deposits of the Group with the Bank of Israel amounted to NIS 39.4 billion, against which there were no loans from the Bank of Israel.

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 54.0 billion.

## Credit to the public, net

Credit to the public in the Leumi Group at the end of 2014 amounted to NIS 252.5 billion, compared with NIS 240.9 billion at the end of 2013. In the Bank, NIS 221.2 billion compared to NIS 209.9 billion at the end of 2013. Credit to the public constitutes 63.7% of total assets, compared with 64.3% at the end of 2013.

The depreciation of the shekel against most foreign currencies contributed to a increase of 1.5% in total credit to the public. Excluding the effect of the depreciation, there was an increase of 3.4% in total credit to the public, so that excluding the effect of the depreciation of the shekel, total credit was NIS 249 billion.

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 15,005 million at the end of 2014, compared with NIS 12,807 million at the end of 2013. These investments also involve credit risk.

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

| | Year 2014 | | | | |
|---|---|---|---|---|---|
| | **Total for the year** | **31 December** | 30 September | 30 June | 31 March |
| Unlinked in NIS millions (a) | **159,755** | **159,755** | 155,722 | 151,614 | 148,635 |
| % increase | **8.7** | **2.6** | 2.7 | 2.0 | 1.2 |
| CPI-linked in NIS millions | **51,221** | **51,221** | 52,763 | 53,502 | 53,046 |
| % increase (decrease) | **(4.3)** | **(2.9)** | (1.4) | 0.9 | (0.9) |
| Foreign currency including foreign currency-linked in NIS millions | **41,504** | **41,504** | 40,996 | 39,269 | 39,592 |
| % increase (decrease) | **2.7** | **1.2** | 4.4 | (0.8) | (2.1) |
| Total in NIS millions | **252,480** | **252,480** | 249,481 | 244,385 | 241,273 |
| % increase | **4.8** | **1.2** | 2.1 | 1.3 | 0.2 |

(a) Including non-monetary items.

Total credit to the public by the Group in Israel amounted to some NIS 229.3 billion at the end of 2014, compared to NIS 217.5 billion at the end of 2013.

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

| | **31 December 2014** | | 31 December 2013 | | Change | |
|---|---|---|---|---|---|---|
| | NIS millions | % of mix | NIS millions | % of mix | NIS millions | % |
| Unlinked (a) | **159,755** | **63.3** | **146,907** | **61.0** | **12,848** | **8.7** |
| CPI-linked | **51,221** | **20.3** | **53,544** | **22.0** | **(2,323)** | **(4.3)** |
| Foreign currency and linked to foreign currency | **41,504** | **16.4** | **40,423** | **17.0** | **1,081** | **2.7** |
| Total | **252,480** | **100.0** | **240,874** | **100.0** | **11,606** | **4.8** |

(a) Including non-monetary items.

Credit to the public in unlinked shekels increased by NIS 12,848 million, or 8.7%, and index-linked credit to the public fell by NIS 2,323 million, or 4.3%. The increase in foreign currency and foreign currency-linked credit to the public amounted to NIS 1,081 million, or 2.7%, 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 fell by 6.0%.

Total credit to the public that was offset deriving from deposits according to the extent of their collection amounted to NIS 4.1 billion in the Group. Some 76.8% 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 2014** | 31 December 2013 | Change | |
|---|---|---|---|---|
| | NIS millions | | NIS millions | % |
| US dollar | **29,813** | 27,213 | 2,600 | 9.6 |
| Euro | **5,599** | 6,020 | (421) | (7.0) |
| Other currencies | **6,092** | 7,190 | (1,098) | (15.3) |
| Total | **41,504** | 40,423 | 1,081 | 2.7 |

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

| | 31 December 2014 | 31 December 2013 | Change | |
|---|---|---|---|---|
| | NIS millions | | NIS millions | % |
| Balance sheet credit risk | **47,579** | 46,064 | 1,515 | 3.3 |
| Guarantees to apartment purchasers (a) | **7,482** | 6,514 | 968 | 14.9 |
| Other off-balance sheet credit risk | **28,362** | 25,768 | 2,594 | 10.1 |
| Total | **83,423** | 78,346 | 5,077 | 6.5 |

(a) 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 7.2% in 2014. The credit risk of the construction and real estate sector in Israel constitutes some 21.5% of total credit risk in Israel. However, in accordance with the rules laid down by the Bank of Israel for calculating the rate of financing by sector of the economy, total indebtedness in the sector at the Bank amounts to some 18.38% of total indebtedness in Israel. In 2013 and 2014, there was no sectoral deviation from concentration of indebtedness.

Further details on the development of credit and credit risks according to market sector, see Exhibit E to the Management Review.

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

| | 31 December 2014 | 31 December 2013 | Change | |
|---|---|---|---|---|
| | NIS millions | | NIS millions | % |
| Households (a) | **110,696** | 100,243 | 10,453 | 10.4 |
| Of which: housing loans | **74,238** | 68,556 | 5,682 | 8.3 |
| Small businesses | **24,034** | 23,299 | 735 | 3.2 |
| Corporate banking | **52,622** | 49,630 | 2,992 | 6.0 |
| Commercial banking | **58,761** | 60,646 | (1,885) | (3.1) |
| Private banking | **5,882** | 6,455 | (573) | (8.9) |
| Financial management | **485** | 601 | (116) | (19.3) |
| Total at end of period | **252,480** | 240,874 | 11,606 | 4.8 |

Total business credit (commercial banking and corporate banking) increased by 1.0% to NIS 111.4 billion on 31 December 2014. Total private credit (households, small businesses and private banking) increased by 8.2% to NIS 140.6 billion.

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

| | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | **4th quarter** | 3rd quarter | 2nd quarter | 1st quarter | 4th quarter | 3rd quarter | 2nd quarter | 1st quarter |
| Balances at end of period | NIS millions | | | | | | | |
| Households | **110,696** | 108,136 | 104,987 | 102,212 | 100,243 | 98,272 | 95,289 | 92,469 |
| Of which: housing loans | **74,238** | 72,779 | 70,992 | 69,388 | 68,556 | 67,221 | 65,239 | 63,214 |
| Small businesses | **24,034** | 24,325 | 24,124 | 23,850 | 23,299 | 23,131 | 22,593 | 22,116 |
| Corporate banking | **58,761** | 59,186 | 58,684 | 58,922 | 60,646 | 62,940 | 63,704 | 66,961 |
| Commercial banking | **52,622** | 51,339 | 50,218 | 49,913 | 49,630 | 49,112 | 49,627 | 48,636 |
| Private banking | **5,882** | 6,065 | 5,927 | 6,069 | 6,455 | 6,840 | 6,720 | 7,361 |
| Financial management and capital markets | **485** | 430 | 445 | 307 | 601 | 597 | 550 | 1,071 |
| Total | **252,480** | 249,481 | 244,385 | 241,273 | 240,874 | 240,892 | 238,483 | 238,614 |

### 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 below in "Lien on Securities" in this chapter.

## Credit risk by economic sector

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

| | 31 December 2014 | | 31 December 2013 | | |
|---|---|---|---|---|---|
| | **Overall credit risk to the public (c)** | **Percentage of total** | Overall credit risk to the public | Percentage of total | Change |
| Sector of the economy | **NIS millions** | **%** | NIS millions | % | % |
| Agriculture | **2,328** | **0.6** | 2,187 | 0.6 | 6.4 |
| Industry | **39,653** | **10.1** | 38,745 | 10.4 | 2.3 |
| Construction and real estate (b) | **83,423** | **21.3** | 78,346 | 20.9 | 6.5 |
| Electricity and water | **4,949** | **1.3** | 4,882 | 1.3 | 1.4 |
| Trade | **32,598** | **8.3** | 30,251 | 8.1 | 7.8 |
| Hotels, accommodation and food services | **4,491** | **1.1** | 4,824 | 1.3 | (6.9) |
| Transportation and storage | **6,764** | **1.7** | 6,296 | 1.7 | 7.4 |
| Communications and computer services | **6,163** | **1.6** | 6,148 | 1.6 | 0.2 |
| Financial services | **42,693** | **10.8** | 46,645 | 12.4 | (8.5) |
| Other business services | **12,813** | **3.3** | 11,253 | 3.0 | 13.9 |
| Public and community services | **11,183** | **2.9** | 9,569 | 2.6 | 16.9 |
| Private individuals - housing loans | **77,883** | **19.9** | 71,985 | 19.2 | 8.2 |
| Private individuals – other | **67,098** | **17.1** | 63,063 | 16.9 | 6.4 |
| Total | **392,039** | **100.0** | 374,194 | 100.0 | 4.8 |

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

(b) Including housing loans which have been extended to purchasing groups in the process of building amounting to NIS 1,383 million and off-balance sheet risk amounting to NIS 1,867 million, compared to NIS 1,175 million and NIS 2,027 million, respectively, as of 31 December 2013.

(c) The amount of the indebtedness in respect of the "add-on" coefficient was reduced in 2014 in order to adjust it for the contents of Appendix C to the Proper Conduct of Banking Management Regulation no. 203.

## 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 2014 | | | 31 December 2013 | | |
|---|---|---|---|---|---|---|---|
| | | **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 | % | | | % | | |
| - | 80 | **80.7** | **6.3** | **20.6** | 81.5 | 6.4 | 19.7 |
| 80 | 600 | **16.1** | **21.1** | **11.0** | 15.4 | 20.3 | 10.5 |
| 600 | 1,200 | **2.2** | **13.4** | **2.9** | 2.0 | 12.5 | 2.7 |
| 1,200 | 2,000 | **0.5** | **5.9** | **1.9** | 0.5 | 5.7 | 1.9 |
| 2,000 | 8,000 | **0.4** | **8.8** | **4.5** | 0.4 | 9.1 | 4.6 |
| 8,000 | 20,000 | **0.1** | **6.7** | **4.6** | 0.1 | 7.0 | 4.9 |
| 20,000 | 40,000 | **0.04** | **6.60** | **5.50** | 0.04 | 6.40 | 5.70 |
| 40,000 | 200,000 | **0.03** | **14.40** | **17.90** | 0.03 | 14.40 | 16.50 |
| 200,000 | 800,000 | **0.01**(a) | **11.50** | **21.60** | 0.01(a) | 10.40 | 22.90 |
| Above 800,000 | | **0.001**(b) | **5.30** | **9.50** | 0.001(b) | 7.80 | 10.60 |
| Total | | **100.0** | **100.0** | **100.0** | 100.0 | 100.0 | 100.0 |

(a) In 2014, 153 borrowers and in 2013, 149 borrowers

(b) In 2014, 18 borrowers and in 2013, 21 borrowers.

For further details about the distribution of credit by size, see Note 4C to the financial statements.

**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 2014:**

**1. Credit risk by size of credit of the borrower:**

| | | **31 December 2014** | | | | | |
|---|---|---|---|---|---|---|---|
| | | Number of borrowers | | Balance sheet credit | | Off-balance sheet credit risk | |
| Credit ceiling in NIS millions | | Total | Of which: Related parties | Total | Of which: Related parties | Total | Of which: Related parties |
| From | To | | | NIS millions | | | |
| 800 | 1,200 | **10** | **-** | **4,656** | **-** | **5,290** | **-** |
| 1,200 | 1,600 | **2** | **-** | **268** | **-** | **2,360** | **-** |
| 1,600 | 2,000 | **2** | **-** | **2,942** | **-** | **400** | **-** |
| 2,000 | 2,400 | **3** | **-** | **4,068** | **-** | **2,019** | **-** |
| 2,800 | 2,855 | **1** | **-** | **2,157** | **-** | **698** | **-** |
| Total | | **18** | **-** | **14,091** | **-** | **10,767** | **-** |

| | | 31 December 2013 | | | | | |
|---|---|---|---|---|---|---|---|
| | | Number of borrowers | | Balance sheet credit | | Off-balance sheet credit risk | |
| Credit ceiling in NIS millions | | Total | Of which: Related parties | Total | Of which: Related parties | Total | Of which: Related parties |
| From | To | | | NIS millions | | | |
| 800 | 1,200 | 9 | 1 | 6,564 | 955 | 2,188 | - |
| 1,200 | 1,600 | 5 | - | 4,382 | - | 2,539 | - |
| 1,600 | 2,000 | 2 | - | 519 | - | 2,795 | - |
| 2,000 | 2,400 | 3 | - | 2,607 | - | 3,777 | - |
| 2,400 | 2,800 | 1 | - | 2,376 | - | 41 | - |
| 2,800 | 3,524 | 1 | - | 2,941 | - | 583 | - |
| Total | | 21 | 1 | 19,389 | 955 | 11,923 | - |

**2. Credit risk according to economic sector:**

| | **31 December 2014** | | |
|---|---|---|---|
| | No. of borrowers | Balance sheet credit | Off-balance sheet credit |
| | NIS millions | | |
| Industry | **5** | **2,637** | **4,981** |
| Construction and real estate | **6** | **2,909** | **3,282** |
| Public and community services | **1** | **685** | **196** |
| Communications and computer services | **1** | **1,957** | **49** |
| Financial services | **3** | **3,570** | **865** |
| Electricity and water | **1** | **2,157** | **698** |
| Hotel, catering services and food services | **1** | **176** | **696** |
| Total | **18** | **14,091** | **10,767** |

| | 31 December 2013 | | |
|---|---|---|---|
| | No. of borrowers | Balance sheet credit | Off-balance sheet credit |
| | NIS millions | | |
| Industry | 3 | 2,257 | 3,327 |
| Construction and real estate | 6 | 4,214 | 3,051 |
| Public and community services | 1 | 735 | 200 |
| Communications and computer services | 1 | 2,376 | 41 |
| Financial services | 8 | 5,813 | 4,182 |
| Electricity and water | 1 | 2,941 | 583 |
| Trade | 1 | 1,053 | 539 |
| Total | 21 | 19,389 | 11,923 |

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 expenses in respect of credit losses have been recorded.

**3. Restriction of indebtedness of a borrower or group of borrowers**

(a) As at 31 December 2014, the Group had no exposure to a group of borrowers whose indebtedness exceeds 15% of the Bank's capital (as defined in Proper Conduct of Banking Management Regulation 313).

For further information on the subject of groups of borrowers, see Chapter, " Exposure to Risk and Methods of Risk Management, below.

(b) The aggregate indebtedness of large borrowers, groups of borrowers and banking groups of borrowers whose debt exceeds 10% of the Bank's capital, constituted 11.40% of the Bank's capital at 31 December 2014, compared with the regulatory limit of 120% of the Bank's capital (as defined in Proper Conduct of Banking Management Regulation 313).

## Problem debts

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

| | **31 December 2014** | | | 31 December 2013 | | |
|---|---|---|---|---|---|---|
| | Balance sheet | Off-balance sheet | Total | Balance sheet | Off-balance sheet | Total |
| | NIS millions | | | NIS millions | | |
| Impaired debts | **3,500** | **212** | **3,712** | 4,267 | 213 | 4,480 |
| Substandard debts | **2,062** | **619** | **2,681** | 1,689 | 185 | 1,874 |
| Special mention debts | **2,645** | **513** | **3,158** | 2,691 | 756 | 3,447 |
| Total | **8,207** | **1,344** | **9,551** | 8,647 | 1,154 | 9,801 |

**Problem credit risk:**

| | **31 December 2014** | 31 December 2013 |
|---|---|---|
| | Problem credit risk | Problem credit risk |
| | NIS millions | |
| Commercial problem credit risk | **10,439** | 10,858 |
| Retail problem credit risk | **1,309** | 1,331 |
| Total | **11,748** | 12,189 |
| Allowance for credit losses | **2,197** | 2,388 |
| Problem credit after allowance for credit losses | **9,551** | 9,801 |

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 2014 amounted to NIS 528 million, a decrease of NIS 30 million, 5.4%, compared with 31 December 2013.

## Securities

### Policy for managing investments in securities (*Nostro*)

The Group's policy for managing investments in securities (*nostro*) is defined in the framework of the Group's annual and multi-year work program. The policy defines the approved risk appetite for attaining the business targets. The risk appetite includes principles and quantitative limits for losses which the Group is willing to absorb in scenarios at various levels of severity. The main restrictions refer to the amounts of investment, level of risk and credit rating, interest duration, etc.) , exposure to issuer, exposure to investment manager/fund manager, geographic exposure, etc. All of the investments are made from a list of investment instruments permitted for investment.

The *nostro* portfolios are managed out of an overall view at the level of the Bank and the Group, being a central component in management of liquidity and market risks.

The overall view reflects, in principle the investment preferences with a partial/low correlation with the rest of the activity of the Bank and the Group. Accordingly, the advantage inherent in the *nostro* investments in foreign currency in securities issued abroad, which contribute to the dispersal of risks outside the Israeli economy are taken into account.

The risk dispersal in the multi-dimensional *nostro* portfolio. Geographical dispersal, between market sectors, between investment managers, between investment instruments, etc.

The investments are made on the basis of risk-adjusted profitability taking into account the appropriate capital requirements.

In the investment considerations, particular emphasis is placed on the avoidance of significant losses (downside risk).

The *nostro* activity is focused on central markets, which function in a developed and active regulatory environment.

The approval of the permitted investment instruments takes into account various aspects, such as, transparency and the ease of access to an independent and reliable source for remeasurement/value pricing, and a minimizing the complexity and operating and legal risks.

The Group's investments in securities as at 31 December 2014 amounted to NIS 52.1 billion, compared with NIS 63.7 billion in 2013, a decrease of 18.2%.

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" 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.

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 classification of the securities item in the consolidated balance sheet:**

| | 31 December 2014 | | | | |
|---|---|---|---|---|---|
| | 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 | **35,609** | **454** | **(121)** | **35,942** | **35,942** |
| For trading | **11,439** | **62** (a) | **(24)** (a) | **11,477** | **11,477** |
| | **47,048** | **516** | **(145)** | **47,419** | **47,419** |
| **Shares and mutual funds** | | | | | |
| Available-for-sale | **2,801** | **390** | **(11)** | **3,180** | **3,180** |
| For trading | **1,400** | **141** (a) | **(27)** (a) | **1,514** | **1,514** |
| | **4,201** | **531** | **(38)** | **4,694** | **4,694** |
| **Total securities** | **51,249** | **1,047** | **(183)** | **52,113** | **52,113** |

(a) Carried to profit and loss.

| | 31 December 2013 | | | | |
|---|---|---|---|---|---|
| | Adjusted cost | Unrealized gains from adjustments to fair value | Unrealized losses from adjustments to | Fair value | Balance sheet value |
| | NIS millions | | | | |
| **Debentures** | | | | | |
| Available-for-sale | 49,854 | 401 | (222) | 50,033 | 50,033 |
| For trading | 9,740 | 76 (a) | (33) (a) | 9,783 | 9,783 |
| | 59,594 | 477 | (255) | 59,816 | 59,816 |
| **Shares and mutual funds** | | | | | |
| Available-for-sale | 2,744 | 156 | (72) | 2,828 | 2,828 |
| For trading | 1,017 | 78 (a) | (4) (a) | 1,091 | 1,091 |
| | 3,761 | 234 | (76) | 3,919 | 3,919 |
| **Total securities** | 63,355 | 711 | (331) | 63,735 | 63,735 |

(a) Carried to profit and loss.

As at 31 December 2014, some 75.1% of the Group's *nostro* portfolio was classified as available-for-sale securities and some 24.9% as the trading portfolio. This classification allows for flexibility in the management of the securities portfolio. Some 9.0% 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.

For details in the value of securities according to the method of measurement, see Note 18C to the financial statements.

**Below is a table of details of investments in corporate debentures (excluding banks) issued in Israel and abroad, by sector of the economy (available-for-sale and trading portfolio):**

| | **31 December 2014** | | 31 December 2013 | |
|---|---|---|---|---|
| | Issued in Israel | Issued abroad | Issued in Israel | Issued abroad |
| | NIS millions | | NIS millions | |
| Agriculture | **-** | **4** | - | 4 |
| Industry | **130** | **1,032** | 60 | 766 |
| Construction and real estate | **74** | **222** | 50 | 171 |
| Electricity and water | **537** | **260** | 590 | 234 |
| Trade | **104** | **3** | 186 | 4 |
| Hotels, catering and food | **-** | **-** | - | - |
| Transportation and storage | **-** | **148** | 9 | 132 |
| Communications and computer services | **45** | **322** | 58 | 198 |
| Financial services (a) | **439** | **11,040** | 431 | 9,495 |
| Business and other services | **12** | **486** | 66 | 209 |
| Public and community services | **25** | **122** | 29 | 115 |
| Total | **1,366** | **13,639** | 1,479 | 11,328 |

(a) Including asset-backed securities.

**Available-for-sale portfolio**

**a.** In 2014, there was a positive change in other comprehensive income in respect of available-for-sale securities amounting to NIS 355 million (before the effect of tax). The change was attributable to an increase in value amounting to NIS 1,002 million, which was partly offset by a negative change in securities sold and classified to profit and loss amounting to NIS 647 million (before tax). This compared with a negative movement in other comprehensive income in respect of available securities amounting to NIS 518 million (before tax) in the corresponding period last year which derived from the sale of securities amounting to NIS 747 million offset by an increase in value amounting to NIS 229 million (before tax).

**b.** In addition, NIS 205 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 209 in 2013**.**

The accumulated net balance of adjustments to fair value of securities held in the available-for-sale portfolio, as at 31 December 2014, amounted to a positive amount of NIS 394 million (after the effect of tax) compared with NIS 179 million at the end of 2013. These amounts represent net 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, which is of a temporary nature. The Bank 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 Note 1 to the financial statements "Significant Accounting Policies", below.

For details regarding adjustment to fair value of available-for-sale securities which were charged to equity, see Note 3 to the financial statements.

## Trading Portfolio

On 31 December 2014, there was NIS 11.5 billion of debentures and NIS 1.5 billion of shares in the trading portfolio, compared to NIS 9.8 billion of debentures and NIS 1.1 billion of shares at 31 December 2013. As of 31 December 2014, the trading portfolio constitutes 24.9% of the Group's total *nostro* portfolio, compared to 17.1% at 31 December 2013.

For a summary of the composition of the portfolio – see Note 3 to the financial statements.

In respect of trading debentures, realized and unrealized profits amounting to NIS 423 million were recorded in the statement of profit and loss, compared with losses amounting to NIS 54 million in 2013, and in respect of shares and funds, realized and unrealized profits were recorded amounting to NIS 33 million, compared with profits of NIS 89 million in 2013.

## Investments in Securities Issued Abroad

The Group's securities portfolio includes some NIS 29 billion (some US$ 7.5 billion) of securities issued abroad. Approximately 89% of the portfolio is invested in debt instruments, all of which (except for some 1.9%) are investment grade securities, of which some 88% are rated 'A-' and above. Some 11% of the portfolio is invested in shares and funds. Around a third of the market risk of the investment in shares and funds is fully hedged. Of the said portfolio, some NIS 24 billion (some US$ 6.2 billion) is classified in the available-for-sale securities portfolio, and the balance is classified in the trading portfolio.

**1. Asset-backed investments in 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 2014, amounted to NIS 9.1 billion (some US$ 2.3 billion), compared with NIS 7.6 billion at 31 December 2013. Of the said portfolio, some NIS 7.7 billion (some US$ 2.0 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 2014 includes an investment in mortgage-backed debentures amounting to NIS 5.6 billion. 87% 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).

For details regarding investments in asset-backed debentures, see Note 3 to the financial statements.

As at 31 December 2014, the accumulated net impairment charged to shareholders' equity resulting from the mortgage-backed securities portfolio was some NIS 49 million.

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 861 million.

The projected term to maturity for all the mortgage-backed securities portfolio is an average of 4.7 years. 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 2.1 billion. Of these, CLO-type debentures amount to NIS 2.0 billion. The projected term to maturity of the debenture portfolio backed by assets other than mortgages is 3.3 years on average.

## 2. Investments in securities issued abroad

The Group's securities portfolio as at 31 December 2014 includes some NIS 19.8 billion (US$ 5.1 billion) of non-asset-backed securities. Of these securities, NIS 16.5 billion (US$ 4.2 billion) are classified in the available-for-sale portfolio, with the balance in the trading portfolio. Of the total securities, 97% are investment grade and they include 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", in the section, "Credit Risk".

As at 31 December 2014, 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 244 million (NIS 152 million after tax).

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. 98% of the securities in the trading portfolio are of investment grade.

The value of the non-asset backed trading portfolio as of 31 December 2014 amounted to NIS 3.3 billion (US$ 0.9 billion). The difference between fair value and adjusted cost, if there is such a difference, is recorded in the profit and loss account.

**Investments in corporate debentures issued in Israel**

Investments in debentures issued in Israel amounted to NIS 21.9 billion on 31 December 2014, of which NIS 20.3 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 58.4% of the investments in corporate debentures amounting to some NIS 0.8 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 0.8 billion includes a positive capital reserve amounting to NIS 35 million and a negative capital reserve amounting to NIS 4 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.

**Investments in shares and funds**

Total investments in shares and funds amounted to some NIS 4,694 million on 31 December 2014, of which NIS 3,098 million was in listed shares and NIS 1,596 million was in non-listed shares. Of the total investment, NIS 3,180 million is classified in the available-for-sale portfolio and NIS 1,514 million is classified in the trading portfolio.

The capital required in respect of these investments at 31 December 2014 was NIS 587 million.

For further details, see Note 3 to the financial statements.

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

**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 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 below in the financial statements, Note 1F, Significant Accounting Policies.

**Main changes in investments in shares in 2014**

**Dead Sea Desalination Limited Partnership**

In August 2014, Leumi Partners purchased 20% of the rights in a partnership, in consideration of NIS 86.4 million. The partnership signed an agreement to purchase 100% of the share capital of Dead Sea Desalination (Holdings) Ltd. a purchase which has not been completed.

**Electra Consumer Products Ltd.**

In January 2014, Leumi Partners sold approximately 1.95 million shares of Electra Consumer Products Ltd. in consideration of NIS 83.8 million. Leumi Partners posted a gain on the sale amounting to NIS 17 million in the first quarter of 2014.

**Partner Communications Ltd.**

In March 2014, Leumi Partners sold approximately 4.6 million shares of Partner Communications Ltd. in consideration of NIS 142 million. Leumi Partners posted a gain from the sale amounting to NIS 70 million in the first quarter of 2014.

**Mobileye N.V. ("Mobileye")**

In August 2014, a public offering was made on the New York Stock Exchange of Mobileye, in which Leumi Partners held 4,124,535 shares, representing 2% of the issued and paid-up share capital. As part of the public offering, which was made at a price per share of US$ 25, and after the exercise of the option granted to the underwriters to purchase additional shares, Leumi Partners sold 2,049,271 shares for consideration of US$ 23.55 per share (the offering price, less underwriting commissions and expenses) and in aggregate consideration of US$ 48.3 million. Following the offering, Leumi Partners held 1% of the issued and paid-up share capital of Mobileye. Leumi Partners recorded a gain on sale amounting to NIS 144 million.

From the end of the blocking period which was established in connection with the issue of Mobileye shares, Leumi Partners sold Mobileye shares for an aggregate amount of NIS 310 million. In respect of these shares, the Bank is expected to record a profit before tax amounting to NIS 290 million in the financial statements at 31 March 2015.

**Securities Lien**

The Bank is a member of the Stock Exchange Clearing House Ltd. and of the Ma'of Clearing House Ltd.

The Bank, like all other Ma'of 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 Ma'of Clearing House. As at 31 December 2014, the Bank had pledged debentures with a value of NIS 1.7 billion to the Ma'of 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 2014 was NIS 92 million.

The Bank has 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 2014 there were no balances outstanding.

As at 31 December 2014, 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 38.9 billion.

The Bank is executing short-term lending of securities in foreign currency from the available-for-sale 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 2014 stood at some NIS 98 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 2014, other assets amounted to NIS 5.5 billion, compared with NIS 5.2 billion at the end of 2013, an increase of some 6.2%,

The balance of the obligation in respect of the fair value of derivative instruments made with and for customers rose from NIS 13.1 billion at 31 December 2013 to NIS 16.9 billion at 31 December 2014.

**Other liabilities and credit balances in respect of derivative instruments**

Other liabilities amounted to NIS 18.7 billion at 31 December 2014, compared with NIS 17.8 billion at 31 December 2013, an increase of 5.1%.

The credit balance in respect of the fair value derivative instruments made with and for customers amounted to NIS 15.7 billion at 31 December 2014, compared with NIS 13.5 billion at 31 December 2013.

## Fixed Assets and Plant

Buildings and equipment - the amortized cost of buildings and equipment as at 31 December 2014 amounted to NIS 3.7 billion, compared to NIS 3.6 billion as at 31 December 2013.

**Investments in buildings and equipment as at 31 December 2014 are as follows:**

| | Cost | Accumulated depreciation | Net book value | |
|---|---|---|---|---|
| | **31 December 2014** | | | 31 December 2013 |
| Buildings and land | **3,517** | **1,935** | **1,582** | 1,541 |
| Equipment, furniture and vehicles | **3,445** | **2,788** | **657** | 665 |
| Software | **5,534** | **4,044** | **1,490** | 1,432 |
| Total | **12,496** | **8,767** | **3,729** | 3,638 |

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 2014 amounted to NIS 26 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) and they own 166 properties, of which 116 are branches and archives and 24 are Head Office buildings. The total area under ownership is some 258,000 sq. mtrs., divided into branches - some 76,000 sq. mtrs., Head Office buildings (excluding the Bank Leumi Service Center complex in North Lod) – some 44,000 sq. mtrs., and the balance, divided amongst offices in use by subsidiaries, a logistical center, plots, vacant properties etc. Properties designated for sale constituted 19,892 sq. mtrs. as of 31 December 2014, and are presented at the lower of amortized cost or realization value.

In addition, the Bank owns "Keshev" – "The Yitzhak Rabin Bank Leumi Service Center", which includes Leumi Technologies Division - the Bank's operations and computerized operating services division, the Procurement, Building and Logistics Department, and the Bank's training center, which is located in Lod, within a facility comprising a total area of 78.8 dunams.

Investment in buildings owned by the Group in 2014 amounted to NIS 1,582 million (including property purchases amounting to NIS 127 million) compared with NIS 1,541 million in 2013 (including property purchases of NIS 70 million). In addition to areas owned by the Bank, the Bank holds leased property covering 90,000 sq. mtrs.

The land held by the Bank, decreased in 2014 by 5,000 sq. mtrs., of which 2,000 sq. mtrs, was owned in comparison to 2013.

In 2014, 8 branches were closed, with an aggregate area of 3,300 sq. mtrs., of which 1,700 sq. mtrs. were owned (not all of the areas were transferred to the owners or to the purchasers, and therefore, their part was deducted from the total areas.) In 2015, a further 8 branches are expected to be closed.

As part of the streamlining program, it was decided to relocate a number of units (including two subsidiaries, Leumi Capital Market Services Ltd. and Bank Leumi Le-Israel Trust Company Ltd.) from Tel Aviv to the outskirts of the Dan Region, a decision which led to a reduction in the costs of rental and municipal rates.

Bank Leumi has two computer centers, the main one, in Keshev, and a second one, in Tel Aviv. In addition, Leumi has set up a center for a third copy of data in the Jerusalem area.

Leumi has an underground facility for the main 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 infrastructure in the new computer center has a tier-3 survival and redundancy level and is in accordance with international standards.

Leumi has 3 mainframe computers produced by IBM, part of the Z Series range, for use by the production, development and testing systems and recovery program. The total operating capacity of the computers is 14,106 mips (the values of the capacity are measured according to the number of instructions in millions per second). The Mortgage Department's main computer center is located in Keshev, receives services from IBM and a backup site for it has been constructed in Tel Aviv.

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 copy of data is stored in an installation in the Jerusalem area. The data passes through a designated communication infrastructure between Leumi's Computer Centers.

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 threats from external factors are increasing, Leumi is prepared for computer attacks and is taking steps to hedge the risks arising from various types of cyber attacks. In addition, the Bank is taking steps in coordination with the Banking Supervision Department in the Bank of Israel, the Antitrust Commissioner and in cooperation with the banking sector to set up a center for sharing know-how and cyber protection and through ABS for coping with cyber threats.

The operations and computer department 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, and in coordination with the IT strategy of Leumi Technologies. Within the context of a multi-year program, , the Bank, together with the overseas subsidiaries, is taking steps to improve and upgrade the systems at the overseas subsidiaries to uniform computerized banking systems.

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.

Leumi Technologies Division operates a system of computer services for the Arab Israel Bank (a subsidiary) and Union Bank, for which there is an agreement relating to computer services which Leumi Technologies Division supplies and includes operating services, computer system development, consulting services, backups and other services.

The Antitrust Commissioner has approved the exemption from a restrictive agreement in relation to the agreement between the Bank and Union Bank through December 2016 which is the termination date of the agreement.

In 2014, the Group invested in equipment including software some NIS 686 million, compared with some NIS 678 million in 2013. The budget was adapted to support the strategic goals as defined by the Bank Management, as well as the operating requirements for future banking.

The major investment in 2014 focused on online areas and improving the "customer experience" through digital services, including Leumi Cellular, trading on capital markets via the Internet and through the CRM project for developing a system for enhancing the customer experience and improving the sales processes. The CRM system will go live immediately on the approval of the regulatory authorities. In addition, as in every year, emphasis was placed on compliance with regulatory provisions, including the implementation of service accessibility regulations in automatic devices and on the Internet, according to time-tables stipulated in the law.

The international trade system on the Internet was started at the end of 2014 for all customers and the Bank combined new services: making payment of document types for import collection, export transactions with a particular purchaser.

In 2014, a "My Bank Account" service on Facebook was added on the social networks, enabling the customer to view his account when he is on Facebook, and even execute a monetary transfer to a friend whom he chooses on Facebook.

A new and important service developed in 2014 is the possibility of the complete opening of an account on the Internet, without the need for visiting a branch. This process includes a "Know Your Customer" chat with a bank clerk by video, signature on documents and raising personal documents, such as an identity card.

In the area of ATM, in 2014, the "withdrawal without a card" service was developed, enabling the withdrawal of cash from the ATM by identifying oneself with a cellular device and without the need of a card - an innovative service, the first in Israel, and in the world.

**The Bank's investments and expenses in respect of information technologies in 2014**

Expenses recorded in the statement of profit and loss amounted to NIS 1,438 million (NIS 1,508 million in 2013), of which NIS 435 million (NIS 420 million in 2013) were recorded in salary and related expenses, NIS 608 million (NIS 655 million in 2013) in depreciation expenses and NIS 395 million (NIS 433 million in 2013) 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 in 2014, amounted to NIS 669 million, compared to NIS 690 million in 2013.

The balance of the assets in respect of the information technology setup as at 31 December 2014 amounted to NIS 2,043 million, compared with NIS 2,095 million at 31 December 2013.

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 Bank has been certified for quality standards from Israel Standards Institute in the following areas: software quality, data security, quality management systems, information technology services management, safety and occupational hygiene, and fire safety.

In 2012-2014, the Israel Standards Institute awarded the Keshev facility in Leumi the prestigious Diamond Medal, which is given to companies with seven or more medals for quality.

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.
5. The Group has intangible assets and goodwill from the acquisition of companies. For further information, see Note 6 to the financial statement, below.

## 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 the Chapter, "Administrative Structure and Activity Sectors" above

**The following are principal data according to operating segments of the principal balance sheet items as at:**

| | Credit to the public | | | Deposits of the public | | | Total assets | | |
|---|---|---|---|---|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | **31 December 2014** | 31 December 2013 | Change | **31 December 2014** | 31 December 2013 | Change |
| | NIS millions | | % | NIS millions | | % | NIS millions | | % |
| Households (a) | **110,696** | 100,243 | 10.4 | **115,480** | 118,634 | (2.7) | **111,377** | 100,913 | 10.4 |
| Small businesses | **24,034** | 23,299 | 3.2 | **26,090** | 22,830 | 14.3 | **24,063** | 23,326 | 3.2 |
| Corporate banking | **58,761** | 60,646 | (3.1) | **27,754** | 22,816 | 21.6 | **60,723** | 62,482 | (2.8) |
| Commercial banking | **52,622** | 49,630 | 6.0 | **66,723** | 51,878 | 28.6 | **54,733** | 53,931 | 1.5 |
| banking | **5,882** | 6,455 | (8.9) | **34,830** | 34,794 | 0.1 | **10,346** | 11,527 | (10.2) |
| Financial management and other | **485** | 601 | (19.3) | **32,520** | 35,051 | (7.2) | **134,892** | 122,361 | 10.2 |
| Total | **252,480** | 240,874 | 4.8 | **303,397** | 286,003 | 6.1 | **396,134** | 374,540 | 5.8 |

(a) Credit to households also including housing loans (mortgages) increased by 10.4% and, after canceling housing loans, increased by 15.1%. Housing loans amounted to NIS 74.2 billion at the end of 2014, having increased by 8.3%.

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

| | Guarantees and documentary credits | | | Securities portfolios, including mutual funds | | |
|---|---|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | **31 December 2014** | 31 December 2013 | Change |
| | NIS millions | | % | NIS millions | | % |
| Households | **369** | 396 | (6.8) | **128,307** | 121,031 | 6.0 |
| Small businesses | **1,461** | 1,456 | 0.3 | **12,630** | 11,391 | 10.9 |
| Corporate banking | **31,468** | 28,038 | 12.2 | **52,890** | 62,850 | (15.8) |
| Commercial banking | **7,050** | 6,574 | 7.2 | **53,402** | 56,942 | (6.2) |
| Private banking | **336** | 399 | (15.8) | **94,520** | 86,451 | 9.3 |
| Financial management and other | **1,295** | 774 | 67.3 | **484,809** | 454,186 | 6.7 |
| Total | **41,979** | 37,637 | 11.5 | **826,558** | 792,851 | 4.3 |

### 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:**

| | **31 December 2014** | 31 December 2013 | Change | |
|---|---|---|---|---|
| | NIS millions | | NIS millions | % |
| Households | **148** | 108 | 40 | 37.0 |
| Small businesses | **292** | 287 | 5 | 1.7 |
| Corporate | **1,170** | 966 | 204 | 21.1 |
| Commercial | **527** | 409 | 118 | 28.9 |
| Private banking | **(1,018)** | (235) | (783) | - |
| Financial management: Capital markets | **(34)** | 296 | (330) | - |
| Non-bank investments | **297** | 110 | 187 | + |
| Other | **120** | 41 | 79 | + |
| Total | **1,502** | 1,982 | (480) | (24.2) |

Below is the return on risk adjusted capital (RORAC) by operating segments:

The 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).

| | Allocation of all the capital | |
|---|---|---|
| | Return on capital (RORAC) | |
| | **31 December 2014** | 31 December 2013 |
| | % | |
| Households | **2.1** | 1.9 |
| Small businesses | **14.4** | 17.3 |
| Corporate banking | **14.9** | 12.0 |
| Commercial banking | **10.1** | 9.1 |
| Private banking | **(112.0)** | (24.8) |
| Financial management | **8.2** | 10.1 |
| Other | **14.9** | 8.4 |
| Total for net profit | **5.5** | 7.8 |

For further details regarding activities of the principal investee companies, see below the Chapter, "Principal Investee Companies".

A breakdown of the results of the operating segments is presented in Note 27 to the financial statements.

## 1. Household Segment

### General

The household segment is characterized by making value proposals and providing financial services to households and private individuals, in relatively low monetary volumes per customer. These proposals and services are provided to customers according to their varying needs and preferences, segmenting customers according to demographics, place of residence, occupation, financial characteristics and stage of life.

In addition, the services are provided to customers in a range of sundry channels:

**Branches:** A wide deployment of 237 branches (including 15 counters and 37 branches of the Arab Israel Bank Ltd.) located throughout the country and organized into eight districts on a geographical basis. Service to customers in the branch is provided by teams of bank officials divided according to customer segment. These teams centralize the handling of all aspects of the customer's affairs and specialize the treatment according to the customer's particular characteristics and needs.

Three branches were opened during 2014 (including one counter and one branch in the Arab Israel Bank Ltd.), and over the same period, seven branches were merged (including two counters).

The Bank will continue to explore branch openings and mergers in 2015, according the Bank's strategy.

**Online and digital banking**: A telephone call center in Leumi Call, Leumi information devices, and through advanced Internet and cellular solutions.

The segment is taking steps, *inter alia*, to expand the number of customers receiving telephone service provided by the Leumi Call center (to which hundreds of thousands of customers are currently connected through which most of the day-to-day transactions in their accounts are carried out) and to expand activity in the digital channels (thousand of transactions are performed every day via the Internet and cellular devices).

In 2014, work continued in the area of cellular devices and a number of new applications were developed, such as: "Instant Balance" – an application which enables a customer to obtain the balance of his account without having to identify himself on the system; "Smart Watch" - a service enabling Leumi customers with the application to see the balance on their personal account on the face of their watch; "Login Pattern" – a service allowing Leumi customers to log in to the system by drawing an "unlock" pattern instead of entering a password.
In addition, the user interface and the functionality of Leumi applications in the iPhone and Android were upgraded.

Furthermore, developments continued on the online banking websites: As part of the digital ancillary services, at the beginning of the year, a Google search engine was incorporated. Moreover, the Bank enabled customers to sign up to "Leumi On-Time" packages, which enable customers to receive account alerts. As a part of this service, customers may join a "WhatsApp/SMS service with a service center that replaces postal mail. The Bank also enabled customers to sign up on the Internet to a basket of commissions (regulatory requirements) and order credit cards via the website.

The value proposals to the customer include a number of core products:

**Private credit**: The Bank offers customers various credit products, which are appropriate to their needs and the various stages in their lives, including the possibility of receiving a 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 recent years, there has been a considerable increase in credit to households in Israel. Loans are attractive, as a result of, among other things, low interest rates in the economy. The leverage level of households in Israel is low compared to other developed countries, although the trend is still one of increasing amounts of credit and with it, the risk.
The Bank's policy is to take steps to disperse credit risk by determining the level of exposure frameworks in the credit portfolio. The management of the credit portfolio is carried out according to considerations of risk and return versus risk.

For information regarding the risk of the increase in credit to households, see Chapter ""Exposure to Risks and Methods of Risk Management ".

**Investments:** 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.

**Mortgages:** The Bank offers housing loans via the Mortgage Department in 103 representative offices operating in Leumi branches and seven independent offices. The Mortgage Department develops tools which are intended to assist customers in planning the appropriate mortgage for them, now and in the future. In this context, the Mortgage Department offers those who are interested in obtaining a mortgage a comprehensive website, a guide including explanatory videos and an application on a cellular device supporting customers in planning the mortgage. In addition, the Bank offers its customers the "Integration Method" which adapts the mix of loan tracks to customer requirements.

The Bank's policy is to continue to focus its activity in the loans segment for apartment purchases and in the loan segment in mortgaging an apartment. In addition, the Bank also extends loans to purchasing groups, see Exhibit E – Market sectors.

**Credit cards:** The Bank offers a range of payment means which are issued via Leumi Card Ltd.

For further information, see chapter on "Activities in products, credit cards", below.

### Objectives and strategy

The following information is "forward-looking information." For the meaning of this term, see above in the Chapter, "Description of the Banking Corporation and Forward-Looking Information".

The Bank's vision is to lead enterprising and innovative banking for customers on the basis of which the following strategic targets of the household segment were determined.

Increasing market share and wallet share while aiming for a fair profit – by increasing its customer base and expanding the activity of existing customers, with an emphasis on providing customer experience and efficient customized service. In this context, it should be noted that loans to the household segment are an important growth engine in retail banking, in view of the high dispersal level and good credit risk management skills.

Maintaining the share of the mortgage market with effective cooperation between all other activities in the household and mortgage segments.

Improving customer experience – Since 2013, the Bank has been focused on the subject of customer experience, adapting and improving service to the customer based on his financial needs. The strategic focus on this topic is based on customized service and value proposals, technological infrastructures and processes supporting customer experience, including the building and leveraging of the world of business data (Big Data) and continuing the development of multi-channel integrated digital banking.

**The important points of emphasis on the line of business in the household segment are:**

- A systematic and constant focus on improving the **level of customer service** by upgrading employee professionalism and skills, and measuring and controlling work procedures and the customer interface. Improving customer service will increase customer satisfaction and loyalty, by creating advantages among groups of customers and providing differential value proposals.
- **Broadening the availability and accessibility of service to customers** by adapting branches to future banking needs, integrating advanced automated instruments and adapting them to the various customer needs and expanding the direct distribution channels;
- **Expanding the availability and accessibility of the direct distribution channels** with advanced telephone, cell phone and Internet response services and devices that enable customers to carry out their financial operations independently;
- **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 financial activities and needs of the relevant customers;
- Systematic, information-based **initiative** *vis-à-vis* customers in all operating segments: investments, pension counseling, consumer and commercial credit and current account services;
- **Collaboration with companies in the Group,** in order to utilize the Group’s abilities in providing comprehensive banking solutions to customers.

**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.

**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 2014 by 3.9%, and in terms of private consumption per capita, by 1.9%. These data indicate a slightly faster expansion than 2013, in which expenditure for private consumption in real terms increased by some 3.3%. This is mainly explained by a faster increase in the consumption of durable products in 2014, compared with 2013, mainly due to an increase in the purchase of motor vehicles for private use.

**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) for customers of the segment;
- Quality: abiding by work procedures, while strictly adhering to principles of compliance with consumer laws and regulations;
- Distribution and availability of points of sale and service: adapting 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) represents a relative advantage of banking in the household segment. The importance of the technological infrastructure increases as the regulatory requirements increase;
- The investment required in physical and technological infrastructure constitutes a barrier to entry.
- 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 and quality human resources in light of increasingly strict and frequently changing regulations, and adaptations to the customer's requirements.

**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 (in the area of consumer credit), mortgage banks, insurance companies, retail marketing chains and financial technology ventures. Some of 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.

**Alternatives to banking products and services in the segment**

The banks constitute the main factor in which objective advice is given – both in the capital market and in the area of pensions.

A current account is may be managed only in banks. Other products and services that may be purchased outside banks are as follows:

**Consumer credit** – Credit card companies, mortgage banks, insurance companies, retail marketing chains and financial technology ventures;

**Capital market** – Brokers, insurance companies, fund managers;

**Pension savings –** Pension marketers (insurance companies, provident fund management companies, training funds, pension funds and insurance agents, private pension consultants);

**Mortgages** – Contractors, building companies, insurance companies.

**Pension Counseling**

The balances of the pension assets held by customers receiving consultation in the Leumi Group which are known to be held at the end of December 2014, 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 20.8 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 above in the Chapter, "Business Lines and Operating Segments".

The segmentation of customers according to the various groups allows each group to be matched to its relevant value proposal, according to its needs and its preferences.

**Marketing and Distribution**

The following information is "forward-looking information." For the meaning of this term, see above in the Chapter, "Description of the Banking Corporation and Forward-Looking Information".

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 correct deployment of branches. 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, cellular devices, 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, the Bank 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 public.

Marketing activity is based both on advanced analytical information systems, and the construction and leverage of the world of business information (Big Data), enabling customers' needs and behavior to be characterized, with a view to offering customers products and services tailored to their needs.

**Human Capital**

In 2014, the average number of positions assigned to the household segment totaled 6,785 of which 1,374 were management staff, compared with 7,007 positions in 2013, of which 1,450 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.

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

| | **2014** | 2013 | |
|---|---|---|---|
| | Annual total | Annual total | Change |
| | NIS millions | | % |
| From Bank funds | **14,681** | 14,699 | (0.1) |
| From Ministry of Finance funds: | | | |
| Directed loans | **26** | 38 | (31.6) |
| Bullet loans | **20** | 28 | (28.6) |
| Total new loans | **14,727** | 14,765 | (0.3) |
| Refinanced loans | **4,564** | 3,083 | 48.0 |
| Total performance | **19,291** | 17,848 | 8.1 |

### Disclosure of housing loans (a)

The following are data relating to the risk characteristics of housing loans pursuant to a letter of the Bank of Israel dated 15 May 2011, developments in credit risk and how they are managed, including consideration of steps taken by the Bank to contend with these risk characteristics.

(a) The definitions mentioned in the disclosure below (for example, repayment ratio, rate of financing, etc.) are in accordance with the definitions of the Bank of Israel.

### Development of credit balance for housing, net:

| | Balance of credit portfolio | Rate of growth |
|---|---|---|
| | NIS millions | % |
| December 2012 | 60,294 | 10.9 |
| December 2013 (a) | 68,152 | 13.0 |
| **December 2014** | **73,919** | **8.5** |

(a) With effect from 2013, data for housing credit include housing credit granted in Leumi other than through the Mortgage Department.

In recent years, there has been an increase in the volume of housing credit, arising from, *inter alia*, an increase in the demand for housing units and a rise in the prices of housing units. Most of this credit constitutes credit for the purpose of acquiring residential apartments.

### 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 2012 | 26,234 | 43.5 | 32,522 | 53.9 | 1,538 | 2.6 | 60,294 |
| December 2013 (a) | 31,740 | 46.6 | 34,718 | 50.9 | 1,694 | 2.5 | 68,152 |
| **December 2014** | **36,727** | **49.7** | **35,447** | **48.0** | **1,745** | **2.3** | **73,919** |

(a) With effect from 2013, data for housing credit include housing credit granted in Leumi other than through the Mortgage Department.

**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 2012 | 2,144 | 10,698 | 24,090 | 21,824 | 1,538 | 60,294 |
| December 2013 (a) | 4,289 | 10,583 | 27,451 | 24,135 | 1,694 | 68,152 |
| **December 2014** | **7,232** | **11,659** | **29,495** | **23,788** | **1,745** | **73,919** |

(a) With effect from 2013, data for housing credit include housing credit granted in Leumi other than through the Mortgage Department.

**Development of new housing credit balance by interest track:**

The development of new credit according to variable and fixed interest tracks (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:

| | **2014** | | | | 2013 (a) | 2012 |
|---|---|---|---|---|---|---|
| | Fourth quarter | Third quarter | Second quarter | First quarter | Annual average | Annual average |
| | Percentage of loans granted | | | | | |
| | % | | | | | |
| Fixed – linked | **22.0** | 22.6 | 25.2 | 22.0 | 14.4 | 13.3 |
| Variable every 5 years and above – linked to index | **14.8** | 18.1 | 18.1 | 17.6 | 29.1 | 40.4 |
| Variable up to 5 years – linked | **2.3** | 1.5 | 1.9 | 2.1 | 2.4 | 4.5 |
| Fixed – unlinked | **25.7** | 20.5 | 18.7 | 20.7 | 13.4 | 8.4 |
| Variable every 5 years and above – unlinked | **6.5** | 6.0 | 6.3 | 7.6 | 9.8 | 4.5 |
| Variable up to 5 years – unlinked | **28.2** | 29.9 | 27.9 | 28.6 | 29.3 | 27.5 |
| Variable – foreign currency | **0.5** | 1.4 | 1.9 | 1.4 | 1.5 | 1.4 |

(a) With effect from 2013, data for housing credit include housing credit granted in Leumi other than through the mortgage department.

The percentage of new credit extended by the Bank in variable interest housing loans during 2014 stood at 56%, compared with 72% in 2013. 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 loans in which the rate of interest is variable, which varies each period of five years and more, which the directive of the Banking Supervision Department of 3 May 2011 excludes from the definition of variable interest loans, the percentage of housing credit at variable interest which stood at 32% during 2014, a little lower than the average for the whole of 2013.

**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 2012 | 60,738 | 829 | 1.4 |
| December 2013 (a) | 68,627 | 810 | 1.2 |
| **December 2014** | **74,410** | **800** | **1.1** |

(a) With effect from 2013, data for housing credit include housing credit granted in Leumi other than through the Mortgage Department.

The allowance for credit losses as at 31 December 2014, 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 491 million, representing 0.66% of the housing credit balance, compared with the balance of the allowance as at 31 December 2013, amounting to NIS 475 million, representing 0.69% of the housing credit balance. In 2013, an increase in the credit loss provision amounting to NIS 50 million was recorded, deriving from an adjustment of the collective allowance for housing loans as required in the Bank of Israel directives of 21 March 2013.

**Data relating to new housing credit:**

In 2014, the Bank extended new housing loans amounting to NIS 14.7 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.)

| | **2014** | | | | 2013 | 2012 |
|---|---|---|---|---|---|---|
| | **4th quarter** | 3rd quarter | 2nd quarter | 1st quarter | Annual average | Annual average |
| Rate of financing | % | | | | | |
| Between 60% and 70% | **20.1** | 17.6 | 19.6 | 16.6 | 18.3 | 22.6 |
| Between 70% and 80% | **15.5** | 14.1 | 13.9 | 14.4 | 16.3 | 12.9 |
| Above 80% | **0.5** | 0.4 | 0.3 | 0.5 | 0.9 | 3.5 |

**Development of the rate of financing, balance of credit portfolio:**

The average rate of financing of the credit portfolio balance at 31 December 2014 was 48.4%, compared to 49.5% in 2013.

**Development of new credit, in which the repayment ratio is lower than 2:**

Loans made in 2014 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 0.5% of the total new extensions of new credit.
This calculation complies with the Bank of Israel directives for the purposes of reporting pursuant to Proper Conduct of Banking Business Management Regulation no. 876.

**Development of new credit, in which the repayment dates are longer than 25 years:**

The percentage of the new credit of housing loans in 2014, in which repayment dates according to loan contracts longer than 25 years, stood on average at 29% of the total of new credit extended, compared to 30% in 2013 and 31% in 2012.

As a rule, the Bank does not extend new loans for new housing, the terms of which 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 second charge, except in exceptional cases.

According to the Bank's credit policy, the Bank extends new housing 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, an 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 2014 was NIS 585 thousand, compared with NIS 558 thousand in 2013 and NIS 530 thousand in 2012.

The quality of the housing credit portfolio is good, based on the data for the 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.

For information regarding update of the directives on the matter of real estate, see Chapter "Regulation, General Environment and the Effect of External Factors on Activity" above.

**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 |
|---|---|---|---|---|---|---|---|
| | **2014** | | | | | | |
| | NIS millions | | | | | | |
| **Net interest income:** | | | | | | | |
| From external sources | **896** | **239** | **6** | **1,912** | **(7)** | **11** | **3,057** |
| Intersegmental | **793** | **(20)** | **(2)** | **(1,217)** | **17** | **(1)** | **(430)** |
| **Non-interest income:** | | | | | | | |
| From external sources | **520** | **551** | **480** | **81** | **6** | **1** | **1,639** |
| Intersegmental | **14** | **167** | **-** | **-** | **-** | **-** | **181** |
| Total income | **2,223** | **937** | **484** | **776** | **16** | **11** | **4,447** |
| Expenses (income) in respect of credit losses | **357** | **25** | **-** | **23** | **-** | **2** | **407** |
| **Operating and other expenses:** | | | | | | | |
| To external sources | **2,486** | **632** | **407** | **243** | **14** | **8** | **3,790** |
| Intersegmental | **1** | **(1)** | **-** | **1** | **-** | **-** | **1** |
| Profit (loss) before taxes | **(621)** | **281** | **77** | **509** | **2** | **1** | **249** |
| Provision for (benefit from) taxes on profit | **(234)** | **90** | **29** | **190** | **1** | **-** | **76** |
| Profit (loss) after taxes | **(387)** | **191** | **48** | **319** | **1** | **1** | **173** |
| Group share in profits of companies included on equity basis after the effect of tax | **-** | **5** | **-** | **-** | **-** | **-** | **5** |
| Net profit attributable to non-controlling interests | **(1)** | **(29)** | **-** | **-** | **-** | **-** | **(30)** |
| **Net profit (loss)** | **(388)** | **167** | **48** | **319** | **1** | **1** | **148** |
| **Return on equity** | | | | | | | **2.1%** |
| Average balance of assets | **24,398** | **10,107** | **172** | **71,021** | **44** | **217** | **105,959** |
| Of which: investments in companies included on equity basis | **-** | **2** | **-** | **-** | **-** | **-** | **2** |
| Average balance of credit to the public, net | **23,966** | **9,882** | **171** | **70,974** | **44** | **217** | **105,254** |
| Average balance of liabilities | **114,918** | **1,264** | **-** | **281** | **945** | **8** | **117,416** |
| Average balance of deposits of the public | **114,749** | **52** | **-** | **-** | **944** | **8** | **115,753** |
| Average balance of risk assets | **26,915** | **9,795** | **172** | **38,464** | **268** | **76** | **75,690** |
| Average balance of mutual funds and supplementary training funds | **-** | **-** | **76,133** | **-** | **-** | **-** | **76,133** |
| Average balance of securities | **-** | **-** | **47,341** | **-** | **182** | **-** | **47,523** |
| Average balance of other assets under management | **3,586** | **-** | **-** | **-** | **-** | **-** | **3,586** |
| Margin from credit-granting activities* | **1,172** | **218** | **4** | **695** | **(7)** | **10** | **2,092** |
| Margin from deposit-taking activities | **517** | **1** | **-** | **-** | **17** | **-** | **535** |
| Total interest income, net | **1,689** | **219** | **4** | **695** | **10** | **10** | **2,627** |
| Balance of credit to the public, net | **25,888** | **10,365** | **168** | **74,015** | **37** | **223** | **110,696** |
| Balance of deposits of the public | **114,380** | **54** | **-** | **-** | **1,038** | **8** | **115,480** |

* 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 Capital Markets Division.
This comment relates to all of the operating segments.

## Household Segment (continued):

| | | | | | Overseas activity | | |
|---|---|---|---|---|---|---|---|
| | Banking and finance | Credit cards | Capital market | Mortgages | Banking and finance | Mortgages | Total |
| | 2013 | | | | | | |
| | NIS millions | | | | | | |
| **Net interest income:** | | | | | | | |
| From external sources | 33 | 240 | 6 | 2,662 | (11) | 11 | 2,941 |
| Intersegmental | 1,734 | (33) | (3) | (2,008) | 17 | (1) | (294) |
| **Non-interest income:** | | | | | | | |
| From external sources | 572 | 513 | 434 | 115 | 6 | - | 1,640 |
| Intersegmental | - | 166 | - | - | - | - | 166 |
| Total income | 2,339 | 886 | 437 | 769 | 12 | 10 | 4,453 |
| Expenses (income) in respect of credit losses | 117 | 13 | - | 48 | 1 | - | 179 |
| **Operating and other expenses:** | | | | | | | |
| To external sources | 2,768 | 673 | 381 | 251 | 14 | 6 | 4,093 |
| Intersegmental | 7 | (6) | - | - | - | - | 1 |
| Profit (loss) before taxes | (553) | 206 | 56 | 470 | (3) | 4 | 180 |
| Provision for (benefit from) taxes on profit | (201) | 60 | 21 | 168 | 1 | - | 49 |
| Profit (loss) after taxes | (352) | 146 | 35 | 302 | (4) | 4 | 131 |
| Group share in profits of companies included on equity basis after the effect of tax | - | 4 | - | - | - | - | 4 |
| Net profit attributable to non-controlling interests | - | (27) | - | - | - | - | (27) |
| **Net profit (loss)** | (352) | 123 | 35 | 302 | (4) | 4 | 108 |
| **Return on equity** | | | | | | | 1.9% |
| | | | | | | | |
| Average balance of assets | 21,407 | 9,025 | 149 | 65,191 | 55 | 206 | 96,033 |
| Of which: investments in companies included on equity basis | - | 2 | - | - | - | - | 2 |
| Average balance of credit to the public, net | 21,089 | 8,815 | 149 | 65,039 | 54 | 206 | 95,352 |
| Average balance of liabilities | 121,803 | 1,042 | - | 272 | 918 | 8 | 124,043 |
| Average balance of deposits of the public | 121,613 | 42 | - | - | 918 | 8 | 122,581 |
| Average balance of risk assets | 23,703 | 8,762 | 144 | 35,323 | 273 | 72 | 68,277 |
| Average balance of mutual funds and supplementary training funds | - | - | 63,654 | - | - | - | 63,654 |
| Average balance of securities | - | - | 47,996 | - | 176 | - | 48,172 |
| Average balance of other assets under management | 4,357 | - | - | - | - | - | 4,357 |
| Margin from credit-granting activities | 993 | 206 | 3 | 654 | (8) | 10 | 1,858 |
| Margin from deposit-taking activities | 774 | 1 | - | - | 14 | - | 789 |
| Total interest income, net | 1,767 | 207 | 3 | 654 | 6 | 10 | 2,647 |
| Balance of credit to the public, net, at 31 December 2013 | 22,112 | 9,358 | 167 | 68,345 | 50 | 211 | 100,243 |
| Balance of deposits of the public at 31 December 2013 | 117,675 | 40 | - | - | 912 | 7 | 118,634 |

**Main Changes in the Volume of Activity**

Total credit to households at the end of 2014 amounted to NIS 110.7 billion, an increase of 10.4%. Of this, consumer credit, accounting for 32.9%, totaled NIS 36.5 billion, and credit for housing, accounting for 67.1%, totaled NIS 74.2 billion. Deposits of the public fell from NIS 118.6 billion to NIS 115.5 billion, a decrease of 2.7%.

**Main Changes in the Net Profit**

Net profit from the household segment totaled NIS 148 million in 2014, compared with NIS 108 million in the corresponding period in 2013, an increase of NIS 40 million, or 37.0%.

**The main reasons for the increase in profits are as follows:**

A decrease in operating expenses of NIS 303 million due to a decrease in salary expenses as a result of streamlining and a decrease in other operating expenses. The increase was offset by an increase in expenses in respect of credit losses amounting to NIS 228 million, deriving, *inter alia*, from the adjustment of the collective allowance in credit to private individuals as required by Bank of Israel regulations.

**Mortgages**

The net profit in mortgages amounted in 2014 to NIS 320 million, compared with NIS 306 million in 2013, an increase of NIS 14 million. The increase stems from an increase in income of NIS 8 million from NIS 779 million in 2013 to NIS 787 million in 2014 and from a decrease in credit loss expenses amounting to NIS 23 million, mainly due to the adjustment of the collective allowance for housing loans as required by a directive of the Bank of Israel which was made last year. On the other hand, operating expenses increased by NIS 5 million.

## 2. Small Business Segment

### General

The small business segment is characterized by the provision of value proposals and financial services to small and medium businesses with an activity turnover of up to NIS 20 million and a balance of indebtedness of NIS 10 million. These proposals and services are provided to 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. The Bank also handles the personal accounts of customers of small and medium businesses who receive an overall service in one place.

The services are provided to small and medium business customers in a range of various channels.

**Branches:** Business customers receive the services from business teams in branches which specialize in the needs of the customers, including through a designated service center and various digital channels.

**Online and digital channels:** A Leumi Call telephone center, Leumi data devices, using advanced Internet and cellular solutions. Leumi invests many resources in development and has reached a high and multi-channel level of availability (telephone, facsimile, e-mail, mobile and Internet) in order to provide customers with an effective interface with the Bank for executing transactions and obtaining data anywhere, anytime.

The Bank allows business customers to perform transactions in the account after logging in using "identification questions". On the business site, as part of the "Digital Assistant", value proposals for the business customer have been incorporated. In addition, on the English business website, new services in English have been integrated: signing execution orders, transfers to another account and signing for international trade services. The international trade service on the Internet was opened at the end of 2014 to all customers and the Bank incorporated new services: payment by import collection documents type, export transactions with a particular purchaser and giving an instruction to change import documentary type transactions, etc.

The small business segment specializes in the provision of banking solutions including advice on commercial credit, advice on investments and routine business activity, with a sub-segmentation according to the level of activity and risk. Value proposals to small and medium business customers include a number of core products.

**Credit: -** The services provided to the business customers include, *inter alia*, ongoing financing according to customers' needs, the 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 managers.

**Investments:** In the field of investments, 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.

### Objectives and Strategy

The following information is "forward-looking" information. For the meaning of this term, see above in the chapter, "Description of the Banking Corporation and Forward-Looking Information".

The Bank's vision is to lead enterprising and innovative banking for customers on the basis of which the strategic targets of the small business segment were determined.

Increase in market share and wallet share – while aiming for a fair profit – by increasing its customer base and expanding the activity of existing customers. These targets naturally place an emphasis on providing a customer experience and streamlined service adapted to the financial needs of business customers.

The Bank has defined small and medium businesses as a targeted population and accordingly, launched Leumi's business arena, which is a package of exclusive and innovative tools and services. The arena includes four separate content worlds:

1. World of credit: Its purpose is to offer credit products customized to the needs of the small and medium business:
   Speedy, flexible credit, in large amounts, available anytime, even if a branch is closed. Among the products are "Leumi Fund" (a fund providing loans at preferred terms to small business customer meeting specific criteria), loans "at the touch of a button", loans to persons transferring a business, etc.

2. Availability and content: Its objective is to provide the business owner with available, professional, speedy service in flexible hours, business service center manned by professional personnel and providing a solution even when the branch is closed.
3. Digital tools: The objective of this world is to enable the business to obtain information and execute transactions in its account anywhere at any time, using a range of means – the Internet, cellular phones, and tablets.
4. Expertise and content: The provision of management tools to the customer using various media.
    - "Business Management School" – Five meetings in conjunction with the Open University (Nationwide) and the best of the experts on management topics (financial management, marketing management, negotiations, networking).
    - Business community on Facebook: Provides the business owner with added value through collaboration – both from similar business owners and from experts in the field at Leumi.

**The points of emphasis on the lines of business in the small business segment are:**

- A systematic and constant focus on improving the **level of customer service** by an upgrade in employee professionalism and skills, and measuring and controlling the work processes and the customer interface. Improving customer service will increase customer satisfaction and loyalty, by creating differential value proposals.
- **Broadening the availability and accessibility of service to customers** by adapting the branches to future banking needs, while integrating advanced automated instruments, and adapting them to the various customer needs and expanding the direct distribution channels.
- **Expanding the availability and accessibility of the direct marketing channels**: by way of 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 relevant customers' financial activities and needs.
- **Systematic, information-based initiative** *vis-à-vis* customers in all the products; commercial credit, consumer credit, international trade, investments, current account services and improving the level of service for increasing customer satisfaction and loyalty, through creating advantages among groups of customers by providing differential service.
- **Collaboration with companies in the Group,** in order to utilize the Group's abilities in providing comprehensive banking solutions to customers.
- **Increasing the use of analytical models** as supporting tools for decisions regarding customer activities.

**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.

**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. However, competition in this segment is increasing (see Competition, below).

**Critical success factors in banking for small businesses:**

Critical success factors in the segment are:

- High levels of management and interpersonal capabilities of the responsible entities 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 to customers;
- Focusing on the provision of proactive service according to the needs and wishes of the customers.

**Main entry and exit barriers in the segment**

- The technological and physical infrastructure (branch distribution) is a relative advantage 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 development of analytical capabilities to effectively adapt solutions for customers based on historical data on customer activity and market behavior.
- The training of high-quality and skilled human resources vis-à-vis strict and frequently changing regulations and adaptation to the customers' requirements.

**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 tailored to their needs.

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 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, and from insurance companies, which are showing interest in financing small businesses.

**Alternatives to the products and services**

In recent years, 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.

**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 above, in the Chapter, "Description of Operating segments".

**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. In addition, Leumi attaches great importance to the direct channels: the Internet, cellular phones, Leumi Call and self-service devices are on a continuing upward trend, both in performing transactions and for information requirements.

Marketing activity is based both on advanced analytical data systems on construction and leverage of the business data world (Big Data), which enable the characterization of customer requirements and their behavior, in order to offer customers products and services tailored to their needs.

**Human Capital**

In 2014, the average number of positions assigned to the small business segment totaled 1,985 of which 479 were management staff, compared with 1,922 positions, of which, 476 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.

**Below is 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 |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | | | | | | |
| | NIS millions | | | | | | | |
| **Net interest income:** | | | | | | | | |
| From external sources | **768** | **20** | **1** | **3** | **315** | **52** | **11** | **1,170** |
| Intersegmental | **(63)** | **(2)** | **-** | **(1)** | **(48)** | **(12)** | **(4)** | **(130)** |
| **Non-interest income:** | | | | | | | | |
| From external sources | **306** | **119** | **31** | **1** | **68** | **21** | **2** | **548** |
| Intersegmental | **2** | **(42)** | **-** | **-** | **-** | **-** | **-** | **(40)** |
| Total income | **1,013** | **95** | **32** | **3** | **335** | **61** | **9** | **1,548** |
| Expenses in respect of credit losses | **111** | **-** | **-** | **-** | **14** | **57** | **-** | **182** |
| **Operating and other expenses:** | | | | | | | | |
| To external sources | **628** | **57** | **16** | **-** | **125** | **39** | **5** | **870** |
| Intersegmental | **-** | **6** | **-** | **-** | **-** | **-** | **-** | **6** |
| Profit (loss) before taxes | **274** | **32** | **16** | **3** | **196** | **(35)** | **4** | **490** |
| Provision for taxes on profit | **103** | **10** | **6** | **1** | **74** | **-** | **1** | **195** |
| Profit (loss) after taxes | **171** | **22** | **10** | **2** | **122** | **(35)** | **3** | **295** |
| Net profit attributable to non-controlling interests | **-** | **(3)** | **-** | **-** | **-** | **-** | **-** | **(3)** |
| **Net profit (loss)** | **171** | **19** | **10** | **2** | **122** | **(35)** | **3** | **292** |
| **Return on equity** | | | | | | | | **14.4%** |
| Average balance of assets | **14,639** | **958** | **21** | **77** | **7,036** | **965** | **257** | **23,953** |
| Average balance of credit to the public, net | **14,628** | **945** | **21** | **77** | **7,034** | **965** | **257** | **23,927** |
| Average balance of liabilities | **17,444** | **1,604** | **-** | **-** | **4,942** | **779** | **144** | **24,913** |
| Average balance of deposits of the public | **17,442** | **-** | **-** | **-** | **4,818** | **779** | **144** | **23,183** |
| Average balance of risk assets | **12,092** | **767** | **19** | **42** | **6,976** | **1,106** | **257** | **21,259** |
| Average balance of mutual funds and supplementary training funds | **-** | **-** | **4,188** | **-** | **-** | **-** | **-** | **4,188** |
| Average balance of securities | **-** | **-** | **9,154** | **-** | **-** | **8** | **-** | **9,162** |
| Average balance of other assets under management | **184** | **-** | **-** | **-** | **-** | **-** | **-** | **184** |
| Margin from credit-granting activities | **612** | **18** | **1** | **2** | **253** | **17** | **5** | **908** |
| Margin from deposit-taking activities | **93** | **-** | **-** | **-** | **14** | **23** | **2** | **132** |
| Total interest income, net | **705** | **18** | **1** | **2** | **267** | **40** | **7** | **1,040** |
| Balance of credit to the public, net | **14,561** | **986** | **29** | **80** | **7,272** | **826** | **280** | **24,034** |
| Balance of deposits of the public | **19,380** | **-** | **-** | **-** | **5,521** | **1,031** | **158** | **26,090** |

**Small Business Segment (continued):**

| | Banking and finance | Credit cards | Capital market | Mortgages | Real estate | Overseas activity: Banking and finance | Overseas activity: Real estate | Total |
|---|---|---|---|---|---|---|---|---|
| | 2013 | | | | | | | |
| | NIS millions | | | | | | | |
| **Net interest income:** | | | | | | | | |
| From external sources | 752 | 22 | 1 | 3 | 289 | 47 | 11 | 1,125 |
| Intersegmental | (87) | (3) | - | (2) | (65) | (15) | (5) | (177) |
| **Non-interest income:** | | | | | | | | |
| From external sources | 350 | 117 | 26 | - | 78 | 15 | 2 | 588 |
| Intersegmental | 2 | (44) | - | - | - | - | - | (42) |
| Total income | 1,017 | 92 | 27 | 1 | 302 | 47 | 8 | 1,494 |
| Expenses (income) in respect of credit losses | 78 | (1) | - | - | 21 | 13 | 1 | 112 |
| **Operating and other expenses:** | | | | | | | | |
| To external sources | 683 | 57 | 16 | - | 132 | 33 | 4 | 925 |
| Intersegmental | 2 | 4 | - | - | - | - | - | 6 |
| Profit before taxes | 254 | 32 | 11 | 1 | 149 | 1 | 3 | 451 |
| Provision for taxes on profit | 91 | 10 | 4 | - | 54 | - | 1 | 160 |
| Profit after taxes | 163 | 22 | 7 | 1 | 95 | 1 | 2 | 291 |
| Net profit attributable to non-controlling interests | - | (4) | - | - | - | - | - | (4) |
| **Net profit** | 163 | 18 | 7 | 1 | 95 | 1 | 2 | 287 |
| **Return on equity** | | | | | | | | 17.3% |
| Average balance of assets | 13,966 | 907 | 23 | 90 | 6,474 | 877 | 262 | 22,599 |
| Average balance of credit to the public, net | 13,956 | 893 | 23 | 90 | 6,473 | 877 | 262 | 22,574 |
| Average balance of liabilities | 16,584 | 1,526 | - | - | 3,888 | 612 | 94 | 22,704 |
| Average balance of deposits of the public | 16,551 | - | - | - | 3,784 | 612 | 94 | 21,041 |
| Average balance of risk assets | 11,430 | 731 | 21 | 56 | 6,409 | 989 | 262 | 19,898 |
| Average balance of mutual funds and supplementary training funds | - | - | 3,091 | - | - | - | - | 3,091 |
| Average balance of securities | - | - | 6,905 | - | - | 9 | - | 6,914 |
| Average balance of other assets under management | 210 | - | - | - | - | - | - | 210 |
| Margin from credit-granting activities | 543 | 19 | 1 | 1 | 203 | 17 | 4 | 788 |
| Margin from deposit-taking activities | 122 | - | - | - | 21 | 15 | 2 | 160 |
| Total interest income, net | 665 | 19 | 1 | 1 | 224 | 32 | 6 | 948 |
| Balance of credit to the public, net, at 31 December 2013 | 14,300 | 903 | 28 | 81 | 6,730 | 957 | 300 | 23,299 |
| Balance of deposits of the public at 31 December 2013 | 17,882 | - | - | - | 4,150 | 666 | 132 | 22,830 |

**Main changes in the volume of activity**

Activity levels in Israel increased this year in the small business segment. Credit to the public increased by NIS 0.8 billion, or 3.8%, while deposits of the public increased by NIS 3.3 billion, or 14.3%,

**Main changes in the net profit**

Net profit in the small business segment totaled NIS 292 million in 2014, compared with NIS 287 million in 2013, an increase of 1.7%.

The increase in net profit derives from an increase in interest income amounting to NIS 92 million, as a result of an increase in activity in this segment. On the other hand, expenses in respect of credit losses increases by NIS 70 million, mainly as a result of expenses in respect of credit losses in the overseas unit in Romania due to local regulatory requirements.

## 3. Corporate Banking Segment

### General

The corporate banking segment specializes in providing banking and financial services to large corporations, some of which are corporations with multi-national activities, and customers whose main occupation is in the fields of construction and real estate and infrastructure projects. 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 through dealing rooms, complex transactions (projects, mergers and acquisitions, syndicate organization), banking services, etc. Services outside of Israel are provided to the corporate segment through the Bank's overseas units - 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 and Commercial Division and the International Credit and Real Estate Division and is dealt with by the Corporate Department and the Construction and Real Estate Department, which together operate seven corporate sectors. 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 segment supplies a comprehensive range of banking services to all types of companies in the various sectors. 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, the acquisition of means of control, examination of investment programs and the financing of projects, international trade activity, finance of foreign debtors/domestic debtors, financial transactions executed by way of a syndicate, etc. are handled by designated units specializing in handling transactions of this kind, due to the complexity and level of risk involved.

The Special Loans Unit, which operates within the framework of the segment, deals with corporate customers who have encountered difficulties, with experience in assisting in the recovery of active customers and the collection of debts of corporate customers who cannot be rehabilitated.

**The seven sectors in the Corporate Department and the Construction and Real Estate Department are as follows:**

a. The technology and tourism sector, specializing in providing services to corporate customers, mainly in the area of high-tech, communications, the security industry, hotels and the media.;

b. The consumption and trade sector, specializing in providing services to corporate customers, mainly in the area of the food and drink industry, retail chains, importers of household appliances, importers of agricultural, wood and metal products;

c. The industry and transport sector, specializing in providing services for corporate customers, mainly from the area of industry, vehicle importers, leasing companies, airline companies.

d. The chemicals, energy, holding companies and public institutions sector, specializing in providing services for holding companies and corporate customers, mainly from the area of chemicals, the pharmaceutical industry, energy and fuel companies and the local authorities.

e. The construction company sector, providing a wide range of banking services for large customers in the sector in the field of construction and real estate in Israel and abroad - in addition, financing the establishment and/or operation of assets in the field of real estate, hotels and nursing retirement homes abroad.

f. The real estate project sector, specializing in the provision of services to corporate customers, including middle-market, and whose main activity is financing the residential sector, which is dealt with using the construction loan method.

g. The infrastructure sector, which is engaged in the financing of national infrastructure projects using the public private partnership method (P.P.P.) which is based on cooperation between the public and private segments and in engaging in the provision of services to corporate customers in the field of performance and infrastructure contracting.

## Business objectives and strategy

The following information is "forward-looking information." For the meaning of this term, see above in the Chapter, "Description of the Banking Corporation and Forward-Looking Information".

The main objective of this segment is to deepen its relative advantage, provide maximum service to the segment's customers and to continue to improve its contribution to the Group's profits, through careful and prudent scrutiny of the exposures deriving from customers' activity and the unique risks for this sector. At the same time, the segment acts to expand the variety of products and services being offered to customers.

In light of the slowdown in business activity which occurred in 2014, the segment continued with the implementation of sound credit policy, distinguishing between the various risk levels, and the determination of credit margins and its terms, respectively.

The financing of business activity in the Bank's main service centers abroad contributes to the dispersal of risks through exposure to various macroeconomic environments and various characteristics of customers.

At the beginning of 2013, the Bank decided to gradually exit the field of diamonds – in March of that year, the process of closing the Bank's Diamond Stock Exchange branch began, continuing into 2014. In addition, the Bank decided to close the entire activity of the Diamonds and Jewelry Department in the Bank's overseas unit in New York by the end of 2015.

## Restrictions, legislation, standards, and special constraints applicable to the segment

The restrictions that are especially relevant for the corporate banking segment are, among others, the restrictions on the amount of indebtedness of large borrowers and groups of borrowers 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 the means of control.

For further information, see the Chapter, "Exposure to Risk and Methods of Risk Management", section, "Credit Concentrations".

According to Proper Conduct of Banking Business Management Regulation no. 315, when the total indebtedness of a certain sector to a banking corporation exceeds 20% of the total indebtedness of the public to a banking corporation (on an unconsolidated basis), the excess is considered a departure for the purpose of concentrations of sector indebtedness. In this case, the Bank is required to make an additional allowance for credit losses in respect of the amount of the excess. The rate of concentrations in the Bank to the various sectors (including real estate) at the end of 2014 is at the regulatory limit.

In the Real Estate Department, the financing of the projects in the construction loan format relies upon, inter alia, the existence of an operating system for the deposit of payments from purchasers of housing units in projects being supported on the basis of the coupon method, and the taking out of sale guarantees with a consistent wording, in accordance with the legislation and the directives of the Bank of Israel.

## Developments in markets of the segment or changes in the characteristics of its customers

The following information is "forward-looking information". For the meaning of this term, see above in the chapter, "Description of the Banking Corporation and Forward-Looking Information".

2014 was characterized by a decline in demand for corporate banking credit, against a background of a slowdown in business activity and by a paucity of large financial transactions, at the same time as an increase in competition by the capital market institutions.

Expectations for 2015 are for a continuation of moderate economic growth in Israel which will also have repercussions for customers in the domestic market. Business activity will be affected by the macroeconomic situation in Israel and around the world, such as the prices of goods and energy, the change between currencies and the geopolitical situation which will impact the investment decisions of the large companies in the Israeli economy.

The corporate segment manages credit risk with extreme caution, routinely examining the population of customer, focusing on the sensitive customers and the examination of the development trends and the implications thereon.

The first six months of 2014 was characterized in the real estate industry by lively activity in the housing market, maintaining a similar risk level to 2013, and the continuation of government/regulatory intervention, against a background of the price of housing which continued to rise (although at a moderate rate compared with past periods). From the beginning of the second half of the year, following public expectations of the implementation of the "Zero VAT" Law, there was a certain slowdown, both in the rate of apartment sales, and in the growth rate in the starting of new residential projects. On cancelation of the initiative, there was an awakening in demand for apartments.

The office rental property market, which serves the corporate segment, correlates strongly with growth in the corporate product. In future years, it is likely that there will be an excess supply of office space in projects which are currently in the process of construction, and noting that fact, there was a significant decrease this year in the rate of starting new projects, particularly in the central part of the country, but no material changes have been noted in the occupancy rate or in rents.

The commercial real estate market is strongly affected by developments in private household consumption. This market retained relative stability throughout the year, which was reflected in maintaining high occupancy rates and stable rents, despite the fall in the level of private consumption in some of the previous quarters. Even in this area, according to the office real estate rental market, there was a decline this year in building starts in new projects.

In the field of national infrastructure, including in the area of performance and infrastructure, which, in recent years, has enjoyed an increase in the volume of housing and non-housing construction, a slowdown in the rate of new project starts at a national level was felt, together with a slowdown arising from the residential market trends, particularly from the second half of 2014.

In 2015, as in previous years, activity in the area of real estate is expected to be affected by the macroeconomic situation, government/regulatory intervention (particularly in the housing market), building completions (particularly in the office market) and the volumes of investments by the State in the area of national infrastructure.

For further information, on the subject of the world economy, see the Chapter, "Principal Developments in the Economy".

### Technological changes

- Employees of the segment are assisted by the automated systems which support various processes carried within it, such as control, definition of and measurement of targets, marketing and business development.
- The segment places technological tools at the disposal of its customers, similar to those used by all of the Bank's customers, *inter alia*, through the business portal which expands the range of services for the convenience of the corporate customer. The Bank continues to strive for the development of these systems in order to address the changing and evolving needs of the customers of the segment.

### Critical success factors in the segment

Critical success factors in the segment are: staff possessing high levels of management, professional and interpersonal 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. In addition, recognizing the various segments of the market and monitoring the changes occurring in the market in order to identify potential and avoid risk. A high degree of skill in planning complex financing packages, proper management and control when supporting projects, constant investment in technological aids, and diligence in supplying service and providing solutions to customers' banking 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

In recent years, the involvement of the capital market has been increasing – whether through the issue of debentures, the extension of direct loans by the institutional entities, or the issue of policies for guaranteeing the funds of apartment purchasers, which significantly affects the volume of demand for banking services supplied by this segment.

**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 financing credit insurance or private insurance companies of projects abroad), financing and guidance of national and international projects, financing of mergers and acquisitions, extension of finance in large transactions through organization of syndicates cooperating with the institutional entities and foreign and Israeli banks, 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 companies, managements and employees of companies in the segment.

Finance in the area of construction and real estate was effected by the use of specific analysis and monitoring tools which assist in the decision-making process and control of financial support given to the various projects and assets. Financing was carried out, directing the diversity of the credit portfolio and distinguishing between the various segments – housing, rental property with a designation for commerce and offices, construction for industry and commerce. The financing of housing projects will, in general, be effected using the construction loan method which facilitates frequent close supervision of the project being financed.

Financing the area of construction and real estate also includes the special funding format for national infrastructure projects using the various types of the public private partnership (PPP) method. Analysis of these transactions and the construction of the appropriate financing package are carried out taking into account the nature of the project, an analysis of the ability to service the debt, the extent of right of recourse to promoters, the establishment and operation contract restriction and technical limitations, etc.

In addition, pursuant to the financing of the area of construction and real estate, the segment also deals with the extension of credit, support of the initiation and development of real estate and hotel projects, the purchase of rental properties, including nursing retirement homes and their operation through the Bank's overseas units.

**Customers**

Customers belonging to this segment are mostly characterized by their leading position in the market and dominance in their field of activity. Some of these are 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.

**Structure of competition in the segment and the changes that have occurred therein**

The status of the Israeli banks as the sole financers of corporations has continued to diminish over the years, such that the weighting of credit to the corporate sector (including small and middle-market businesses) provided by the banking system is below 50%.

There is competition in the segment, both on the part of the other banking groups in Israel and foreign banks, and on the part of the Israeli capital market and the institutional entities, such as insurance companies and pension funds, which make up most of the competition for business credit (particularly for large companies). In recent years, there has been a greater involvement from the institutional entities, and, as a consequence, the percentage of direct loans extended by institutional corporate entities has continued to increase.

**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 accountants, project and investment plan unit, international trade finance unit, mergers and acquisitions, unit for financing syndicate participation, etc.).

In 2014, the average number of positions assigned to the segment (including the International Credit and Real Estate Division) totaled 954 positions, of which, 407 were management positions, compared with 1,034 positions in 2013, 429 of which were management staff. Most of the employees have an academic education, and 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.

**Below is 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 |
|---|---|---|---|---|---|---|---|
| | **2014** | | | | | | |
| | NIS millions | | | | | | |
| **Net interest income:** | | | | | | | |
| From external sources | **1,172** | **20** | **1** | **741** | **1** | **1** | **1,936** |
| Intersegmental | **(433)** | **(2)** | **1** | **(260)** | **7** | **3** | **(684)** |
| **Non-interest income:** | | | | | | | |
| From external sources | **502** | **188** | **13** | **431** | **2** | **1** | **1,137** |
| Intersegmental | **(164)** | **(92)** | **-** | **(108)** | **-** | **-** | **(364)** |
| Total income | **1,077** | **114** | **15** | **804** | **10** | **5** | **2,025** |
| Expenses in respect of credit losses | **(370)** | **-** | **-** | **(119)** | **-** | **-** | **(489)** |
| **Operating and other expenses:** | | | | | | | |
| To external sources | **363** | **81** | **9** | **171** | **7** | **3** | **634** |
| Intersegmental | **1** | **-** | **-** | **-** | **-** | **-** | **1** |
| Profit before taxes | **1,083** | **33** | **6** | **752** | **3** | **2** | **1,879** |
| Provision for taxes on profit | **408** | **9** | **2** | **284** | **1** | **-** | **704** |
| Profit after taxes | **675** | **24** | **4** | **468** | **2** | **2** | **1,175** |
| Net profit attributable to non-controlling interests | **-** | **(5)** | **-** | **-** | **-** | **-** | **(5)** |
| **Net profit** | **675** | **19** | **4** | **468** | **2** | **2** | **1,170** |
| **Return on equity** | | | | | | | **14.9%** |
| Average balance of assets | **39,298** | **381** | **67** | **21,042** | **89** | **43** | **60,920** |
| Average balance of credit to the public, net | **37,689** | **354** | **66** | **20,998** | **89** | **42** | **59,238** |
| Average balance of liabilities | **19,452** | **2,874** | **-** | **5,432** | **461** | **167** | **28,386** |
| Average balance of deposits of the public | **17,956** | **-** | **-** | **4,887** | **461** | **167** | **23,471** |
| Average balance of risk assets | **62,638** | **391** | **83** | **21,078** | **142** | **43** | **84,375** |
| Average balance of mutual funds and supplementary training funds | **-** | **-** | **1,879** | **-** | **-** | **-** | **1,879** |
| Average balance of securities | **-** | **-** | **58,714** | **-** | **-** | **-** | **58,714** |
| Average balance of other assets under management | **192** | **-** | **-** | **-** | **-** | **-** | **192** |
| Margin from credit-granting activities | **729** | **18** | **-** | **471** | **-** | **2** | **1,220** |
| Margin from deposit-taking activities | **10** | **-** | **2** | **10** | **8** | **2** | **32** |
| Total interest income, net | **739** | **18** | **2** | **481** | **8** | **4** | **1,252** |
| Balance of credit to the public, net | **37,481** | **378** | **-** | **20,836** | **42** | **24** | **58,761** |
| Balance of deposits of the public | **22,316** | **-** | **-** | **5,012** | **252** | **174** | **27,754** |

## Corporate Banking Segment (continued):

| | Banking and finance | Credit cards | Capital market | Real estate | Overseas activity Banking and finance | Overseas activity Real estate | Total |
|---|---|---|---|---|---|---|---|
| | 2013 | | | | | | |
| | NIS millions | | | | | | |
| **Net interest income:** | | | | | | | |
| From external sources | 1,519 | 24 | - | 985 | (1) | 1 | 2,528 |
| Intersegmental | (675) | (5) | - | (487) | 21 | 2 | (1,144) |
| **Non-interest income:** | | | | | | | |
| From external sources | (274) | 194 | 16 | 137 | 6 | 1 | 80 |
| Intersegmental | 523 | (92) | (1) | 137 | - | - | 567 |
| Total income | 1,093 | 121 | 15 | 772 | 26 | 4 | 2,031 |
| Expenses in respect of credit losses | (36) | (2) | - | (128) | - | - | (166) |
| **Operating and other expenses:** | | | | | | | |
| To external sources | 399 | 80 | 7 | 185 | 13 | 3 | 687 |
| Intersegmental | - | 1 | - | - | - | - | 1 |
| Profit before taxes | 730 | 42 | 8 | 715 | 13 | 1 | 1,509 |
| Provision for taxes on profit | 261 | 11 | 3 | 259 | 3 | - | 537 |
| Profit after taxes | 469 | 31 | 5 | 456 | 10 | 1 | 972 |
| Net profit attributable to non-controlling interests | - | (6) | - | - | - | - | (6) |
| **Net profit** | 469 | 25 | 5 | 456 | 10 | 1 | 966 |
| **Return on equity** | | | | | | | 12.0% |
| Average balance of assets | 42,647 | 393 | 166 | 23,104 | 232 | 92 | 66,634 |
| Average balance of credit to the public, net | 41,007 | 367 | 166 | 23,037 | 232 | 92 | 64,901 |
| Average balance of liabilities | 18,031 | 2,780 | - | 5,472 | 1,102 | 163 | 27,548 |
| Average balance of deposits of the public | 16,520 | - | - | 4,907 | 1,102 | 163 | 22,692 |
| Average balance of risk assets | 66,244 | 406 | 166 | 23,507 | 314 | 92 | 90,729 |
| Average balance of mutual funds and supplementary training funds | - | - | 2,366 | - | - | - | 2,366 |
| Average balance of securities | - | - | 59,059 | - | 62 | - | 59,121 |
| Average balance of other assets under management | 212 | - | - | - | - | - | 212 |
| Margin from credit-granting activities | 830 | 19 | - | 483 | 3 | 1 | 1,336 |
| Margin from deposit-taking activities | 14 | - | - | 15 | 17 | 2 | 48 |
| Total interest income, net | 844 | 19 | - | 498 | 20 | 3 | 1,384 |
| Balance of credit to the public, net, at 31 December 2013 | 38,504 | 328 | 166 | 21,446 | 158 | 44 | 60,646 |
| Balance of deposits of the public at 31 December 2013 | 16,523 | - | - | 5,364 | 767 | 162 | 22,816 |

### Main Changes in the Volumes of Activity

In the corporate banking segment, there was a decrease in credit to the public of some NIS 1.9 billion, or 3.1%, primarily from domestic activities. There was an increase in deposits of the public of some NIS 4.9 billion, or 21.6%, which is attributable to an increase in activity in Israel.

### Main Changes in the Net Profit

Net profit in the corporate banking segment in 2014 totaled NIS 1,170 million, compared with NIS 966 million in the corresponding period in 2013, an increase of 21.1%. The increase in profit derived mainly from income in respect of credit losses amounting to NIS 489 million, which were recorded in 2014, compared with income in respect of credit losses amounting to NIS 166 million which were recorded last year, due to an increase in the collection of debts. This decrease was partly offset by a decrease in interest income amounting to NIS 132 million, as a result of a decrease in credit activity.

## 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. 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 and the financing of start-up companies.

The commercial banking segment also includes activities outside of Israel through the Bank's subsidiaries abroad. Companies that are served by the Commercial Department also prefer to work with these offices, in expanding their overseas activities. 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 United Kingdom and Romania view the servicing of these companies as a direct continuation of the banking activities in Israel.

For further details about the overseas units, see below in the Chapter, "Principal Investee Companies".

### Structure of the segment

The segment is managed in Israel by the Commercial Department, which is a part of the Commercial Corporate Division. The Commercial Department is a unique structure 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 Department has 22 business branches located in industrial zones and in the major cities, which are attributed geographically to four commercial districts and four sub-divisions belonging to the Commercial Sub-Division in the Tel Aviv Central Branch. The branches specialize in the management of business activities characteristic of the segment's customers, giving the Department a competitive advantage.

### 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 above in the Chapter, "Description of the Banking Corporation and Forward-Looking Information".

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 banking solutions for the benefit of its customers operating in Israel and abroad. As part of these services, in 2014, the Commercial Department began financing construction projects using the Closed End Financing (the C/L Format) in accordance with criteria specified for this purpose. In addition, one of the strategic focuses is strengthening Leumi's advantage and leadership in the field of hi-tech, leveraging the expertise and professionalism of the hi-tech teams in the Commercial Department in conjunction with Leumi Tech.

### Restrictions, legislation, regulations and special constraints that apply to the segment

See details above in the chapter. "Regulation, General Environment and Effect of External Factors on Activity".

### 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, hi-tech, trade and services and real estate sectors of the economy and markets abroad, either directly or through foreign subsidiaries.

Expectations for 2015 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 Commercial Department is taking particularly cautious steps in risk management, regularly reviewing the customer population, and, in particular, sensitive customers, in particular, and reviewing trends of development and their implications.

**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 standard 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 spheres of credit and investments and banking services, are all of the banks operating in Israel (domestic and foreign), overseas banks, entities operating in the capital market, and insurance companies. Most of the competition at this stage with the insurance companies is in the area of investment services, 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 from all the abovementioned factors is growing stronger.

**Human Capital**

- The average number of positions assigned to the segment in 2014 totaled 1,754 of which 716 were management positions, compared with 1,844 positions in 2013, 769 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 Department's customers.

**Below is 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 |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | | | | | | |
| | NIS millions | | | | | | | |
| **Net interest income:** | | | | | | | | |
| From external sources | **631** | **9** | **2** | **325** | **545** | **-** | **146** | **1,658** |
| Intersegmental | **17** | **(1)** | **(1)** | **(101)** | **(66)** | **-** | **(43)** | **(195)** |
| **Non-interest income:** | | | | | | | | |
| From external sources | **265** | **77** | **47** | **43** | **69** | **6** | **14** | **521** |
| Intersegmental | **67** | **(33)** | **-** | **16** | **-** | **-** | **-** | **50** |
| Total income | **980** | **52** | **48** | **283** | **548** | **6** | **117** | **2,034** |
| Expenses in respect of credit losses | **(4)** | **-** | **-** | **2** | **121** | **-** | **34** | **153** |
| **Operating and other expenses:** | | | | | | | | |
| To external sources | **519** | **34** | **44** | **68** | **325** | **3** | **31** | **1,024** |
| Intersegmental | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Profit before taxes | **465** | **18** | **4** | **213** | **102** | **3** | **52** | **857** |
| Provision for taxes on profit | **175** | **6** | **1** | **80** | **41** | **1** | **23** | **327** |
| Profit after taxes | **290** | **12** | **3** | **133** | **61** | **2** | **29** | **530** |
| Net profit attributable to non-controlling interests | **-** | **(3)** | **-** | **-** | **-** | **-** | **-** | **(3)** |
| **Net profit** | **290** | **9** | **3** | **133** | **61** | **2** | **29** | **527** |
| **Return on equity** | | | | | | | | **10.1%** |
| Average balance of assets | **26,622** | **360** | **176** | **8,973** | **14,102** | **-** | **3,132** | **53,365** |
| Average balance of credit to the public, net | **24,304** | **349** | **160** | **8,957** | **13,904** | **-** | **3,071** | **50,745** |
| Average balance of liabilities | **44,460** | **1,115** | **81** | **3,050** | **11,287** | **-** | **204** | **60,197** |
| Average balance of deposits of the public | **43,588** | **-** | **81** | **2,951** | **11,073** | **-** | **193** | **57,886** |
| Average balance of risk assets | **30,035** | **306** | **184** | **8,816** | **11,726** | **-** | **3,132** | **54,199** |
| Average balance of mutual funds and supplementary training funds | **-** | **-** | **5,847** | **-** | **-** | **120** | **-** | **5,967** |
| Average balance of securities | **-** | **-** | **47,878** | **-** | **74** | **1,377** | **-** | **49,329** |
| Average balance of other assets under management | **497** | **-** | **-** | **-** | **-** | **-** | **-** | **497** |
| Margin from credit-granting activities | **596** | **8** | **-** | **217** | **243** | **-** | **99** | **1,163** |
| Margin from deposit-taking activities | **52** | **-** | **1** | **7** | **236** | **-** | **4** | **300** |
| Total interest income, net | **648** | **8** | **1** | **224** | **479** | **-** | **103** | **1,463** |
| Balance of credit to the public, net | **24,393** | **367** | **145** | **9,591** | **14,693** | **-** | **3,433** | **52,622** |
| Balance of deposits of the public | **50,168** | **-** | **344** | **3,476** | **12,554** | **-** | **181** | **66,723** |

**Commercial Banking Segment (continued):**

| | | | | | Overseas activity | | | |
|---|---|---|---|---|---|---|---|---|
| | Banking and finance | Credit cards | Capital market | Real estate | Banking and finance | Capital market | Real estate | Total |
| | 2013 | | | | | | | |
| | NIS millions | | | | | | | |
| **Net interest income:** | | | | | | | | |
| From external sources | 583 | 10 | - | 357 | 571 | - | 135 | 1,656 |
| Intersegmental | 20 | (2) | - | (162) | (92) | - | (46) | (282) |
| **Non-interest income:** | | | | | | | | |
| From external sources | 223 | 78 | 45 | 62 | 70 | 7 | 7 | 492 |
| Intersegmental | 125 | (34) | (4) | (4) | - | - | - | 83 |
| Total income | 951 | 52 | 41 | 253 | 549 | 7 | 96 | 1,949 |
| Expenses (income) in respect of credit losses | (27) | (1) | - | (1) | 89 | - | 126 | 186 |
| **Operating and other expenses:** | | | | | | | | |
| To external sources | 551 | 34 | 39 | 66 | 342 | 4 | 39 | 1,075 |
| Intersegmental | - | 1 | - | - | - | - | - | 1 |
| Profit (loss) before taxes | 427 | 18 | 2 | 188 | 118 | 3 | (69) | 687 |
| Provision for taxes on profit | 155 | 5 | 1 | 68 | 57 | 1 | (12) | 275 |
| Profit (loss) after taxes | 272 | 13 | 1 | 120 | 61 | 2 | (57) | 412 |
| Net profit attributable to non-controlling interests | - | (3) | - | - | - | - | - | (3) |
| **Net profit (loss)** | 272 | 10 | 1 | 120 | 61 | 2 | (57) | 409 |
| **Return on equity** | | | | | | | | 9.1% |
| Average balance of assets | 24,511 | 357 | 258 | 8,184 | 14,985 | - | 3,047 | 51,342 |
| Average balance of credit to the public, net | 22,842 | 347 | 257 | 8,160 | 14,784 | - | 2,993 | 49,383 |
| Average balance of liabilities | 36,899 | 1,082 | - | 2,521 | 10,877 | - | 247 | 51,626 |
| Average balance of deposits of the public | 36,295 | - | - | 2,440 | 10,684 | - | 238 | 49,657 |
| Average balance of risk assets | 27,237 | 306 | 262 | 8,104 | 14,770 | - | 3,047 | 53,726 |
| Average balance of mutual funds and supplementary training funds | - | - | 5,005 | - | - | 148 | - | 5,153 |
| Average balance of securities | - | - | 45,120 | - | - | 1,532 | - | 46,652 |
| Average balance of other assets under management | 653 | - | - | - | - | - | - | 653 |
| Margin from credit-granting activities | 541 | 8 | - | 186 | 262 | - | 85 | 1,082 |
| Margin from deposit-taking activities | 62 | - | - | 9 | 217 | - | 4 | 292 |
| Total interest income, net | 603 | 8 | - | 195 | 479 | - | 89 | 1,374 |
| Balance of credit to the public, net, at 31 December 2013 | 23,320 | 321 | 238 | 8,481 | 14,276 | - | 2,994 | 49,630 |
| Balance of deposits of the public at 31 December 2013 | 38,792 | - | - | 2,666 | 10,206 | - | 214 | 51,878 |

**Main Changes in the Volumes of Activity**

Credit to the public fell by some NIS 3.0 billion, 6.0%. Deposits of the public increased by some NIS 14.8 billion, 28.6%, as a result of an increase in activity in Israel amounting to NIS 12.5 billion and an increase in overseas activity amounting to NIS 2.3 billion.

**Main Changes in the Net Profit**

Net profit in the commercial banking segment totaled NIS 527 million in 2014, compared with NIS 409 million in 2013, an increase of 28.9%.

The increase in profit derives primarily from a increase in interest income amounting to NIS 89 million, as a result of an increase in activity, a decrease in credit loss expenses amounting to NIS 33 million, mainly in the United Kingdom office and decrease in operating expenses amounting to NIS 52 million**.**

## 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 overseas offices.

For further information in respect of subsidiaries operating overseas, see Chapter "Principal Investee Companies, Consolidated Companies, Branches and Overseas Agencies".

### The structure of the segment

The private banking line is operated in Israel through the provision of exclusive and personal service by professional teams in six unique centers around the country, who serve local residents and foreign residents in their native tongue, 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' activity.

### 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, enterprising and competitive teams, and the highest standard of service orientation.

The Bank has decided on the exit of its overseas agencies and representative offices engaged in private banking, including the closure of most of the Bank's representative offices overseas, the sale of the Bank's activity in Switzerland and a decision to exit the office in Luxembourg.

In January 2015, an organizational change was effected, in which the Private Banking Department in Israel was transferred to the responsibility of the Banking Division.

### Restrictions, legislation, regulations and special constraints that apply to the operating 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.

In recent years, Private Banking has been affected by changes both in regulation and in international enforcement. Like other banks, Bank Leumi is taking steps on a number of plains to reduce the exposures arising from these changes and adapt its activity to them.

For further information on the subject of FATCA, see above in the Chapter, "Regulation, General Environment and the Effect of External Factors on Activities".
For further information regarding "American customers", see below in the Chapter, "Legal Proceedings".
For further information regarding "Cross Border", see below in Chapter on "Exposure to Risk and Methods of Risk Management".

### Developments in the markets of the operating segment, or changes in its customers' characteristics

Business reality is characterized by a high degree of uncertainty, increasing risk, fierce competitive conditions, with substantial changes in regulations.

### Technological changes

The private banking segment has technology systems at its disposal, which provide detailed reports to customers regarding their investments and assets and assists the counselors to better manage and monitor customers' portfolios.

Advanced innovative 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 competitors 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 for customers by a professional team supported by analysts and information systems.
- Provision of personal and customized VIP services, over and above routine financial services.

**The main entry and exit barriers in the segment**

- Skilled and qualified manpower possessing high levels of professionalism and service skills.
- Implementation of means of control over the entire range of activities.
- Establishment, maintenance and upgrade 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, while complying with the provisions in the regulations. In addition, the Bank takes steps to retain customers and increase the Bank's share in customers' asset portfolios. 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 and communal institutions in Israel and around the world, direct mailings and the Internet.

**Competition**

In the private banking segment, Leumi competes in Israel with Israeli banks, investment houses and 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 other Israeli banks.

**Human capital**

In 2014, the average number of positions assigned to the segment was 798 of which 424 were management positions, compared with 806 positions in 2013, of which 419 were management positions.

Employees of the private banking segment undergo comprehensive training, including wide-ranging professional and management training courses. In addition, the employees attend extensive workshops for acquiring strong service skills.

**Cooperation agreements**

As stated, the private banking segment offers customers a broad range of products, within the framework of open architecture.

For further information regarding a cooperation agreement with Julius Baer Bank and the sale of activity in Switzerland, see Chapter "Material Agreements" below.

**Below is 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 |
| | **2014** | | | | | | | | | |
| | NIS millions | | | | | | | | | |
| **Net interest income:** | | | | | | | | | | |
| From external sources | **(97)** | **-** | **(8)** | **1** | **12** | **47** | **-** | **38** | **(1)** | **(8)** |
| Intersegmental | **160** | **-** | **9** | **(1)** | **2** | **141** | **-** | **(24)** | **3** | **290** |
| **Non-interest income:** | | | | | | | | | | |
| From external sources | **21** | **1** | **165** | **-** | **18** | **175** | **182** | **4** | **1** | **567** |
| Intersegmental | **13** | **1** | **-** | **-** | **2** | **14** | **-** | **-** | **-** | **30** |
| Total income | **97** | **2** | **166** | **-** | **34** | **377** | **182** | **18** | **3** | **879** |
| Expenses in respect of credit losses | **11** | **-** | **-** | **-** | **-** | **3** | **-** | **-** | **-** | **14** |
| **Operating and other expenses:** | | | | | | | | | | |
| To external sources | **430** | **2** | **74** | **-** | **15** | **1,051** | **337** | **12** | **2** | **1,923** |
| Intersegmental | **1** | **1** | **-** | **-** | **-** | **1** | **1** | **-** | **-** | **4** |
| Profit (loss) before taxes on profit | **(345)** | **(1)** | **92** | **-** | **19** | **(678)** | **(156)** | **6** | **1** | **(1,062)** |
| Provision for (benefit from) taxes | **(35)** | **-** | **34** | **-** | **7** | **(17)** | **(5)** | **1** | **-** | **(15)** |
| Profit (loss) after taxes | **(310)** | **(1)** | **58** | **-** | **12** | **(661)** | **(151)** | **5** | **1** | **(1,047)** |
| Net profit attributable to non-controlling interests | **-** | **-** | **-** | **-** | **-** | **29** | **-** | **-** | **-** | **29** |
| **Net profit (loss)** | **(310)** | **(1)** | **58** | **-** | **12** | **(632)** | **(151)** | **5** | **1** | **(1,018)** |
| **Return on equity** | | | | | | | | | | **(112.0%)** |
| Average balance of assets | **1,468** | **70** | **15** | **57** | **749** | **7,469** | **-** | **810** | **-** | **10,638** |
| Average balance credit to the public, net | **1,371** | **70** | **15** | **56** | **739** | **3,018** | **-** | **810** | **-** | **6,079** |
| Average balance of liabilities | **17,569** | **-** | **146** | **-** | **1,527** | **15,848** | **-** | **14** | **114** | **35,218** |
| Average balance of deposits of the public | **17,372** | **-** | **145** | **-** | **1,519** | **15,188** | **-** | **14** | **113** | **34,351** |
| Average balance of risk assets | **1,633** | **52** | **17** | **31** | **738** | **4,995** | **-** | **284** | **-** | **7,749** |
| Average balance of mutual funds and supplementary training funds | **-** | **-** | **9,212** | **-** | **-** | **116** | **1,598** | **-** | **-** | **10,926** |
| Average balance of securities | **-** | **-** | **44,556** | **-** | **-** | **2,389** | **32,548** | **-** | **-** | **79,493** |
| Average balance of other assets under management | **82** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **82** |
| Margin from credit-granting activities | **17** | **-** | **1** | **-** | **10** | **44** | **-** | **14** | **-** | **86** |
| Margin from deposit-taking activities | **46** | **-** | **-** | **-** | **4** | **144** | **-** | **-** | **2** | **196** |
| Total interest income, net | **63** | **-** | **1** | **-** | **14** | **188** | **-** | **14** | **2** | **282** |
| Balance of credit to the public, net | **1,494** | **74** | **4** | **61** | **781** | **2,642** | **-** | **826** | **-** | **5,882** |
| Balance of deposits of the public | **18,321** | **-** | **91** | **-** | **1,646** | **14,665** | **-** | **13** | **94** | **34,830** |

## Private Banking Segment (continued):

| | | | | | | Overseas activity | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Banking and finance | Credit cards | Capital market | Mortgages | Real estate | Banking and finance | Capital market | Mortgages | Real estate | Total |
| | 2013 | | | | | | | | | |
| | NIS millions | | | | | | | | | |
| **Net interest income:** | | | | | | | | | | |
| From external sources | (155) | - | - | 1 | 6 | 40 | - | 37 | (1) | (72) |
| Intersegmental | 233 | - | - | (1) | 6 | 145 | - | (23) | 4 | 364 |
| **Non-interest income:** | | | | | | | | | | |
| From external sources | (27) | 1 | 172 | - | 17 | 172 | 193 | 4 | 1 | 533 |
| Intersegmental | 63 | 1 | (1) | - | 1 | 13 | - | - | - | 77 |
| Total income | 114 | 2 | 171 | - | 30 | 370 | 193 | 18 | 4 | 902 |
| Expenses in respect of credit losses | 3 | - | - | - | 2 | 4 | - | - | - | 9 |
| **Operating and other expenses:** | | | | | | | | | | |
| To external sources | 404 | 2 | 73 | - | 14 | 384 | 215 | 10 | 2 | 1,104 |
| Intersegmental | 1 | 1 | - | - | - | 1 | 1 | - | - | 4 |
| Profit (loss) before taxes on profit | (294) | (1) | 98 | - | 14 | (19) | (23) | 8 | 2 | (215) |
| Provision for (benefit from) taxes | (36) | - | 33 | - | 5 | 10 | 2 | 2 | - | 16 |
| Profit (loss) after taxes | (258) | (1) | 65 | - | 9 | (29) | (25) | 6 | 2 | (231) |
| Net profit attributable to non-controlling interests | - | - | - | - | - | (4) | - | - | - | (4) |
| **Net profit (loss)** | (258) | (1) | 65 | - | 9 | (33) | (25) | 6 | 2 | (235) |
| **Return on equity** | | | | | | | | | | (24.8%) |
| Average balance of assets | 1,439 | 65 | 31 | 43 | 646 | 8,782 | - | 858 | - | 11,864 |
| Average balance credit to the public, net | 1,328 | 65 | 31 | 43 | 638 | 4,146 | - | 858 | - | 7,109 |
| Average balance of liabilities | 18,804 | - | 6 | - | 1,426 | 16,481 | - | 17 | 150 | 36,884 |
| Average balance of deposits of the public | 18,563 | - | 6 | - | 1,419 | 16,070 | - | 17 | 151 | 36,226 |
| Average balance of risk assets | 1,763 | 48 | 31 | 25 | 607 | 6,511 | - | 300 | - | 9,285 |
| Average balance of mutual funds and supplementary training funds | - | - | 6,406 | - | - | - | 1,775 | - | - | 8,181 |
| Average balance of securities | - | - | 42,174 | - | - | - | 35,127 | - | - | 77,301 |
| Average balance of other assets under management | 188 | - | - | - | - | - | - | - | - | 188 |
| Margin from credit-granting activities | 19 | - | - | - | 8 | 45 | - | 14 | - | 86 |
| Margin from deposit-taking activities | 59 | - | - | - | 4 | 140 | - | - | 3 | 206 |
| Total interest income, net | 78 | - | - | - | 12 | 185 | - | 14 | 3 | 292 |
| Balance of credit to the public, net, at 31 December 2013 | 1,225 | 68 | 31 | 48 | 789 | 3,476 | - | 818 | - | 6,455 |
| Balance of deposits of the public at 31 December 2013 | 17,700 | - | 30 | - | 1,520 | 15,384 | - | 14 | 146 | 34,794 |

**Main changes in volume of activity in the segment**

Credit to the public decreased by NIS 0.6 billion, as a result of a reduction in overseas activity, following a decision of the Bank to exit branches and representative offices abroad engaged in Private Banking.

Deposits of the public totaled NIS 34.8 billion, similar to 2013. There was an increase in deposits of the public of Israeli residents, which was wholly offset by a decrease in deposits of the public of foreign residents.

**Changes in net profit**

The loss of the private banking segment in 2014 amounted to NIS 1,018 million, compared with a loss of NIS 235 million in the corresponding period in 2013, an increase of NIS 783 million. The loss derives from expenses in respect of the arrangements with overseas authorities in 2014 which was recorded in the segment.

## 6. Financial Management Segment – Capital Markets

### General

This segment includes two areas:

1. The financial management of the Bank and of the Group deals with the management of the dealing rooms and provides various services to banks and institutional investors, and acts as a "customer manager" for them. The main 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 and management of direct investments, in the companies' tradable and non-tradable shares, with the non-bank investments being managed by Leumi Partners.
   - Management of the dealing rooms, which provide trading services to customers of the Bank, including market-making, primarily in currencies, securities and derivative instruments;
   - Management of sources and applications and liquidity;
   - 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;
   - Development of financial instruments.
2. Leumi Partners, which constitutes the investment banking vehicle of the Leumi Group and operates a unique merchant banking platform combining four areas of activity:
   - Management of a portfolio of nonbank investments of Leumi Group;
   - Underwriting, consulting and management of private and public capital mobilizations in Israel;
   - Consulting and management of the mergers and acquisition (M&A) processes and capital mobilizations;
   - Economic analyses and valuations.

For further information regarding Leumi Partners, see Chapter on "Principal Investee Companies", below.

### Structure and business strategy in the segment

Financial management (except for activity carried by Leumi Partners as outlined above) is carried out by the Capital Markets Division, which centralizes and coordinates the topic at Group level. The financial management activity includes the banking portfolio and the trading portfolio, as well as providing service to customers active in the capital and money markets, including institutional customers. Activity in the banking portfolio is managed in the ALM Department and includes the management of sources and applications and exposure to market risks and liquidity. Activity for commerce is performed by the trading rooms and *nostro* units in Israeli and foreign currencies.

The main tools for management of the banking portfolio – transition prices, activity in the available-for-sale *nostro* portfolios and the use of derivative instruments.

The main areas of responsibility of ALM – Management of the Bank's financial capital and exposures to market risks, management of corporate and statutory liquidity and liquidity risk, as well as the allocation of sources to the various applications by means of the implementation of transition price policy. This policy is determined according to: the Bank's requirements, planning and management of the mix of sources and applications, developments in the corporate environment and forecasts. Within this framework, the methodology for settling accounts between the profit centers is also determined, and the complex and special transactions are priced.

The day-to-day management of the liquidity is applied pursuant to the Bank's policy and according to the requisite directives. The management is carried out by a designated unit, whose main function is the optimal planning and management of the liquidity balances, subject to the risk appetite, ensuring a level of liquidity which enables corporate activity, compliance with all the Bank's financial obligations in a normal business environment and in stress scenarios. The measurement, analysis, planning and reporting is carried out through Summix (formerly Risk Pro) risk management system, which provides vast information on any financial activity of the Bank and on market and liquidity risks inherent therein. The system facilitates review and control of the effect of various scenarios (price and quantity) on the Bank's financial profitability and capital.

For a description of the main points of policy for investments in securities (*nostro*), see Chapter on "Securities", above.

**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 units 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, the dealing rooms and ALM management, 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;
- 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 deriving from market-making activity;
- Income/expenses deriving from the investment for pension, jubilee and regular holiday reserves;
- Particular costs relating to pension liabilities, calculated on an actuarial basis;
- 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**

The financial management was managed in 2014 against a background of a number of significant trends, including a decline in the level of returns and credit margins in Israel and around the world, devaluation of the shekel, and a decline in the rate of increase in the price index which was affected by a reduction in the prices of goods around the world, particularly energy prices.

During 2014, 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 within the proper response time-frames. The support of the activity by automated available, flexible and reliable systems is an additional important factor in the segment's success. During the year, the Bank continued the integration of a new system, called Calypso, which is intended to improve the management and control ability in the area of derivative instruments.

**Technological changes**

The financial instruments are in constant development. The Bank invests numerous resources in the purchase and adaptation of computer systems which support these instruments.

The Capital Markets Division launched the TradeOn system brand for institutional customers and portfolio managers. This involves an electronic platform that permits customers to be offered trading in Israeli securities on the basis of Leumi Finance system, securities and foreign currency. It is planned, in future years, to provide "front-to-back" trading services in a variety of different base assets.

**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 and domestic and foreign banks.

**Human capital**

In 2014, the average number of positions assigned to the segment was some 710 positions, of which 343 were management positions, compared with 682 positions in 2013, 313 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:**

| | For the year ended 31 December | |
|---|---|---|
| | **2014** | 2013 |
| | NIS millions | |
| **Net interest income:** | | |
| From external sources | **(450)** | (821) |
| Intersegmental | **1,137** | 1,521 |
| **Non-interest income:** | **-** | - |
| From external sources | **694** | 2,040 |
| Intersegmental | **118** | (733) |
| Total income | **1,499** | 2,007 |
| Expenses (income) in respect of credit losses | **205** | (52) |
| **Operating and other expenses:** | **-** | - |
| To external sources | **1,048** | 1,005 |
| Intersegmental | **51** | 50 |
| Profit before taxes | **195** | 1,004 |
| Provision for tax on profit (tax benefit) | **(31)** | 303 |
| Profit after taxes | **226** | 701 |
| Group share in losses (profits) of companies included on equity basis after effect of tax | **37** | (297) |
| Loss attributable to non-controlling interests | **-** | 2 |
| **Net profit** | **263** | 406 |
| **Return on equity** | **8.2%** | 10.1% |
| Average balance of assets | **114,850** | 113,601 |
| Average balance credit to the public, net | **438** | 586 |
| Average balance of liabilities | **81,919** | 79,208 |
| Average balance of deposits of the public | **33,069** | 33,032 |
| Average balance of risk assets | **35,403** | 32,304 |
| Average balance of mutual funds and supplementary training funds | **113,742** | 95,879 |
| Average balance of securities | **376,643** | 307,190 |
| Margin from credit-granting activities | **3,804** | 6,265 |
| Margin from deposit-taking activities | **(3,117)** | (5,565) |
| Total interest income, net | **687** | 699 |
| Balance of credit to the public, net | **485** | 573 |
| Balance of deposits of the public | **32,511** | 35,039 |

In 2014, the net profit of the segment amounted to NIS 263 million, compared with a profit of NIS 406 million in 2013. 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. A decrease in income amounting to NIS 508 million deriving from a decrease in noninterest income amounting to NIS 495 million, as a result of a decrease in profits from the sale of shares and sale of loans and expenses from exchange rate differences as a result of a devaluation of exchange rates against the dollar.

b. Expenses in respect of credit losses amounting to NIS 205 million, compared with income amounting to NIS 52 million in 2013.

On the other hand, there was an increase in operating expenses amounting to NIS 44 million, deriving from a decrease in operating expenses that were not loaded on the other operating segments, mainly salary expenses, as a result of a decrease in pension expenses amounting to NIS 217 million and a decrease in a provision for early retirement of NIS 75 million, which was recorded last year.

In addition, profit was recorded in the segment in respect of companies included on equity basis amounting to NIS 37 million, compared with a loss of NIS 297 million last year due to the Israel Corporation.

**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 2,216 million on 31 December 2014, compared with NIS 1,689 million on 31 December 2013.

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

| | Book value | | | Market value | | Capital adequacy requirements (a) | |
|---|---|---|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | **31 December 2014** | 31 December 2013 | **31 December 2014** | 31 December 2013 |
| | NIS millions | | % | NIS millions | | | |
| The Israel Corporation Ltd. | **1,318** | 1,137 | 16.0 | **2,566** | 2,526 | **165** | 102 |
| Others | **898** | 552 | 62.6 | **-** (b) | - (b) | **112** | 50 |
| Total | **2,216** | 1,689 | 31.2 | **2,566** | 2,526 | **277** | 152 |

(a) The capital requirements have been computed at 12.5% in accordance with the minimum ratio applicable from 1 January 2015. In 2013, the capital requirements were computed at 9% in accordance with the minimum required until the end of 2013.
(b) Of which, NIS 194 million at 31 December 2014 and NIS 207 million at 31 December 2013 are quoted.

**The contribution of the companies to the Group's net profit (in NIS millions) is as follows:**

| | For the year ended 31 December | | | |
|---|---|---|---|---|
| | **2014** | 2013 | Change | |
| | NIS millions | | | % |
| The Israel Corporation Ltd. | **(8)** | (340) | 332 | 97.6 |
| Others | **50** | 47 | 3 | 6.4 |
| Total | **42** | (293) | 335 | + |

The contribution of companies included on equity basis to other comprehensive income at 31 December 2014 was NIS 78 million, compared with a loss of NIS 12 million at 31 December 2013.

**The Israel Corporation**

As of 31 December 2014, the Bank held 17.96% of the means of control in the Israel Corporation Ltd., (hereinafter, "the Israel Corporation") which is considered a significant non-bank corporation pursuant to the Banking Law (Licensing), as amended via the Concentrations Law on 11 December 2013 (for this purpose, see "the Concentrations Law") in the Chapter, "General Environment and the Effect of External Factors on Activities"). According to the Concentrations Law, the Bank is obliged to reduce its holdings in the Israel Corporation to 10% by 11 December 2019.

On 7 January 2015, the Israel Corporation announced the completion of a process of splitting wherein holdings in a number of subsidiaries were transferred from the Israel Corporation to Kenon Holdings, all of whose shares were allocated, prior to the transfer of the assets, to the shareholders in the Israel Corporation (hereinafter, "the split"). The shares of Kenon are listed for trading on the New York Stock Exchange and on the Tel Aviv Stock Exchange. At the beginning of January 2015, the Bank's investment in the shares of Kenon will be presented in the available-for-sale securities portfolio.

In anticipation of the aforementioned split, the Bank updated the Banking Supervision Department, that as a result of the split, the Bank will hold two non-bank corporations. The Banking Supervision Department notified the Bank that it will allocate dates to it for reducing the rates of shareholding. As of the date of the report, no provisions as to the last date for reducing the holdings had been received.

On 11 February 2015, the Bank sold 531,550 shares of the Israel Corporation Ltd. to a number of entities (hereinafter, "the purchasers") at a price of NIS 1,330 per share and aggregate consideration of NIS 707 million. The shares sold represent 6.904% of the issued and paid-up capital of the Israel Corporation.

The transactions noted above are expected to yield for the Bank, a total of NIS 547 million, before the effect of tax, which is expected to be included in the financial statements for the first quarter of 2015. An estimate of the profit was computed on the basis of the cost of the shares of the Israel Corporation in the Bank's books, in accordance with the financial statements of 31 December 2014, and after adjustment of this cost for a dividend which was paid by the Israel Corporation in January 2015 and a reduction in value, as outlined in an immediate report published by the Bank on 27 January 2015 (Ref. no. 2015-01-019978).

Following the sale, shares of the Israel Corporation representing 11.1% of the issued and paid-up share capital of the Israel Corporation will be left in the hands of the Bank.

For the purpose of preparing the Bank's audited financial statements as of 31 December 2014, and in order to include the data of the Israel Corporation, on the basis of the audited statements, on 4 March 2015, the Bank obtained approval from the Bank of Israel to publish the 2014 financial statements on the date after the publication date of the audited financial statements if the Israel Corporation for 2014, and no later than 31 March 2015. Accordingly, the Bank's financial statements for 2014 include the Bank's share in the results of the Israel Corporation for 2014 in its entirety.

In accordance with a directive of the Banking Supervision Department, dated 4 March 2015, in order for the Bank to include the results of the Israel Corporation in the financial statements for the first quarter of 2015, the Bank will publish its financial statements to 31 March 2015, through 31 May 2015 (instead of through 19 May 2015, pursuant to the date provided in the directives of the Banking Supervision Department). In addition, a directive of the Banking Supervision Department determined that the Bank will take steps to discontinue its significant influence in the Israel Corporation, including by way of a permanent waiver of the Bank's representation in the board of directors of the Israel Corporation and its right to appoint directors therein.

On 15 March 2015, the Board of Directors of the Bank resolved to confirm the cancelation of a shareholder agreement, and pursuant thereto, to waive the right to recommend the appointment of directors in the Israel Corporation.

Further to this resolution, a document was signed between the Bank and the companies which hold a controlling interest in the Israel Corporation, pursuant to which the shareholder agreement was canceled, including the right to recommend the appointment of directors. In addition, a notice was sent to the Israel Corporation by the two directors, who were appointed to the Israel Corporation in accordance with the Bank's recommendation, on the termination of their term of office in the Israel Corporation, with effect from 30 March 2015.

For further details, see Note 31C.

The profits of companies included on equity basis to the Group in 2014, amounted to a profit of NIS 42 million, compared with a loss of NIS 293 million for the corresponding period in 2013. The increase in the contribution to the Group’s profit in 2014 in comparison to 2013 arose from an increase in the profitability of the Israel Corporation in 2014, compared with losses recorded in respect of the Israel Corporation in 2013.

**Companies included on equity basis purchased in 2014 through Leumi Partners**

**Nilit B.V.**

On 5 December 2014, Leumi Partners completed the purchase of 20% of the ordinary share capital of Nilit B.V. (hereinafter - Nilit). The shares were purchased from M.C.G.H. Holland (2006), a Dutch company wholly owned by partnerships comprising the Markstone Fund. The immediate purchase proceeds was US$ 45.3 million, with the purchase agreement providing mechanisms for adjusting the consideration in accordance with the performance of Nilit in the future, which are likely to bring the consideration to a aggregate amount of US$ 59.8 million. In addition, in the future, there could be the payment of additional consideration contingent on compliance with further conditions outlined in the agreement.

**New Lineo Cinema (2006) Ltd.**

In October 2014, Leumi Partners purchased 20% of the share capital of Cinema City in consideration of NIS 105 million. The consideration was subject to adjustments in accordance with the EBITDA results of Cinema City in 2015-2016 as provided in the agreement, such that the aggregate proceeds will be in a range of between NIS 95 million and NIS 110 million.

**Tene for Investment in Gadot Limited Partnership**

In April 2014, Leumi Partners purchased 20% of the rights in a partnership which holds 100% of the share capital of Gadot Chemical Containers and Terminals Ltd. in consideration of NIS 51.2 million. In addition, the company holds 20% of the rights in the general partner of the partnership.

## 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 the part of Leumi Partners which does not belong to the financial management segment and Leumi Capital Market Services.

The profit in the "other" segment in 2014 amounted to NIS 120 million, compared with a loss of NIS 41 million in 2013.

**The following table presents a summary of the main changes, in NIS millions:**

| | For the year ended 31 December | | | |
|---|---|---|---|---|
| | **2014** | 2013 | Change | |
| | NIS millions | | | % |
| Net profit in the Bank | **74** | 41 | 33 | 80.5 |
| Other companies in Israel | **15** | 13 | 2 | 15.4 |
| Companies abroad | **5** | 10 | (5) | (50.0) |
| Tax adjustments (a) | **26** | (23) | 49 | + |
| Total | **120** | 41 | 79 | + |

(a) 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, including consulting in training funds, the operation of all the dealing rooms for market-making, trade, currency brokerage, interest rates, in derivatives and securities, brokerage and custodial services, and banking and financial services to entities active in the capital market. A subsidiary of Leumi Partners Ltd., Leumi Partners Underwriters, engages in underwriting and the distribution of private and public offerings. The loss in capital market activity amounted to NIS 70 million, compared to a profit of NIS 86 million in the corresponding period in 2013, a decrease in net profit of NIS 156 million, deriving mainly from an increase in operating expenses amounting to NIS 222 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:**

| | Households | Small businesses | Corporate banking | Commercial banking | Private banking | Financial managementand others | Overseas activities | Total |
|---|---|---|---|---|---|---|---|---|
| | **2014** | | | | | | | |
| | NIS millions | | | | | | | |
| Net interest income | **4** | **1** | **2** | **1** | **1** | **5** | **-** | **14** |
| Non-interest income | **480** | **31** | **13** | **47** | **165** | **129** | **194** | **1,059** |
| Total income | **484** | **32** | **15** | **48** | **166** | **134** | **194** | **1,073** |
| Operating and other expenses | **407** | **16** | **9** | **44** | **74** | **179** | **376** | **1,105** |
| Profit (loss) before taxes | **77** | **16** | **6** | **4** | **92** | **(45)** | **(182)** | **(32)** |
| Net profit (loss) | **48** | **10** | **4** | **3** | **58** | **(26)** | **(167)** | **(70)** |

| | Households | Small businesses | Corporate banking | Commercial banking | Private banking | Financial managementand others | Overseas activities | Total |
|---|---|---|---|---|---|---|---|---|
| | 2013 | | | | | | | |
| | NIS millions | | | | | | | |
| Net interest income | 3 | 1 | - | - | - | 5 | - | 9 |
| Non-interest income | 434 | 26 | 15 | 41 | 171 | 126 | 205 | 1,018 |
| Total income | 437 | 27 | 15 | 41 | 171 | 131 | 205 | 1,027 |
| Operating and other expenses | 381 | 16 | 7 | 39 | 73 | 140 | 227 | 883 |
| Profit (loss) before taxes | 56 | 11 | 8 | 2 | 98 | (9) | (22) | 144 |
| Net profit (loss) | 35 | 7 | 5 | 1 | 65 | (4) | (23) | 86 |

### B. Credit cards - Leumi Card

Leumi Card Ltd. (hereinafter: "Leumi Card") is a credit card company which is engaged in issuing credit cards, clearing credit card transactions, credit card operations and providing payment solutions and financial products.

Issuance segment – Leumi Card issues cards under the brand names, Visa and Mastercard, through which businesses that honor these brands in Israel and around the world may be paid. Leumi Card issues two types of credit card: credit cards issued jointly with Bank Leumi and Arab Israel Bank Ltd. and credit cards issued generally in cooperation with business entities to customers of all of the banks ("non-bank credit cards"),

The number of valid cards held by Leumi Card customers at the end of 2014 amounted to 2.36 million (of which 1.59 million were bank cards and 775 thousand were non-bank cards), compared with 2.20 million cards (of which 1.51 million were bank cards and 718 thousand were non-bank cards) at the end of 2013, an increase of 6%. The percentage of active cards stands at 82% of total valid cards (for this purpose, "active cards" are valid cards with which at least one transaction has been made in the course of the last quarter.

The total issuance turnover of Leumi Card in 2014 – (The volume of purchases made in all of the cards of Leumi Card during the period, excluding withdrawals of cash in Israel, and net of elimination of transactions) amounted to NIS 63.9 billion (of which NIS 47.3 billion was for bank cards and NIS 16.6 billion was for non-bank cards), compared to NIS 60.4 billion in 2013 (of which NIS 44.6 billion was for bank cards and NIS 15.8 billion was for non-bank cards)– an increase of 6%.

Clearing sector – Leumi Card clears the Visa and Mastercard-type credit cards, and from May 2012, also clears the Isracard-type credit cards. The clearing of the credit cards from the said brands is performed through a joint interface which is operated via the Automated Bank Services Ltd. ("ABS"). In 2015, the company will begin clearing the UnionPay brand, in accordance with a license agreement it signed with UnionPay International Co. Ltd.

The clearing services include the securing of payment to businesses with which Leumi Card is connected in clearing agreements in respect of transaction vouchers executed by credit cards of the types that Leumi Card clears, this, in exchange for a commission collected by Leumi Card from the business ("business commission"). In addition, Leumi Card offers businesses credit products and financial solutions, such as loans, discounting of vouchers and advance payments.

In October 2013, the Company notified the New General Histadrut Employees Organization that it recognizes it as the representative employee organization of the Company's employees, this, further to an application from the Histadrut in September 2013 that it be accepted in the Company, according to which more than one-third elected to join it. Negotiations are underway between the management and representatives of the employees for signing a first collective labor agreement in the Company.

On 31 December 2013, the Supervisor of Banks published a final version of the regulatory framework for the grant of clearing licenses (for new entities requesting to be engaged in this field) by virtue of the Banking Law (Licensing). After completion of the requisite proceedings, it will be possible for additional entities in Israel to conduct credit card clearance activity through the receipt of a license from the Bank of Israel. The receipt of clearing activity by the new entities is expected to increase competition in the area of clearing.

For information relating to legislation regarding credit cards, see Chapter "Regulation", below.

**Profitability**

The income of Leumi Card totaled some NIS 1,015 million in 2014, compared with some NIS 987 million in 2013.

Leumi Card ended 2014 with a net profit of NIS 200 million, similar to the corresponding period last year.

**The following table presents data on credit card activities in the Group, as presented in the various operating segments:**

| | Households | Small businesses | Corporate banking | Commercial banking | Private banking | Total |
|---|---|---|---|---|---|---|
| | **2014** | | | | | |
| | NIS millions | | | | | |
| Net interest income | **219** | **18** | **18** | **8** | **-** | **263** |
| Non-interest income | **718** | **77** | **96** | **44** | **2** | **937** |
| Total income | **937** | **95** | **114** | **52** | **2** | **1,200** |
| Expenses in respect of credit losses | **25** | **-** | **-** | **-** | **-** | **25** |
| Operating and other expenses | **631** | **63** | **81** | **34** | **3** | **812** |
| Profit (loss) before taxes | **281** | **32** | **33** | **18** | **(1)** | **363** |
| Profit attributed to non-controlling interests | **(29)** | **(3)** | **(5)** | **(3)** | **-** | **(40)** |
| Net profit (loss) | **167** | **19** | **19** | **9** | **(1)** | **213** |

| | Households | Small businesses | Corporate banking | Commercial banking | Private banking | Total |
|---|---|---|---|---|---|---|
| | 2013 | | | | | |
| | NIS millions | | | | | |
| Net interest income | 207 | 19 | 19 | 8 | - | 253 |
| Non-interest income | 679 | 73 | 102 | 44 | 2 | 900 |
| Total income | 886 | 92 | 121 | 52 | 2 | 1,153 |
| Expenses (income) in respect of credit losses | 13 | (1) | (2) | (1) | - | 9 |
| Operating and other expenses | 667 | 61 | 81 | 35 | 3 | 847 |
| Profit (loss) before taxes | 206 | 32 | 42 | 18 | (1) | 297 |
| Profit attributed to non-controlling interests | (27) | (4) | (6) | (3) | - | (40) |
| Net profit (loss) | 123 | 18 | 25 | 10 | (1) | 175 |

### 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.

**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 |
|---|---|---|---|---|---|---|
| | **2014** | | | | | |
| | NIS millions | | | | | |
| Net interest income | **267** | **481** | **224** | **14** | **128** | **1,114** |
| Non-interest income | **68** | **323** | **59** | **20** | **20** | **490** |
| Total income | **335** | **804** | **283** | **34** | **148** | **1,604** |
| Expenses (income) in respect of credit losses | **14** | **(119)** | **2** | **-** | **34** | **(69)** |
| Operating and other expenses | **125** | **171** | **68** | **15** | **41** | **420** |
| Profit before taxes | **196** | **752** | **213** | **19** | **73** | **1,253** |
| Net profit | **122** | **468** | **133** | **12** | **44** | **779** |

| | Small businesses | Corporate banking | Commercial banking | Private banking | Overseas activity | Total |
|---|---|---|---|---|---|---|
| | 2013 | | | | | |
| | NIS millions | | | | | |
| Net interest income | 224 | 498 | 195 | 12 | 109 | 1,038 |
| Non-interest income | 78 | 274 | 58 | 18 | 14 | 442 |
| Total income | 302 | 772 | 253 | 30 | 123 | 1,480 |
| Expenses (income) in respect of credit losses | 21 | (128) | (1) | 2 | 127 | 21 |
| Operating and other expenses | 132 | 185 | 66 | 14 | 48 | 445 |
| Profit (loss) before taxes | 149 | 715 | 188 | 14 | (52) | 1,014 |
| Net profit (loss) | 95 | 456 | 120 | 9 | (45) | 635 |

### 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:**

| | For the year ended 31 December | | | |
|---|---|---|---|---|
| | **2014** | 2013 | Change | |
| | NIS millions | | NIS millions | % |
| The Bank (d) | **1,676** | 1,810 | (134) | (7.4) |
| Consolidated companies in Israel (a) | **595** | 556 | 39 | 7.0 |
| Overseas consolidated companies (b) (d) | **(773)** | (52) | (721) | - |
| Companies included on equity basis (a) | **4** | (332) | 336 | + |
| Net profit | **1,502** | 1,982 | (480) | (24.2) |
| Profit (loss) of overseas subsidiaries, in nominal terms (US$ millions) (c) | **(250)** | 19 | (269) | - |

(a) Companies included on equity basis of subsidiaries in Israel were included in consolidated subsidiaries in Israel.
(b) Following particular adjustments to Israeli accounting principles.
(c) As reported by the subsidiaries abroad, including net profit to noncontrolling interest holders.
(d) The attribution of the expenses in respect of the arrangements with overseas authorities to overseas offices was made in 2014. In 2013, the expenses were recorded in the Bank.

**Following are the principal changes in the contributions of the profit centers (after translation adjustments):**

**The Bank**

The decrease in net operating profit is due mainly to:

- an increase in expenses in respect of credit losses amounting to NIS 168 million, primarily attributable to an increase in the collective allowance in respect of credit to private individuals pursuant to directives of the Bank of Israel.
- a decrease in noninterest income amounting to NIS 548 million, attributable to expenses of exchange rate differences on sources against which available-for-sale shares were purchased in foreign currency and the effect of exchange rate differences in respect of which an amount was recorded to an adjustment from available-for-sale securities fund in other comprehensive income and a decrease in profits from the sale of shares from the available portfolio.

On the other hand, the decrease in salary and operating and other expenses amounting to NIS 542 million partially offset the above changes.

**Subsidiaries in Israel**

The increase in net profit of consolidated companies in Israel is due mainly to an increase in the profits of Leumi Partners amounting to NIS 74 million, which was partly offset by a decrease in the profits of the Arab-Israel Bank and others.

**Subsidiaries abroad**

The increase in net profit of the overseas subsidiaries (excluding overseas branches) as a convenience translation to U.S. dollars amounted to a loss of US$ 249.9 million, compared with some US$ 18.9 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 loss of NIS 773 million, compared with a loss of NIS 52 million in the corresponding period last year. The decrease in profit arises from the fact that the attribution of the expenses in respect of the arrangements with overseas authorities to overseas offices was made in 2014, while, in 2013, all of the expenses were attributed to the Bank.

**Companies included on equity basis**

The income of companies included on equity basis comprises the results of a company included on equity basis, the Israel Corporation, and those companies of Leumi Partners. The improvement in the contribution of companies included on equity basis derives mainly from the decrease in the accrued loss in respect of the Israel Corporation. In 2014, a loss of NIS 8 million was recorded in respect of the Israel Corporation, compared with a loss of NIS 340 million which was recorded last year.

**Activities according to the Group's Structure**

in 2014, the volume of activities in Israel was by 90.8%, an increase of 0.5%, compared with 2013. The volume of overseas activity in 2014 was 9.2%, a decrease of 0.5%.

Credit to the public in activities in Israel totaled some NIS 229.3 billion at the end of 2014, compared with NIS 217.4 billion at the end of 2013, an increase of 5.5%. Credit to the public in overseas activities totaled some NIS 23.2 billion at the end of 2014, compared with NIS 23.5 billion at the end of 2013, a decrease of 1.4%.

Deposits of the public in activities in Israel totaled some NIS 272.5 billion at the end of 2014, compared with NIS 256.6 billion at the end of 2013, an increase of 6.2%. Total deposits in overseas activities totaled some NIS 30.9 billion at the end of 2014, compared with NIS 29.4 billion at the end of 2013, an increase of 5.2%.

**Information according to geographical regions (a):**

**The following table presents principal data according to geographical regions (in NIS millions):**

| | Total Balance Sheet | | | Credit to the Public | | | Deposits of the public | | |
|---|---|---|---|---|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | **31 December 2014** | 31 December 2013 | Change | **31 December 2014** | 31 December 2013 | Change |
| | NIS millions | | % | | | % | | | % |
| Israel | **359,835** | 338,322 | 6.4 | **229,314** | 217,381 | 5.5 | **272,452** | 256,586 | 6.2 |
| United States | **20,225** | 18,055 | 12.0 | **14,363** | 12,926 | 11.1 | **16,471** | 13,982 | 17.8 |
| United Kingdom | **8,778** | 9,272 | (5.3) | **6,242** | 7,155 | (12.8) | **7,200** | 7,510 | (4.1) |
| Switzerland | **5,105** | 5,999 | (14.9) | **1,259** | 1,917 | (34.3) | **4,955** | 5,406 | (8.3) |
| Luxembourg | **756** | 1,279 | (40.9) | **406** | 447 | (9.2) | **1,368** | 1,610 | (15.0) |
| Romania | **1,249** | 1,282 | (2.6) | **841** | 849 | (0.9) | **818** | 707 | 15.7 |
| Others abroad | **186** | 331 | (43.8) | **55** | 199 | (72.4) | **133** | 202 | (34.2) |
| Total | **396,134** | 374,540 | 5.8 | **252,480** | 240,874 | 4.8 | **303,397** | 286,003 | 6.1 |

(a) 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 | | | |
|---|---|---|---|---|
| | **31 December 2014** | 31 December 2013 | Change | |
| | NIS millions | | | % |
| Israel (a) | **2,279** | 2,029 | 250 | 12.3 |
| United States (b) | **(224)** | 66 | (290) | - |
| United Kingdom (c) | **73** | (67) | 140 | + |
| Switzerland (d) | **(554)** | (57) | (497) | - |
| Luxembourg | **(29)** | 15 | (44) | - |
| Romania (e) | **(58)** | (7) | (51) | - |
| Others abroad (f) | **15** | 3 | 12 | + |
| Total | **1,502** | 1,982 | (480) | (24.2) |

The profit from activities abroad is shown according to their contribution in the consolidated financial statements.

(a) Net profit in Israel increased by some NIS 250 million. Net profit after tax at the Bank in Israel increased due to the reasons set forth in the chapter, "Development of Income, Expenses and Tax Provision".
The net profit also increased at a number of subsidiaries in Israel, mainly in Leumi Partners.

(b) The profits of the subsidiary in the United States fell compared with the corresponding period last year, as well as in terms of U.S. dollars, mainly due to the expenses in respect of the arrangements with overseas authorities which were attributed to the office in the United States in 2014.

(c) The profit of the subsidiary in the United Kingdom increased relative to the corresponding period last year, as well as in local terms, mainly as a result of a decrease in expenses in respect of credit losses in 2014 compared with 2013.

(d) The increase in the losses of the subsidiary in Switzerland derives from its material share in the expenses in respect of the arrangements with overseas authorities in 2014.

(e) The loss in the Romanian office in 2014 derives from an increase in credit loss expenses as a result of a requirement of the Central Romanian Bank from the whole banking system in Romania to increase the level of provisions.

(f) The profit relates mainly to Leumi Re.

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

## Major Investee Companies*

The Leumi Group operates in Israel and abroad through subsidiaries which are: banks, finance companies and financial services companies. The Group also invests in non-bank corporations operating in the fields of insurance, energy, chemicals, infrastructure, etc.

With regard to investments in non-banking corporations, see chapter, "Operating segments, Activity in Products and Profit Centers in the Group – Companies Included on Equity Basis (Non-banking)".

The Bank's total investments in subsidiaries and affiliates (including investments and capital notes) amounted to NIS 13.6 billion on 31 December 2014, compared with NIS 13.2 million on 31 December 2013, and the contribution of the investee companies to the Group's net profit amounted to a loss NIS 174 million, compared with a profit of NIS 172 million in 2013.

* For a definition of investee companies, see Note 1B to the financial statements.

**The following table sets out the breakdown of the contribution of the Bank and its subsidiaries and investee companies to the net profit of the Group:**

| | Return on Group investment | | Contribution (a) to Group net profit | | |
|---|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 | Change |
| | % | | NIS millions | | % |
| **The Bank** | **10.4** | 12.9 | **1,676** | 1,810 | (7.4) |
| **Total consolidated subsidiaries in Israel** | **10.8** | 11.2 | **595** | 556 | 7.0 |
| of which: | | | | | |
| Arab Israel Bank | **17.1** | 21.7 | **100** | 106 | (5.6) |
| Leumi Card | **13.8** | 15.6 | **160** | 160 | (0.4) |
| Leumi Partners (b) | **36.3** | 40.6 | **287** | 213 | 34.6 |
| Leumi Capital Market Services Ltd. | **9.3** | 11.5 | **4** | 4 | (12.2) |
| Leumi Real Holdings | **0.6** | 1.2 | **6** | 11 | (47.7) |
| Leumi Finance | **6.4** | 7.7 | **10** | 13 | (17.5) |
| Leumi Tech (formerly Leumi Leasing and Investments) | **0.9** | 2.2 | **9** | 22 | (57.6) |
| Others | **-** | - | **19** | 27 | (30.9) |
| **Total overseas consolidated subsidiaries** | **-** | - | **(773)** | (52) | - |
| of which: | | | | | |
| Leumi USA (B.L.C.) | **-** | 2.6 | **(224)** | 66 | - |
| Leumi UK | **9.7** | - | **73** | (67) | + |
| Leumi Private Bank | **-** | - | **(554)** | (57) | - |
| Leumi Luxembourg | **-** | 6.2 | **(20)** | 10 | - |
| Leumi Romania | **-** | - | **(58)** | (7) | - |
| Leumi Re | **18.0** | 5.8 | **15** | 6 | + |
| **Total of companies included on equity basis** | **0.3** | - | **4** | (332) | + |
| **Total net profit of the Group** | **5.5** | 7.8 | **1,502** | 1,982 | (24.2) |

(a) The profit (loss) shown is according to the company's share in the Group's results.
(b) Including the profit and/or loss companies included on the equity basis of Leumi Partners.

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 6,055 million on 31 December 2014, compared with NIS 5,295 million on 31 December 2013. Their contribution to Group net operating profit amounted to some NIS 595 million in 2014, compared with NIS 556 million in 2013, an increase of 7.0%. The Group's return on its investment in the consolidated companies in Israel was 10.8% in 2014 compared with 11.2% in 2013.

**Financial and other data concerning the major consolidated subsidiaries are 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 areas (North and South Galilee and the Northern Triangle) and 37 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 7,576 million at the end of 2014, compared with NIS 6,869 million at the end of 2013. Net profit of the Arab Israel Bank totaled NIS 100.4 million in 2014, compared with NIS 106.5 million in 2013, a decrease of 5.7%. The net return on shareholders' equity reached 16.7% as of 31 December 2014, compared with 21.2% at the end of 2013.

Shareholders' equity of the Arab Israel Bank amounted to NIS 653 million as at 31 December 2014, compared with NIS 553 million as at 31 December 2014.

The ratio of equity to risk assets as at 31 December 2014, reached 13.36%, as compared with 12.50% as at 31 December 2013. The Tier 1 capital ratio to risk components at 31 December 2014 was 12.27%, compared with 11.85% at 31 December 2013.

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 54 million in 2014, similar to 2013.

As a part of the business strategy, the Bank continues in expanding the deployment of the branches, activity in the digital channels, improving customer experience and assimilating processes for positioning the Bank in Arab society. The Bank's placing derives also from active involvement and promotion of the company's aims in which the Bank operates in order to assist its development and prosperity. An organizational culture is assimilated in the Bank based on values of fairness, transparency and innovation.

### Medium and Long-Term Financing Companies [(1)]

The assets of these companies amounted to NIS 19.1 billion at the end of 2014, compared to NIS 20.0 billion in 2013. The business activity of these companies complements the activity of the Bank. The net profit of these companies amounted to some NIS 20.8 million in 2014, compared with NIS 36.8 million in 2013.

(1) Including: Leumi Industrial Development Ltd., Leumi Agricultural Development Ltd., Leumi Finance Company Ltd. and Leumi Tech.

**The following are details concerning the main companies:**

**Leumi Tech Ltd (formerly Leumi Leasing & Investments Ltd.)**

Leumi Tech will operate in future years to promote the activity of the Leumi Group in the area of banking services for the high-tech industry, including professional support for all of the Group companies in Israel and abroad, deepening ties with the industry, building and expanding the banking services and creating knowledge infrastructure – all this, in order to establish the Leumi Group as a key factor in the Israeli high-tech industry.

In the past, the company financed the acquisition of equipment under leasing conditions for medium and long terms. In 2012, the company ceased to finance new projects, but continued managing the existing leasing portfolio.

The balance of credit to the public totaled NIS 203 million as at 31 December 2014, compared with NIS 381 million at the end of 2013.

The company's total assets totaled NIS 1,029 million as at 31 December 2014, compared with NIS 1,035 million at the end of 2013.

The net profit in 2014 totaled NIS 9 million, compared with a profit of NIS 22 million in 2013.

**Leumi Finance Company Ltd.**

The company was merged with the Bank on 4 January 2015. For further information regarding the merger, see Chapter "Business Description of Leumi Group and their Economic Development" below.

Until the date of the merger, the company was engaged in the raising of financial sources in Israel for the Bank through issues to the public and private placements of securities, which grant a participatory right in the company and are not convertible to shares – for example, debentures, subordinated notes, subordinated capital 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 17,885 million at the end of 2014, compared with NIS 19,063 million at the end of 2013. Shareholders' equity amounted to NIS 167.7 million as at the end of 2014, compared with NIS 157.3 million at the end of 2013. The company's net profit amounted to NIS 10.4 million in 2014, compared to NIS 12.6 million in 2013.

**Leumi Partners Ltd.**

Leumi Partners is the investment banking vehicle of the Leumi Group and operates in four areas of activity:

1. Management of a portfolio of nonbank investments of Leumi Group,
2. Underwriting, consulting and management of private and public capital mobilizations in Israel;
3. Consulting and management of the mergers and acquisition (M&A) processes and capital mobilizations;
4. Economic analyses and valuations

Leumi Partners and its subsidiaries employ 36 employees, most of whom are professional personnel, including lawyers, economists and accountants.

Leumi Partners finished 2014 with a profit of NIS 308 million, which arose mainly from the realization of investments and an increase in commission income, compared with a profit of NIS 226 million in 2013.

Shareholders' equity as at 31 December 2014 totaled NIS 1,167 million, compared with NIS 721 million at the end of 2013.

**Below are details concerning developments and main fields of activity:**

**1. Management of the non-banking investment portfolio of the Leumi Group.**

Leumi Partners (hereinafter – the Company) engages in initiating, locating and carrying out direct and indirect investments in companies, projects and private investment funds. The balance of the Company's undertakings to invest in the private investment funds as at 31 December 2014 amounted to some NIS 419 million.

The non-banking investment policy of the Leumi Group is in line with its risk appetite and the restrictions of the Banking (Licensing) Law, and therefore, includes minority holdings only (up to 20% of all means of control, and without control). The Company focuses on investments with a medium to long-term horizon, appropriate to the policy which has been established.

Leumi Partners invests in non-banking corporations as an auxiliary corporation under the provisions of the Banking (Licensing) Law.

**2. Underwriting, consulting and management of private and public capital mobilizations in Israel**

Through the subsidiary, Leumi Partners Underwriters, the company provides a wide range of services in the area of underwriting and consulting to companies and interested parties.

In 2014, Leumi Partners Underwriters was one of the leading firms of underwriters in the Israeli market. Leumi Partners Underwriters participated in public offerings amounting to NIS 14 billion, and led 23 public offerings amounting to NIS 4 billion.

**3. Consulting and management of the processes of mergers and acquisitions (M&A) and capital mobilizations**

The services are provided to Israeli and foreign companies who wish to effect a strategic expansion through purchases, or investors or controlling owners who are interested in selling or reducing their holdings.

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 abroad. At the beginning of 2015, the company signed an exclusive cooperation agreement with an American investment bank, Stifel Nicolaus, which specializes in the MID-CAP sector, in general, and in the technology sector, in particular.

**4. Economic analyses and appraisals**

Through, the subsidiary, Leumi Partners Research, the Company is engaged in conducting economic analyses and appraisals, mainly for the Leumi Group and outside economic entities.

Leumi Partners Research maintains continuous support of the company's extensive activity in its investment transactions.

In addition, Leumi Partners Research provides consulting services for the Bank's credit units and conducts regular economic reviews of marketable securities on the stock exchange for the Bank's Consulting Department, maintaining the principles for avoiding a conflict of interests between the Bank and the company and the customers of the Consulting Department.

**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 liability notes, including exchange traded certificates. In June 2014, the company received a license to act as a trustee for mutual funds. In addition, the company provides trust services for private companies and corporate customers.

The company's income from trust business for 2014 amounted to NIS 9.0 million compared with NIS 11.8 million in 2013. The company's profit in 2014 amounted to NIS 877 thousand, compared with a profit of NIS 2,430 thousand in 2013.

For information on the legal claims against the trust company, 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:

- For private customers: establishment of private and public funds, financial asset management, real-estate management and the execution of wills and the management of estates;
- For business customer: security trustees, pledges on shares, supervision of the execution of agreements – escrow transactions, holding of shares on trust as part of merger and acquisition transactions, split accounts for insurance agencies;
- For customers in the area of the capital market: representation of foreign banks at general meetings, trusts for liability notes.

## 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.

## Overseas Consolidated Companies, Branches and Agencies

The Bank's main overseas units are located in the world's most important financial centers: New York and London. The Group's deployment overseas is intended to maximize the business potential vis-à-vis Israeli corporate customers, local middle-market customers operating in sectors of the economy in which Leumi has the expertise in the 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 are located. The Bank's major overseas target population is commercial companies. These customers receive a range of services from the units, such as customer financing and support, investment financing, foreign trade and transactions in foreign currency and their derivatives, as well as general banking services. The cooperation between the overseas units and the Bank in Israel and amongst the overseas units enables maximum utilization of the relative advantage of every unit.

Reports on ongoing developments and special findings in the units are sent to the Bank management and the Board of Directors.

The Risk Management Division carries out routine monitoring, analysis, identification, mapping and evaluation of material focuses of risk in the overseas units.

In 2014, changes were made in the international deployment of the Group in order to adapt for business and regulatory changes around the world, as follows: The Group representative offices – in France, Germany, Canada, Chile, Hong Kong, and the representative office of the branch in Switzerland and Israel – were closed. At the end of 2014, the Georgetown branch in the Cayman Islands was closed, and Bank Leumi in Panama ceased its business activity.

In September 2013, the requisite approvals from the regulatory authorities in China were received to establish a representative office of the Leumi Group in Shanghai. The establishment of the office is the fruit of a strategic initiative of Leumi to penetrate new markets and open them up for the Group's businesses. The representative office constitutes the first time an Israeli bank has made its way into China. By virtue of the license held by the office, its areas of activity are limited to those of a marketing nature only, including the collection of data on the market, the establishment of a potential customer base and the examination of the future feasibility in China. The representative office reports to the Deputy President and CEO.

The Bank's total investment in overseas units at the end of 2014 amounted to NIS 4,123 million, compared with NIS 4,597 million at the end of 2013.

**The following table sets forth the effect of principal overseas consolidated companies to the Group's net profit (loss):**

| | Return on Group investment | | Contribution to Group profit | | |
|---|---|---|---|---|---|
| | For the year ended 31 December | | | | |
| | **2014** | 2013 | **2014** | 2013 | Change |
| | % | | NIS millions | | % |
| Leumi USA (BLC) | **-** | 2.6 | **(224)** | 66 | - |
| Of which: | | | | | |
| BL USA | **-** | 3.3 | **(225)** | 64 | - |
| Leumi UK | **9.7** | - | **73** | (67) | + |
| Leumi Private Bank | **-** | - | **(554)** | (57) | - |
| Leumi Luxembourg | **-** | 6.2 | **(20)** | 10 | - |
| Leumi Re | **18.0** | 5.8 | **15** | 6 | + |
| Leumi Romania | **-** | - | **(58)** | (7) | - |
| Others | **-** | - | **(5)** | (3) | - |
| **Total consolidated companies abroad** | **-** | - | **(773)** | (52) | - |

**The following table sets forth details of the net profit (loss) of the overseas units, as reported by them:**

| | For the year ended 31 December | | | |
|---|---|---|---|---|
| | **2014** | 2013 | Change | |
| | In millions | | | % |
| Leumi USA (BLC) - US$ | **(99.7)** | 11.4 | (111.1) | - |
| Of which: BL USA - US$ | **(50.0)** | 11.1 | (61.1) | - |
| Leumi UK - £ | **7.6** | (5.4) | 13.0 | + |
| Leumi Private Bank - CHF | **(141.6)** | 7.5 | (149.1) | - |
| Leumi Luxembourg - € | **(3.5)** | 2.9 | (6.4) | - |
| Leumi Romania – ron (a) | **(52.2)** | 2.1 | (54.3) | - |
| Leumi Re - US$ | **(8.6)** | 3.3 | (11.9) | - |
| Others - US$ | **(2.0)** | - | (2.0) | - |
| Overseas branches - US$ | **(1.7)** | 1.5 | (3.2) | - |
| Total translated to US dollars | **(251.6)** | 20.4 | (272.0) | - |

(a) 1 Ron = NIS 1.0535

**The following table sets forth a summary of the assets and liabilities of the Bank's overseas units and branches (in US$ millions* prior to offsetting mutual balances):**

| | December 2014 | |
|---|---|---|
| | **2014** | 2013 |
| Credit to the public | **5,957** | 6,769 |
| Deposits with banks | **2,287** | 2,843 |
| Securities | **1,530** | 1,312 |
| Other assets | **385** | 369 |
| Total | **10,159** | 11,293 |
| Deposits of the public | **7,931** | 8,507 |
| Deposits from banks | **366** | 829 |
| Other liabilities | **784** | 581 |
| Shareholders' equity | **1,078** | 1,376 |
| Total | **10,159** | 11,293 |
| Total trust deposits and securities under management | **11,302** | 11,374 |

The total balance sheet of the consolidated overseas subsidiaries and branches of the Bank amounted to US$ 10.2 billion (NIS 39.3 billion) at the end of 2014, compared with US$ 11.3 billion (NIS 39.2 billion) at the end of 2013.

* The translation to US$ is a convenience translation of the data according to the representative rates of exchange on 31 December 2014 and 31 December 2013, respectively.
The amounts are as published by the overseas units.
The data in shekel terms is presented in the report according to sectors - see Note 27 to the Financial Statements.

**The following table sets out principal data regarding the Bank's overseas units (in US$ millions) at 31 December 2014:**

| | USA | UK | Switzerland | Luxembourg | Romania |
|---|---|---|---|---|---|
| Total assets | **5,202** | **2,267** | **1,605** | **518** | **333** |
| Credit to the public | **3,659** | **1,600** | **324** | **104** | **216** |
| Deposits of the public | **4,401** | **1,883** | **1,450** | **322** | **210** |
| Shareholders' equity | **542** | **209** | **97** | **46** | **47** |
| Trust deposits and managed securities | **4,403** | **377** | **4,183** | **909** | **-** |
| Net profit | **(50)** | **11** | **(142)** | **(4)** | **(14)** |
| Return on equity (%) | **3.0** (a) | **5.7** (a) | **0.8** (a) | **7.5** | **(22.9)** |

(a) Return excluding the expenses in respect of the arrangements with overseas authorities.

The loss for all the consolidated overseas companies, including overseas branches, as published by them, totaled US$ 251.6 million in 2014, compared with a profit of US$ 20.4 million in 2013, a decrease of US$ 272.0 million.

The attribution of the expenses in respect of the arrangements with overseas authorities for overseas offices was made only in 2014. In 2013, all of the provision made in respect of the arrangements with overseas authorities was accrued in the Bank in Israel.

The negative contribution of the overseas units to the net profit of the Group in shekels in 2014 amounted to a loss of NIS 773 million, compared with a loss of NIS 52 million in 2013.

For further details concerning the contribution of the units to the Group's profit, see Notes 6 and 27 to the Financial Statements.

**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$ 5.2 billion as at 31 December 2014, similar to the end of 2013, and the annual loss amounted to US$ 50 million, compared with a profit of US$ 11.4 million in 2013.

The decrease in net profit resulted primarily from the payment of US$ 65 million in respect of the arrangements with overseas authorities. The return on equity of BLL Corp. excluding expenses related to the arrangements with overseas authorities, reached 2.35%, compared with 1.6% in 2013.

As at 31 December 2014, the equity amounted to US$ 637 million. The ratio of equity to total assets was 12.24% and the ratio of equity to risk assets was 14.34%.

**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 financing medium and larger sized (middle-market) local companies, in international banking, mainly with Israeli companies, and also private banking for U.S. and non-U.S. residents.

BLUSA's consolidated assets amounted to US$ 5.2 billion on 31 December 2014, similar to the end of 2013. Total shareholders' equity amounted to US$ 542 million on 31 December 2014 compared with US$ 547 million at the end of 2013. Credit to the public totaled US$ 3,659 million at the end of 2014, a decrease of 0.5%, while deposits of the public, which totaled US$ 4,401 million, decreased by 0.5%.

Customers' managed securities portfolios, which are not included in the balance sheet, totaled US$ 4,403 million at the end of 2014, compared with US$ 4,132 million at the end of 2013.

BLUSA ended 2014 with a loss of US$ 50 million, compared with US$ 11 million in 2013. The loss resulted from the payment of US$ 65 million in respect of the arrangements with overseas authorities.

The return on equity of net profit in 2014, excluding expenses in respect of the arrangements with overseas authorities, was 2.99%, compared with 2.54% in 2013.

The balance of the expenses in respect of credit losses at the end of 2014 amounted to US$ 19.1 million, constituting 0.5% of total credit to the public.

The ratio of equity to total assets is 10.4% (10.5% in 2013) and the ratio of equity to risk assets was 14.23% (14.54% in 2013). 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 including a number of initiatives intended to improve the bank's long-term profitability increasing business focus in the areas of commercial banking and local private banking, upgrading core abilities and systems and operational streamlining. As a part of the operating process, the Bank merged its three branches in California into one branch, and as of the end of 2014, BLUSA had five branches, located in four states: New York, California, Florida and Illinois.

In 2013, BLUSA entered into agreements in connection with the sale of its interests in two buildings in New York which serve as its offices. The execution of the agreements is contingent on complex commercial conditions. If all of the conditions are fulfilled according to the assessment of BLUSA's management, the sale is likely to take effect by the end of 2015. In view of the uncertainty, it is not possible, at this stage, to give a reliable estimate of the expected gain on the sale.

**The Bank's Branches and Agencies**

The Bank is in the process of closing its overseas branches, with business activity in the overseas branches having closed completely by the end of 2014.

The Board of Directors of Leumi has passed a resolution to close the New York branch and the unit is due to close.

Total assets of the agency in overseas branches amounted to some US$ 35 million at the end of 2014 (before offsetting mutual balances), compared with some US$ 144 million at the end of 2013.

**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 by Bank Leumi Jersey, and Leumi ABL Ltd., a subsidiary 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, finance of media, mainly in Europe, 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 investments and development of residential real estate and the financing of commercial real estate (mainly hotels, retirement homes, and student halls of residence). The financing is provided to both local and non-resident customers (mostly Israelis).

On 23 October 2014, Bank Leumi completed the acquisition of minority shares (0.19% of the share capital), of Bank Leumi UK through its subsidiary, LuxInvest. Following this acquisition Bank Leumi holds, directly and though the subsidiary, LuxInvest, holds 100% of Bank Leumi UK.

Bank Leumi UK ended the year 2014 with a profit of £ 7.6 million, compared with a loss of £ 5.4 million in 2013. The transition to profit loss resulted from a decrease in expenses in respect of credit losses.

Total consolidated assets of Bank Leumi UK amounted to £ 1,454 million at the end of 2014, compared to £ 1,614 million at the end of 2013.

Deposits of the public fell from £ 1,327 million at the end of 2013 to £ 1,208 million at the end of 2014. Bank Leumi Jersey's portion of the balance of deposits at the end of 2014 was £ 357 million. Credit to the public decreased from some £ 1,244 million at the end of 2013 to £ 1,026 million at the end of 2014. The share of Bank Leumi Jersey and LABL of the balance of credit at the end of 2014 was £ 120 million and £ 214 million, respectively.

Capital, reserves and surpluses totaled some £ 134 million at 31 December 2014, compared with some £ 129 million at the end of 2013.

In 2013, there was a change in the regulatory authorities in the United Kingdom. The Financial Services Authority (FSA) was replaced by two regulatory authorities: the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). In contrast to the supervisory body which preceded it, the PRA displays an intensive involvement compared with the past, as well as in relation to the foreign banks in the United Kingdom, including in Leumi UK. Leumi UK has taken and is taking steps required in relation to the regulatory provisions expressing this involvement.

On 1 August 2014, Mr. Eli Katsav, commenced his duties as General Manager of Bank Leumi UK., replacing Mr. Larry Weiss, who terminated his employment in the Group.

The ratio of equity to assets amounted to 9.2% (8.0% in 2013)

**Leumi Private Bank S.A. (formerly Bank Leumi Switzerland)**

Bank Leumi (Switzerland) (above and below "Bank Leumi Switzerland"), was founded in 1953.

In February 2011, Bank Leumi Le-Israel Ltd. (hereinafter: "Leumi") acquired Banque Safdié SA in Switzerland (hereinafter: "Banque Safdié") and in January 2012, the activity of Banque Safdié was merged with that of Bank Leumi Switzerland and its name was changed to Leumi Private Bank SA (LPB).

In November 2014, the final settlement of accounts in connection with the abovementioned acquisition was made between Bank Leumi and the Safdié family, and thus, the contractual engagement between Leumi and the vendors will come to its complete and absolute conclusion, with all of the various aspects of responsibility, indemnities and collateral, as defined in the acquisition agreement, being null and void, and all existing and future claims and/or exposures will be the sole responsibility of Leumi, without the right of return to the vendors.

On 21 July 2014, Leumi signed the strategic cooperation agreement with Julius Baer, a leading private banking group in Switzerland. As a part of this agreement, Leumi is take steps to exit private banking activity currently conducted in the Bank office in Switzerland (Leumi Private Bank) and transfer most of its customers to Julius Baer. This transfer is expected to take place in March 2015.

In December 2014, an agreement was signed with minority shareholders in Leumi Private Bank for the acquisition of the minority shares at a rate of 5.03%. The purchase was completed in February 2015, and as of the publication of this report, Leumi hold 99.84% of the shares of the office.

As a part of the preparations for the cessation of activity, in November 2014, Leumi Private Bank signed an agreement to sell the funds in Luxembourg and Switzerland. These agreements are expected to be closed progressively towards the end of 2015.

On 18 March 2015, the transaction for the sale of the activity of Leumi Switzerland to Julius Baer was completed, after most of the customers were transferred to Julius Baer and the consideration pursuant to the sales agreement, amounting to CHF 10 million, was paid to Leumi Switzerland. The shareholders' equity of Leumi Switzerland is not being transferred as part of the transaction.

For details regarding a cooperation arrangement with Bank Julius Baer and the sale of the activity of Leumi Switzerland, see Chapter "Material Agreements", below.

The assets and liabilities in Switzerland which were transferred pursuant to the agreement are not material from the Group's point of view, and accordingly are dealt with, from an accounting perspective, as a discontinued activity.

Total assets of Leumi Private Bank amounted to CHF 1,583 million at the end of 2014, compared with CHF 1,706 million at the end of 2013. The loss in 2014 amounted to CHF 143 million, compared with a profit in 2013 of CHF 19.6 million, arising mainly due to expenses amounting to CHF 131 million which was recorded due to a significant share of Leumi Switzerland in the payment of the penalty to the U.S. authorities.

The total of capital and reserves, including internal funds, amounted to CHF 87 million at the end of 2014, compared with CHF 241 million at the end of 2013.

Total assets managed and/or held for customers and not included in the balance sheet at the end of 2014 amounted to CHF 5.7 billion, compared to CHF 6.9 billion at the end of 2013.

**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 2014 amounted to some € 426 million, compared with some € 529 million at the end of 2013.

At the end of 2014, deposits of the public totaled some € 265 million compared with some € 312 million at the end of 2013. Customers' assets held by customers of the bank and not included in the balance sheet totaled € 749 million at the end of 2014, compared with € 685 million in 2013.

Bank Leumi Luxembourg ended 2014 with a loss of € 3.3 million, compared with a loss of € 2.8 million in 2013, mainly due to the payment of € 8 million to the U.S. authorities which was recorded in its statements.

The capital means of Bank Leumi Luxembourg totaled some € 38 million, compared with € 43 million at the end of 2013.

In light of Leumi Group's decision to exit from private banking activity in Europe, the Bank decided to exit this office.

**Bank Leumi Romania**

Leumi Romania is a banking corporation in Romania which was acquired in 2006. The bank operates 21 branches, and engages in financial activity that includes, *inter alia*, the accepting of deposits, the extension of credit, international trade and foreign currency activities.

The commercial banking activity includes real estate financing, the financing of Israeli customers operating in Romania and the financing of small and medium-sized local businesses.

In 2010-2014, and in view of the general situation in Romania, 15 branches of Bank Leumi Romania were closed.

Bank Leumi Romania ended 2014 with a loss of 51 million Romanian ron (some US$ 14 million), compared with a profit in 2013 of some 2.1 million Romanian ron (some US$ 0.6 million). In 2013, the loss was incurred as a result of an increase in credit loss expenses as a result of the Romanian central bank's demand from the entire banking system in Romania to increase the level of provisions, particularly against the credit portfolio, which, according to the definition of the Romanian central bank, is classified as not income-earning.

Following the negative growth rate of the Romanian economy in 2009-2010, due to the harshest recession for 20 years, there was a moderate improvement in the country's economy since 2011. The growth rate is expected to increase gradually as a result of the increase in the amount of investments in support grants from the European Union, which will be received under a number of conditions, including reforms in the government authorities and an increase in competition in sectors controlled by government companies. The banking regulatory authorities in Romania are taking steps towards Romania's joining the regulatory framework of the Central European Bank, while increasing the involvement in the banking system, at this stage, mainly in relation to the subject of provisions to a reserve.

The assistance program of the International Monetary Fund to Romania (Standby Agreement) was approved in 2013 for a further 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 loans, classified as problematic, are on a rising trend, and the level of credit activity continues to moderate.

In 2014, there was certain recovery in the activity of the real estate market in the residential sector, especially in Bucharest, and therefore, the Bank renewed its activity in providing financial support (C/L) for financing the establishment of residential projects.

In the retail sector, the bank continues to grant mortgages as part of the "First Home" project which is backed by government guarantee.

The total assets of Bank Leumi Romania amounted to 1,231 million Romanian ron (US$ 334 million) at the end of 2014, compared with 1,198 million Romanian ron (some US$ 368 million) at the end of 2013. Deposits of the public amounted to 777 million Romanian ron (some US$ 211 million) at the end of 2014, compared with some 665 million Romanian ron (some US$ 204 million) at the end of 2013, and credit to the public amounted to 798 million Romanian ron (some US$ 216 million), compared with some 797 million Romanian ron (some US$ 245 million) at the end of 2013.

The capital, reserves and surplus amounted to some 175 million Romanian ron (some US$ 47 million) at the end of 2014, compared with 227 million Romanian ron (some US$ 70 million) at the end of 2013.

1 Romanian ron = US$ 0.271 (end of 2013 - US$ 0.307)

**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.

In the context of changes in the international deployment of the Group to adapt it for business and regulatory changes around the world, the Board of Directors of Leumi has passed a resolution for the cessation of activity of Bank Leumi (Latin America).

Total assets of Leumi (Latin America) were US$ 47 million at the end of 2014, similar to 2013.

Capital, reserves and retained earnings totaled some US$ 7 million on 31 December 2014, compared with US$ 10 million in 2013.

2014 ended with a loss of some US$ 1,837 thousand compared with a profit of some US$ 137 thousand in 2013. The balance of off-balance sheet activity totaled some US$ 270 million in 2014, compared with US$ 297 million at the end of 2013.

**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 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, liability insurance and property insurance;
- The company shall only engage in insurance for the Bank Leumi Group.

The company’s **total assets** at the end of 2014 amounted to US$ 38.2 million, compared with US$ 38.4 million at the end of 2013, and the **insurance reserves** amounted to some US$ 31.3 million at the end of 2014, compared with some US$ 19.2 million at the end of 2013. **Shareholders’ equity** amounted to some US$ 4.2 million as of 31 December 2014, compared with US$ 12.9 million at 31 December 2013.

The loss for 2014 amounted to US$ 8.6 million, compared with a profit of US$ 3.3 million in 2013.

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 2,216 million as at 31 December 2014, compared with NIS 1,689 million as at 31 December 2013. The contribution to net profit of the companies included on the equity basis amounted to a loss of NIS 42 million in 2014, compared with a loss of NIS 293 million in 2013.

For further details, see above in the Chapter, "Operating Segments, Product Activities and Profit Centers in the Group – Companies Included on Equity Basis".

# Exposure to Risk and Methods of Risk Management

## Risk management

## Risk management in Leumi

The Bank is engaged in a wide spectrum of financial activities that involve the taking of risks, primarily credit risks and market and liquidity risks. 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. 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 based on three "lines of defense". The first line of defense 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 determining, supervising and confronting the risk levels to which the Bank and the Group are exposed.

The Chief Risk Officer, who is a member of management in the Bank, and Head of the Risk Management Division, is responsible for leading the management of the main risks in the Bank and in the Group, with the management of legal risk under the authority of the Bank's Chief Legal Advisor and the management of reputational risk under the responsibility of the Marketing, Advertising and Spokesperson's Department. 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, an overall risk-return manager and the Head of the Compliance Department. With effect from the beginning of 2014, the credit risk management (CRM) units, which independently conduct risk assessments and render independent opinions regarding credit of more than NIS 25 million, were made subject to the Chief Risk Officer. At the same time, overall responsibility for the appropriateness of classifications and allowances in the Bank was transferred to the Risk Management Division. These changes are in accordance with Proper Conduct of Banking Business Directive no. 311 which was published in December 2012. In the said procedure, the Banking Supervision Department requires a high involvement at the transaction level of the risk management function.

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 the preparation of 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.

**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, which periodically discusses the overall risk picture.
- Risk management committees according to various topics headed by the Chief Risk Officer and with the participation of corporate entities from the various divisions: credit, market, operational and 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, and supervision is exercised by the board of directors of each subsidiary.

### Main risks inherent in the Bank's activity

The Group's main risk 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 dispersal of risk by determining the maximum exposure facilities to activity with borrowers, setting limits limitations on exposure in the credit portfolio and the assessment of concentration risk in the portfolio. Portfolio management is carried out according to considerations of return on risk and not just in terms of exposure.

For details of credit risk and its management, see below in this chapter.

Market risk, including liquidity risk, is another important risk in the Bank's activity. 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 as a part of the system of restrictions established by the Board of Directors and the risk committees at different levels which delineates the impact of market's exposure on the economic value, the accounting profit, capital reserve and liquidity position.

For details of market risk and its management, see below in this chapter.

In the Bank's activity as a financial intermediary, there are operational risks which also include, inter alia, the areas of business continuity, information security, system technology risk, and cyber risks. Operational risk management is conducted in accordance with the generally accepted ("best practice") standards in all parts of the Group, and as far as the risk environment changes, the Bank updates the tools for managing these risks. In recent years, as a result of the rapid development in technology, in general, and, because of that, in banking, and as a result of external changes for the Bank, there has been an increase cyber risks and the risks of leaking information, and the Bank continues to take steps to strengthen the risk management in this area.

For details of operational risk and its 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 as a basis for decision-making. The main tools used in the management of risk are: determining risk appetite, which defines, *inter alia*, the establishment of risk policies and restrictions **-** for each type of risk; setting 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; 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 parties involved.

**Changes in the risk environment and their impact on the Bank**

The main risk focal points in 2014 were a marked economic slowdown in the Euro Area, geo-political tension between Russia and the western nations against a background of the Ukraine crisis, the low interest environment and the concern for the formation of an asset bubble, as well as a slowdown in the local economy. Simultaneously, operating risks and compliance risks continued to increase in accordance with a trend of recent years in banking as a whole. We assess that those risks will continue to be a risk focal point in 2015, too.

**The main risk areas which are expected to impact the Bank's activities in the coming year are as follows:**

1. **Macro environment – Continuation of slow recovery in the Euro Area, geo-political tension and the local slowdown in the local economy**

   The economy in Western Europe is expected to continue the trend of slow recovery and influence the growth and markets in the world. The central banks continue the low interest rate policy, in order to support the economic recovery. However, at the same time, an environment is being created in which the concern of the formation of an asset bubble is increasing. This trend, in addition to the existing geopolitical tension between Russia and the United States and European countries, is liable to lead to high volatility in the capital and currency markets, (as we have seen in recent months, in various currencies including the strengthen of the dollar against the euro, the devaluation of the Russian ruble, the appreciation of the Swiss franc and the fall in the value of the shekel against the dollar). The Israeli economy, and therefore, also Leumi's borrowers, are affected by these factors which contribute to a continuation of moderate growth in the economy.

2. **Compliance risk**

   In recent years, compliance risks have increased, banks around the world are absorbing substantial penalties in respect of failure to comply with regulations in many and various areas, starting with activities in the capital market, the sale of various financial products ("bank customer risk" or "conduct risk"), via a breach of international sanctions, culminating in the area of private banking. In addition, the frequent changes in regulations require constant pro-active monitoring and assessments within a short time-framework, which require the allocation of several resources.

   As a result of changes in legislation and the principles of enforcement in Israel and around the world, and in view of the provision of services by the Bank to foreign resident customers, compliance with international laws and principles has become more complex than in the past. In addition to consumer topics and issues of the prohibition of money laundering and the financing of terrorism, there is an increase in the importance of guaranteeing compliance with the laws connected to the management of investments, the provision of banking services and the compliance of foreign resident customers with the tax laws relevant to them (cross-border activity).

   Following the changes in legislation and in enforcement throughout the world and the start of the United States investigation into Leumi Group, the Bank has taken steps over the past three years on a number of planes to reduce these exposures. Pursuant thereto, contact was made with all private U.S. customers in order to obtain their signatures on W9 tax forms, which evidence the fact that they declare their monies to the U.S. authorities as required. The Bank is prepared to comply with the FATCA rules and the inter-government agreement (IGA) to guarantee compliance with the U.S. requirements (as outlined in the part below on "Management of Compliance Risk"). Further to dealing with the subject of the United States, it was decided to exit the representative and other offices overseas that have been engaged in private banking, including closing the major bulk of the representative offices abroad, the sale of the Bank's office in Switzerland, and the decision to exit the office in Luxembourg. A "declared money policy" has been established, which is aimed to ensure, based on indications of risk, that new foreign residents and new monies transferred to the Bank from various countries are declared by the customers to their countries of origin. Furthermore, under the said policy, a risk-oriented multi-year outline was defined for dealing with the Bank's existing customers, with the aim of ensuring that their monies were declared or in the process of a declaration. The implementation of the said policy has been adapted to regulatory processes defined around the world for dealing with this topic, foremost of which is an "Automatic Exchange of Information" Agreement of the OECD, which, the Ministry of Finance has announced, it will join.

   The management of all the compliance risks is carried out in Leumi by allocating the responsibility among three "lines of defense", whereby the management of cross-border activity risk is handled by the International Private Banking Department, assisted by the Compliance Department and the Legal Counsel

Department of the Bank. As a further part of the Bank's preparedness for overall management of the compliance risks that have arisen and have become more complex, over the past year, the Bank has made a structural change in the compliance function, centralizing the employees of the "second line" from the field to the head office, and defining their duty, inter alia, in the detection of broad-based compliance risk. In addition, on the corporate side, the handling of foreign resident customers has been concentrated in a number of centers in the Banking Division, which specialize in dealing with the requirements of customers and compliance with the necessary regulations.

**3. Tighter regulatory requirements, principally capital requirements**

Since the financial crisis in 2008, the requirements on banks have become considerably stricter in Israel and around the world, against a backdrop of the lessons absorbed and still being learnt from the crisis. The main changes, as reflected in the Basel III directives dealt mainly with a significant strengthening of capital and liquidity requirements of the banks in Israel and around the world, a trend which is expected to continue in future years. The impact of these regulatory requirements on the banking system in the world, and in Israel, as well, is substantial, both on the profitability and on the business model. Leumi is required to prepare for strengthening of the capital adequacy and for attaining the capital; targets required by the regulatory authorities, in view of the initial application of the standard on employee rights effective from 2015, which substantially reduces the Bank's capital at the date of implementation.

At the same time, there has been an increase in additional initiatives for reforms in the banking system which are likely to affect the Bank's activity and its profits. In addition, Leumi Group has made preparations towards international regulatory reforms which have implications for business activity, including the U.S. reforms, Dodd-Frank and the Volcker Law and the European initiative, EMIR.

**4. The rapid increase in credit to households**

In recent years, there has been a considerable increase in credit to households in Israel, either by way of mortgages or by way of consumer credit. Customers are increasing their liability, inter alia, as a result of the low interest rate in the market. The level of leverage of households in Israel is still relatively low, compared to other developed countries. However, the trend is one of rapid increase in credit compared with income, an increase in leverage, and with it, an increase in risk. In the current quarter, the Bank increased the collective allowance for private individuals as a result of the Bank of Israel directives of January 2015. The retail credit portfolio is monitored on a monthly basis, and objective tests are carried out on a number of parameters, particularly, indications of a deterioration in the risk ratings of the borrowers, and allowance percentages at each credit risk rating.

**5. Cyber risk and leakage of information**

During the past year, a number of cyber events and leakage of information materialized in Israel and around the world. This trend is expected to continue into 2015 in view of the numerous technological changes in the world of banking, the large volume of information which has accumulated and relatively easy accessibility of hostile parties to the tools enabling a cyber attack. The adverse changes in the geopolitical environment also act to increase the risk from cyber attacks, as the virtual arena has become one of the leading war zones for organizations and states.

**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 an estimate of the exposure to the various risks and the quantification of the impact of the materialization of serious scenarios on the Group's capital, i.e., its stability. The degrees of severity defined below are based on the results of the occurrence of potential stress scenarios, assuming they will happen, and present the level of risk divided into five levels. This is as a function of the extent of impairment in relation to the Group's Tier 1 shareholders' equity adequacy in the event of the risk materializing. Risk at a "low" level of severity is defined as impairment of up to 0.5% in capital adequacy; "low-medium" as impairment in a range of 0.5%-1%, "medium" as impairment in a range of 1%-2%, "medium-high" as impairment of more than 2%, but without reducing the Tier 1 shareholders' equity adequacy ratio to below 6.5%. Impairment that will lead to a decrease in the Tier 1 shareholders' equity adequacy ratio to below 6.5% is defined blow as risk of "high" severity. It should be noted that the methodology was updated with effect from these financial statements. The main changes are the addition of interim degrees of severity – five levels instead of three, as in previous years, and an increase in the level of risk in a number of categories, even on the basis of subjective assessments in risks that are difficult to quantify. Thus, the level of severity of compliance risk was raised (from low to low-medium), reputational (from low to low-medium), operating (from low-to low-medium), risk of bond margin and price of shares in *nostro* (from low to low-medium), and risk of global systemic risk scenario (from medium to high). The emphasis in the abovementioned methodology is that the level of risk which is defined takes into account the impact on the Bank's stability, which is based, first and foremost on its shareholders' equity. Under this methodology, there may be losses or events which in absolute terms and in relation to the Bank's profit are not immaterial. However, in terms of the capital adequacy, they will still be classified as relatively low risk.

It is important to note that the said methodology for assessing the severity of the risk factors is also based on subjective valuations by an expert from among the relevant factors in the Bank. When any quantitative index, according to our estimate, does not give sufficient expression to the severity of the risk factor, more weight will be given to a qualitative assessment. 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 adequacy. 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.

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" 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 a 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 | Quality of borrower and securities risk | The 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 | Bond 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-medium |
| 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 that can arise from weaknesses or failures in processes, large projects, people, systems, or external events, including cyber events. | Low-medium |
| 3.1 | Legal and compliance risk | The risk arising from activity which does not correspond with legislation (civil), legal errors and class actions conducted against the Bank or the risk that can arise from non-compliance with requirements of the authorities, which will be expressed in fines imposed on the Bank or on employees. | Low-medium |
| 4 | Reputational risk | The risk that negative publicity will lead to a decrease in customer base, a decrease in income, in liquidity or high legal costs. | Low-medium |
| 5 | Global systemic risk | Risks that may be due to external global and local events that could lead to the materialization of a number of risks simultaneously at a high level of severity. | Medium-high |
| 6 | Local systemic risk | The risks caused as a result of serious local events that could lead to the materialization of a number of risks simultaneously. | Medium |

* In relation to potential impairment in capital adequacy and the subjective assessment of the impact of risks that are difficult to quantify, the level of risk does not reflect the probability of its realization, but rather the impairment in the Bank if the scenario were to occur.

**Definitions of risks in the above table:**

## 1. Credit risk

Credit risk is defined as 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. (For further details on risk management, see below in this chapter.) 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 the quality of 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 was defined as medium.

**Concentration risk:** Credit risk in a significant exposure to borrowers with similar economic characteristics or who are engaged in similar activities or under the control and/or management of a certain factor, 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 borrowers. Below are details of sub-risks included in the definition according to the Group mapping:

**1.2 Large borrower and group of borrowers concentration risk:** The severity of the risk level is defined as low;

**1.3 Sectoral and segmental concentration risk:** 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.

## 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 risk**: The severity of the risk was defined as low-medium and was revised upwards in this quarter.

The severity of the general risk and sub-risks was evaluated in accordance with the most severe stress scenario in the set of scenarios for these risks.

**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 external events, including cyber events. This risk includes legal risk, but excludes strategic and reputational risks. The evaluation of the level of severity relates to a highly serious scenario and a review of historical events. The level of severity of the risk is defined as low-medium and was revised upwards in this quarter. For more information on management of the risk, see below in this chapter.

- **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 was categorized as low-medium severity. For more information on management of the risk, see below in this chapter.

- **Compliance risk:**

  The risk that may derive from non-compliance with regulatory requirements and laws of the various authorities in Israel and abroad. The level of severity for compliance risk within the Group was defined as low-medium, and, as aforesaid, was revised upwards in this quarter.

**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. Reputational risk is likely to affect the Bank's decision as to whether to enter into certain transactions, preferring to preserve the Bank's goodwill over short-term income. The level of severity of reputational risk was defined as low-medium, and, as aforesaid, was revised upwards during this quarter.

**5. Global systemic risk**

Risks deriving from extremely serious economic, political, and geopolitical events around the world, such as a global economic crisis. The assessment of the risk is based on the total loss in a very severe stress global scenario of the Group including the occurrence of a number of risks together. The degree of severity of risk in Leumi was defined as medium-high, and as aforesaid, was revised upward during this quarter.

**6. Local systemic risk**

Risks deriving from economic, political, and geopolitical events in Israel, and thus, result in a local crisis in real estate. The assessment of the risk is based on the total loss in a stress real estate scenario of the Group including the occurrence of a number of risks together, and on Bank of Israel scenario to the entire banking system (as outlined below). The degree of severity of risk in Leumi is defined 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 2014 are calculated and presented in accordance with the principles of the standardized approach in Basel. The capital adequacy ratio of 14.01% presented by Leumi at 31 December 2014 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 12 | - |
| Capital Structure (Qualitative and Quantitative) | 2 | Page 30 * | Note 13 |
| Capital Adequacy (Qualitative and Quantitative) | 3 | Page 31 | - |
| Risk Exposures and Assessment – General Qualitative Disclosure | | Pages 161-168 | |
| Credit Risk Qualitative Disclosure | 4(a) | Pages 170-177 | - |
| Credit Risk Exposures by Principal Types of Credit | 4(b) | Page 179 | |
| Exposures by Geographic Area to Foreign Countries | 4(c) | * | Exhibit F |
| Credit Risk Exposures by Third Party and Principal Types of Credit | 4(d) | * | |
| Credit Exposures by Repayment Period | 4(e) | * | |
| Problematic Credit Risk Exposures and Provision for Doubtful Debts by Economic Sector | 4(f) | - | Exhibit E |
| Total Impaired Loans and Provisions by Geographic Area | 4(g) | - | Exhibit F |
| Movement in Balances of Allowance for Credit Losses | 4(h) | - | Note 4A.1 |
| Credit Exposures by Risk Weighting | 5 | * | |
| Mitigation of Credit Risk (Qualitative and Quantitative) | 7 | * | - |
| Credit Exposures in Derivatives by Counter Party (Qualitative and Quantitative) | 8 | * | - |
| Securitization (Qualitative and Quantitative) | 9(f), 9(g) | * | Note 3 |
| Market Risk (Qualitative and Quantitative) | 10 | Page 189 | - |
| Operational Risk - Qualitative Disclosure | 12 | Pages 198-200 | - |
| Investment in Shares (Qualitative and Quantitative) | 13(b) | Pages 90-91 | - |
| Investment in Shares of Companies Included on Equity Basis | 13(b) | Page 141 | - |
| Interest Risk | 14 | Page 191 | Exhibit D |
| Compensation disclosure | | * | |

* The tables are presented on the Bank's website: /http://leumi.co.il/home01/32587. An outline of the main characteristics if the regulatory capital instruments issued are presented on the Bank's website : /http://leumi.co.il/home01/32587.

## Internal Capital Adequacy Assessment Process (ICAAP)

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 were 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 was developed, and processes of managing the risks and the risk management structure in the Group were examined.

The results of the process were formally collated in the ICAAP document which was submitted to the Supervisor of Banks in April 2014. This process was examined by the Supervisor of Banks as part of the Supervisory Review Process (SREP).

**Macro-economic stress-tests based on a uniform scenario of the Bank of Israel**

Commencing 2012, the Banking Supervision Department in the Bank of Israel has conducted a macro-economic stress test for the banking system based on a uniform scenario. Within this context, Bank Leumi, like all other banks, estimates the results of the test using a variety of models and methodologies also based on subjective "expert valuations".

The performance of a uniform stress test is a generally accepted international standard in accordance with the recommendations of the Basel Committee, and contributes to an understanding of the risk focal points to which the banking system and a single bank is exposed. This process strengthens transparency and the discipline of the market in the banking system and enables the compliance of the banking corporations in a situation of the development of negative market conditions to be examined and compared. The process supports the improvement of the methodologies and an understanding of the risk factors in the banking corporations and in the Banking Supervision Department.

The Banking Supervision Department integrates the results of the uniform stress test as a complementary component in the supervisory assessment processes (SREP), including quantitative and qualitative consideration. At the same time, the banking corporations are required to combine the uniform stress test in an internal process for assessing the ICAAP in the banks.

At the basis of the uniform stress tests which are carried out once a year, banks have two macro-economic scenarios which were designed by the Bank of Israel – a basis scenario and a stress scenario, which varies from year to year. It is important to note that the scenarios that are taken into account should not be construed as a forecast, but rather hypothetical scenarios which are intended to examine the compliance of the banking corporations in a very severe macro-economic environment.

Bank Leumi has carried out a uniform stress scenario for 2013-2014 (a local stress scenario) and in the first quarter of 2015, is performing a calculation of a uniform stress scenario for 2014-2015 (a local and global stress scenario), at the directive of the Bank of Israel.

## Basel III

In September 2014, the Bank of Israel published a new draft of Proper Conduct of Banking Business Management Directive 221 regarding Liquidity Coverage Ratio (LCR), which will come into effect on 1 April 2015. Pursuant to this directive, the ratio will be measured according to the Basel III recommendations and the position of the Supervisor on subjects in which the Supervisor may exercise discretion. The minimum requirement for the liquidity coverage ratio will be 60% until the end of 2015 and will increase to 80% on 1 January 2016 and to 100% on 1 January 2017. Proper Conduct of Banking Business Management Directive 342 regarding Liquidity Risk continues to be in force at the same time as this directive. Simulations to examine the effect of implementation on the Bank's balances were conducted, and as of the date of the report, the Bank will be meet the standard stipulated in the transitional provisions.

## Credit risks

Credit risk is the risk of the Bank incurring a loss as a result of the possibility that a borrower (or group of borrowers) 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 of all the above is a work program relating to business goals, as determined by management and the Board of Directors.

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 guiding principles in the Bank's credit policy are based on the dispersal of risks and their controlled management. This is reflected in the diversification of the credit portfolio among the various sectors of the economy and over a large number of borrowers.

**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.
- Business initiative 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 manages it must be aware of the risks in the area of its operations and responsible for its routine management. This includes awareness and risk management in the area of compliance likely to accompany transactions (credit, liabilities to customers and routine activity).
- 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 activities:
    - Activities/segments with a low level of risk which the Bank is interested in financing and would like to expand;
    - Activities/segments with a medium level of risk, in which the financing is selective.
    - Activities/segments with a high level of risk which the Bank tends to avoid because of the increase of exposure.

  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 limits. 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 the establishment of centers of expertise for the area of credit in the Retail Division, the merger of mortgage activity in the Banking Division and the intensification of the "segmentation" of corporate customers in the appropriate lines of business and in the framework of specialist branches. These processes provide a broad overall view of Leumi's liabilities and customer risk.

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 for a number of years, with the involvement of Credit Risk Management (CRM) units, which were, as aforesaid, transferred at the beginning of 2014 to the aegis of the Risk Management Division. This transition, which was in compliance with the requirements Banking Supervision Department, will strengthen the independence and autonomy of the CRM units, and will support better synergy between the individual consideration and the management at the total Leumi portfolio level, while streamlining the credit processes.

For further details, see paragraph "Organizational structure and management responsibility for credit risks", below.

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. The Bank maintains a constant review 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 implemented 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 also applies *inter alia*, in these principles the updates that have come into force during 2014 to the Proper Conduct of Banking Management Regulations regarding credit risk management (Directive 311- Credit Risk Management and Directive 314 – Fair Disclosure of Credit Risks and Fair Measurement of Debts).

The Bank employs an automated 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 on 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.

The Board of Directors of the Bank approves the Bank's credit policy (including the policy with regard to collateral) and 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. 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. A summary description of credit and the main characteristics of the credit portfolio in the overseas units are presented once every period to the Board of Directors of the Bank in Israel.

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 specialized niches. 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, the distribution of problem credit among the various units of the Bank, and information on particularly sensitive customers, etc. and other segmentations as far they are required, in the opinion of Bank management or the Board of Directors.

**Organizational structure and management responsibility of credit risk**

**Risk management functions**

There is a dedicated risk management culture in the Leumi Group which is the key to effective risk management. The Board of Directors prescribes the risk management processes and risk appetite of the Group on the basis of suggestions brought by the management.

Risk management in the Bank is based, as aforesaid, on three lines of defense, i.e., risk management is effected at the different levels of authority and responsibility in the three lines of defense.

**First line – Business lines**

The business units (first line of defense), whose activity entails assuming credit risk, operate in an appropriate risk environment, within which the processes for underwriting, managing and operating loans are defined. The process of credit approval is carried out in accordance with the Bank's credit policy and in accordance with the scale of authorities that has been established.

Control activity is an integral part of the risk management process. Pursuant to the first line, specialist units operate, providing a professional solution for aspects of activity and/or control, according to their designation. See below for an explanation regarding credit management centers in the Banking Division and regarding the Special Loans Unit.

**Credit and risk management centers – in the Banking Division**

Credit centers which are involved in the approval processes and credit management, are professional centers, which report directly to the divisional risk manager and are manned by professional and experienced credit 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 be dealt with 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, aspects which have been expanded and established during the past year.

**Special Credit Department**

The Special Credit Department, as a part of risk management in the "first line", operates under the responsibility of the Head of the Credit and Real Estate Division. The department specializes in dealing with customers in difficulty from the commercial banking and corporate banking segments, 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, accountants, architects/engineers, lawyers, etc.

**Second line – Risk Management Division**

As a rule, the responsibility of the Risk Management Division is to formulate risk policy and limits for the approval of the Board of Directors, to develop and challenge the assessment or risk in material transactions and new activity and analyze the risks in the credit portfolio with a collective vision. This is in order to assist the management to advance an integrated corporation-wide perspective of risks. As aforesaid, at the beginning of the chapter, with effect from 2014, the responsibility for analyzing risks in specific loans whose amount exceeds NIS 25 million, and the overall responsibility of the appropriateness of the classifications and allowances has been transferred to the Risk Management Division.

**Credit Risk Management (CRM) Department in the Risk Management Division**

The designation of the CRM units is to take steps for the optimization of decision-making in credit portfolios. CRM units are responsible for the in-depth analysis of credit applications from business units, validating borrowers' risk ratings (assessment of the internal risk), carrying out a periodic review in conjunction with the business units with regard to particularly sensitive borrowers, making recommendations on classifications and provisions. Alongside this, the CRM units, in conjunction with the credit risk section and managements of the corporate divisions, are working to develop methodologies and financing "formats", develop control processes and assimilate working procedures and rules for granting credit at Bank level. The main work of the units focuses on making an independent examination of customer relations managers' recommendations for determining or for 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.

The CRM units provide a solution for borrowers with a total credit of NIS 25 million and more in the Commercial, Corporate and Real Estate Department. In addition, 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 (in excess of the specified threshold amount), carried out by certified appraisers, and to determine the maximum collateral value of the properties.

**Credit risk management section 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), which complements the CRM activity. The department is responsible for analyzing credit risk at the total credit portfolio level, including leading the formulation of the credit and credit risks policy document for approval by management and the Board of Directors, independently retrospectively examining and controlling specific credit portfolios and developing quantitative models and tools for measuring and controlling credit risks.

**Third line – Internal Audit**

Its function is to examine (usually post facto) the correctness and effectiveness of the risk management process in accordance with the Bank's targets and to expose weaknesses in internal controls.

## Tools for credit risk management

In managing credit risk, use is also made of quantitative models for rating the risk of borrowers and for evaluating and monitoring the 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, according to which the level of risk of exposure to the customer's activity is estimated over time in the account. 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. The rating systems have been developed by the Bank and are based on its internal assessments.

In analyzing risk at the total credit 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 the various cross-sections.

**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.

**Credit risk mitigation**

**Policy and processes regarding valuation and the management of collateral**

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. The main consideration is the borrower's current repayment capacity.

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 rating of the borrowers 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 the receipt of collateral, the manner of establishing the rate of reliance on the collateral, courses of action when receiving them, methods and timing for updating their value and the means of control and review, 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 Risk Management Division is responsible, as aforesaid, for the operation of the Appraisal Section whose function, inter alia, is appraisals of real estate assets pledged to the Bank (in excess of the defined threshold amount).

In special transactions, and in cases when shares of a corporation serve as the main collateral and/or the main source of repayment of a loan, an updated appraisal and an examination of the ability of the corporation as a source of debt repayment is required. 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 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, review 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 customer.

Special emphases regarding specific collaterals also appear in the Bank's Credit and Credit Risks Policy document.

## Activity in Derivative Instruments for the purpose of reducing credit risks

### Hedging and/or Risk Mitigation Policy and Strategies and Processes for Monitoring the Continuing Effectiveness 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, there are 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. There is awareness of exposure to currency risks 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 and/or commodity prices, 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 exchange rates and/or commodity prices included in its activity.

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.

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.

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 who work according to complex strategies or in new types of activities not yet computerized, the collateral requirement is directly monitored against the actual activity and collateral.

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.

**The following table presents the exposures pertaining to counterparty credit risk:**

| | **31 December 2014** | 31 December 2013 |
|---|---|---|
| | **NIS millions** | |
| Derivatives hedging a positive gross fair value | **1** | 73 |
| ALM derivatives with a positive gross fair value | **16,913** | 12,981 |
| Other derivatives with a positive gross fair value | **-** | - |
| Credit derivatives with a positive gross fair value | **-** | - |
| Total fair value | **16,914** | 13,054 |

**The following table shows credit exposure with respect to the fair value of derivatives, according to counterparties to the contract, as at 31 December 2014, in NIS millions:**

| | AAA to AA- | A+ | A | A- | BBB to BBB- | BB+ to B- | Unrated | Total |
|---|---|---|---|---|---|---|---|---|
| Foreign banks | NIS millions | | | | | | | |
| Euro area (a) | **2,240** | **-** | **-** | **-** | **-** | **-** | **-** | **2,240** |
| United Kingdom (b) | **2,216** | **-** | **-** | **-** | **-** | **-** | **-** | **2,216** |
| United States | **2,358** | **-** | **-** | **-** | **-** | **-** | **-** | **2,358** |
| Other | **239** | **-** | **-** | **-** | **-** | **-** | **-** | **239** |
| Total foreign banks | **7,053** | **-** | **-** | **-** | **-** | **-** | **-** | **7,053** |
| Israeli banks (c) | **-** | **2,486** | **-** | **-** | **-** | **-** | **-** | **2,486** |
| **Corporate customers, by sectors of the economy** | | | | | | | | |
| Financial services (d) | | | | | | | | **6,016** |
| Industry (e) | | | | | | | | **893** |
| Construction and real estate | | | | | | | | **92** |
| Transportation and storage | | | | | | | | **49** |
| Trade | | | | | | | | **98** |
| Electricity and water | | | | | | | | **2** |
| Business services | | | | | | | | **18** |
| Private individuals | | | | | | | | **19** |
| Communications and computer services | | | | | | | | **157** |
| Others | | | | | | | | **31** |
| Total corporate customers | | | | | | | | **7,375** |
| Total exposure | | | | | | | | **16,914** |

See comments on following page:

**The following table shows credit exposure with respect to the fair value of derivatives, according to counterparties to the contract, as at 31 December 2013, in NIS millions:**

| | AAA to AA- | A+ | A | A- | BBB to BBB- | BB+ to B- | Unrated | Total |
|---|---|---|---|---|---|---|---|---|
| Foreign banks | NIS millions | | | | | | | |
| Euro area (a) | 2,949 | - | - | - | - | - | - | 2,949 |
| United Kingdom (b) | 1,272 | - | - | - | - | - | - | 1,272 |
| United States | 1,715 | - | - | - | - | - | - | 1,715 |
| Other | 340 | - | - | - | - | - | - | 340 |
| Total foreign banks | 6,276 | - | - | - | - | - | - | 6,276 |
| Israeli banks (c) | - | 2,531 | - | - | - | - | - | 2,531 |
| Corporate customers, by sectors of the economy | | | | | | | | |
| Financial services (d) | | | | | | | | 3,544 |
| Industry (e) | | | | | | | | 431 |
| Construction and real estate | | | | | | | | 82 |
| Transportation and storage | | | | | | | | 6 |
| Trade | | | | | | | | 92 |
| Electricity and water | | | | | | | | 4 |
| Business services | | | | | | | | 13 |
| Private individuals | | | | | | | | 19 |
| Communications and computer services | | | | | | | | 29 |
| Others | | | | | | | | 27 |
| Total corporate customers | | | | | | | | 4,247 |
| Total exposure | | | | | | | | 13,054 |

(1) This amount includes transactions in 5 countries (2013 – includes transactions in 5 countries).

(2) This amount includes transactions with 10 banks (2013 – includes transactions with 10 banks).

(3) This amount includes transactions with 9 banks (2013 – includes transactions with 9 banks).

(4) This amount includes transactions with 454 customers, where the highest amount for a single customer is NIS 1,286 million (in 2013 – includes transactions with 413 customers, with the customer with the highest amount being NIS 763 million).

(5) This amount includes transactions with 256 customers, where the highest amount for a single customer is NIS 264 million (in 2013 – includes transactions with 254 customers, with the customer with the highest amount being NIS 237 million).

## 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.

The Bank's credit policy regarding various activity segments and various market sectors changes from time to time in accordance with the business environment, the Bank's corporate focus, the Bank's risk appetite and general and specific directives of the Bank of Israel.

In addition to the sector dispersal limitation, which was 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**

The real estate area is the area of activity in which the Bank has 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 which is specially adapted for dealing with customers in this area.

The real estate sector is financed, 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 demands.

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, while relying on and with the assistance of external building supervisors.

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.

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 on a selective basis, giving priority to customers, with whom the Bank has positive experience, in a controlled fashion and after examining all of the customers' activity in Israel and abroad, in certain countries, taking into consideration the country's political and economic risk, with a meticulous examination of the projects, with the Bank's overseas units overseeing the projects.

**Group of borrowers**[1]

The Bank monitors the exposure of groups of borrowers in all their components, using the automated 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 in the bank ("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 group 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.

**The regulatory limits on the indebtedness of a group of borrowers, as set forth in Proper Conduct of Banking Business Management Regulation no 313, are as follows:**

1. The net indebtedness of a group of borrowers / group of banking borrowers must not exceed 25% of the Bank's capital.
2. The net indebtedness of a controlled group of borrowers must not exceed 50% of the Bank's capital.
3. The net aggregate indebtedness of borrowers / groups of borrowers/groups of banking borrowers, whose net indebtedness exceeds 10% of the Bank's capital, must not exceed 120% of the Bank's capital.

As of 31 December 2014, the Bank complies with these limits.

As of 31 December 2014, the Group had no credit exposure to a group of borrowers whose indebtedness exceeds 15% of the Bank's equity of the Bank (as defined in Proper Conduct of Banking Management Regulation no. 313).

**Exposure of the Bank to leveraged finance**

Proper Conduct of Banking Business Directive 311 provides that a bank's credit policy should relate to leveraged finance. The Bank operates according to a unique credit policy which it has established for the area. It should be noted that there is no banking directive specifically for leveraged financing beyond the regulation relating to financing the means of control as set forth below.

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 by them; an investee corporation which is material for a holder who has no control and anyone controlled by them; borrowers related in such a way that the impairment in the financial stability of any of them is likely to have implications for the financial stability of the other, or that those factors are likely to have implications for the financial stability of both of them.

**The Bank defines leveraged finance as finance that meets one of the following criteria:**

1. Financing the purchase of the means of control held (constitutes an expansion to that required pursuant to Proper Conduct of Banking Business Directive 323). See also separate consideration below.
2. Financing "pure" holding companies, as defined in the Bank's policy.
3. Financing a borrower in the various segments of the defined industry sectors, characterized in significant exceptional values of certain parameters in relation to norms in the area of the relevant market sector, such as the ability to service an insufficient debt compared to norms established by the Bank, a low shareholders' equity to total assets ratio.

**The following table presents the aggregate balances of credit to leveraged borrowers, each of which has the balance of credit amounting to 0.5% of the Bank's capital, by sector of the economy, as of 31 December 2014:**

| Market sector | **31 December 2014** | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| Real estate | **3,044** | 3,301 |
| Industry | **2,683** | 2,868 |
| Trade | **881** | 666 |
| Financial services | **509** | 1,513 |
| Communications | **254** | 308 |
| Transport and storage | **250** | 224 |
| Other corporate services | **-** | 331 |
| Total | **7,621** | 9,211 |

* Net balance sheet and off-balance sheet credit, after deduction of allowances of credit losses and deductible collateral (and including the holding of debentures in nostro and irrevocable undertakings to grant credit).

Credit balances to leveraged borrowers, above, include the balance of the credit for financing the purchase of the means of control pursuant to Proper Conduct of Banking Management Regulation no. 323, (see definition below), was NIS 1,953 million as of 31 December 2014.

In addition, the Bank has established internal quantitative limits relating to leveraged financing, both absolutely and in relation to the Banks capital ratio.

The Bank has decided that reports will be presented to the Board of Directors and Bank management every six months on the compliance with the quantitative limits that have been established and on the volume of the portfolio, including trends and changes.

**Exposure limits in transactions to finance the means of control**

Credit for acquiring the means of control is defined in Proper Conduct of Banking Business Regulation no. 323.

The regulation applies to transactions that fulfill the following two conditions, in aggregate:

**a.** The credit balance is higher than 0.5% of the Bank's capital.

**b.** The repayment of the credit is mainly based on the acquired corporation.

The regulation provides quantitative limits on the balance of credit for acquiring the means of control, and the Bank complies with them.

In addition, the Bank has established additional internal limits in the quantitative plain and the qualitative plain, relating both to transactions for acquiring the means of control according to the regulation and to transactions for any purpose against the means of control.

As of 31 December 2014, the Bank complies with these limits.

**Geographic dispersal**

**Mapping of exposure data of the activity of borrowers to countries/regions:**

Geographic dispersal is defined as one of the potential credit concentration risks in a portfolio (in addition to sector dispersal and exposure to large borrowers and to groups of borrowers). Geographic risk 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.

As part of borrower rating questionnaires, which are used for estimating the internal rating of corporate borrowers, questions relating to geographic exposure are included. This refers to the mix of revenues and/or the mix of the firm's cash flows, the location of the material assets being used and creating its activity (assets used in 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 [(a)]:**

| | **31 December 2014** | | | |
|---|---|---|---|---|
| | Balance sheet credit risk (b) | Securities (c) | Current off-balance sheet credit risk (d) | Current credit exposure |
| | NIS millions | | | |
| **External credit rating (e)** | | | | |
| AAA to AA- | **19,274** | **4,086** | **1,595** | **24,955** |
| A+ to A- | **2,138** | **29** | **1** | **2,168** |
| BBB+ to BBB- | **84** | **1,806** | **150** | **2,040** |
| BB+ to B- | **61** | **22** | **2** | **85** |
| Below B- | **-** | **-** | **1** | **1** |
| Unrated | **248** | **-** | **2** | **250** |
| Total current credit exposure to foreign financial institutions | **21,805** | **5,943** | **1,751** | **29,499** |
| Problem debt balances | **-** | **-** | **-** | **-** |

| | 31 December 2013 | | | |
|---|---|---|---|---|
| | Balance sheet credit risk (b) | Securities (c) | Current off-balance sheet credit risk (d) | Current credit exposure |
| | NIS millions | | | |
| **External credit rating (e)** | | | | |
| AAA to AA- | 13,469 | 4,275 | 1,074 | 18,818 |
| A+ to A- | 1,752 | 125 | 32 | 1,909 |
| BBB+ to BBB- | 171 | 917 | 190 | 1,278 |
| BB+ to B- | 80 | 79 | 1 | 160 |
| Below B- | 1 | - | - | 1 |
| Unrated | 142 | - | - | 142 |
| Total current credit exposure to foreign financial institutions | 15,615 | 5,396 | 1,297 | 22,308 |
| Problem debt balances | - | - | - | - |

(a) Overseas financial institutions include banks, investment banks, insurance companies and institutional bodies.

(b) 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).

(c) Including subordinated bank debentures amounting to NIS 759 million as at 31 December 2014 and NIS 998 million as at 31 December 2013.

(d) Mainly guarantees and undertakings for the provision of credit (excluding off-balance sheet derivatives).

(e) 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.

**Notes:**

(1) Credit exposures do not include investments in asset-backed securities. (See the details in the note on securities.)

(2) 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.

(3) 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) 18%, United Kingdom 22%, and other countries, 15%.

The exposure includes mainly deposits in overseas banks for short periods 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.

**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 [(a)]:**

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):

| | **31 December 2014** | | |
|---|---|---|---|
| | Balance sheet credit risk | Off-balance sheet credit risk | Total current credit risk |
| | NIS millions | | |
| USA | **30,378** | **6,279** | **36,657** |
| UK | **14,907** | **3,339** | **18,246** |
| France | **2,289** | **1,151** | **3,440** |
| Germany | **4,898** | **292** | **5,190** |
| Switzerland | **3,147** | **398** | **3,545** |
| Belgium | **1,154** | **74** | **1,228** |
| Italy | **273** | **27** | **300** |
| Netherlands | **943** | **206** | **1,149** |
| Denmark | **119** | **7** | **126** |
| Norway | **648** | **-** | **648** |
| Austria | **46** | **60** | **106** |
| Sweden | **513** | **5** | **518** |
| China | **947** | **448** | **1,395** |
| China | **1,838** | **211** | **2,049** |
| Brazil | **1,254** | **22** | **1,276** |
| Australia | **1,395** | **61** | **1,456** |
| Others | **4,783** | **681** | **5,464** |
| Total | **69,532** | **13,261** | **82,793** |

| | 31 December 2013 | | |
|---|---|---|---|
| | Balance sheet credit risk | Off-balance sheet credit risk | Total current credit risk |
| | NIS millions | | |
| USA | 26,360 | 9,243 | 35,603 |
| UK | 12,956 | 5,543 | 18,499 |
| France | 2,796 | 1,923 | 4,719 |
| Germany | 5,045 | 1,028 | 6,073 |
| Switzerland | 2,910 | 773 | 3,683 |
| Belgium | 700 | 183 | 883 |
| Italy | 328 | 35 | 363 |
| Netherlands | 2,380 | 139 | 2,519 |
| Denmark | 582 | 14 | 596 |
| Norway | 46 | - | 46 |
| Austria | 83 | 13 | 96 |
| Sweden | 139 | 18 | 157 |
| China | 567 | 548 | 1,115 |
| China | 702 | 160 | 862 |
| Brazil | 126 | 23 | 149 |
| Australia | 166 | 57 | 223 |
| Others | 4,679 | 626 | 5,305 |
| Total | 60,565 | 20,326 | 80,891 |

(a) In connection with exposure to foreign countries, see also Exhibit E.

**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 2014:**

| | Balance sheet exposure | Off-balance sheet exposure | Total exposure | Percentage of exposure in relation to total | Of which problem commercial credit risk |
|---|---|---|---|---|---|
| High-income OECD countries | **64,059** | **12,087** | **76,146** | **92** | **1,175** |
| High-income countries | **1,469** | **190** | **1,659** | **2** | **3** |
| Mid-high income countries | **3,910** | **851** | **4,761** | **6** | **402** |
| Mid-low income countries | **92** | **131** | **223** | **-** | **4** |
| Low-income countries | **2** | **2** | **4** | **-** | **-** |
| Total | **69,532** | **13,261** | **82,793** | **100** | **1,584** |

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 1,712 million and relates to 15 countries.

**The countries are rated according to national income per capita as follows:**

High income - exceeding US$ 12,746 per capita.

Mid-high income - from US$ 4,126 to US$ 12,745 per capita.

Mid-low income - from US$ 1,046 to US$ 4,125 per capita.

Low income – up to US$ 1,045 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, Russia and Croatia.

**c.** Countries with mid-high income:

Argentina, Brazil, Bulgaria, Mexico, Panama, Romania, Russia, South Africa, Turkey, Venezuela, Uruguay, Columbia and Peru.

**d.** Countries with mid-low income:

Egypt, India, Paraguay, the Philippines, Thailand and the Ukraine.

**e.** Countries with low income:

Most of the African countries, Haiti and Nepal**.**

**Overall exposure to certain foreign countries:**

| | 31 December 2014 | | | | |
|---|---|---|---|---|---|
| | Credit to the public | Bonds - banks and others | Bank deposits | Other | Total |
| | NIS millions | | | | |
| Italy (a) | **50** | **217** | **6** | **26** | **299** |
| Ireland | **35** | **158** | **-** | **1** | **194** |
| Greece | **-** | **-** | **-** | **1** | **1** |
| Spain | **21** | **96** | **3** | **11** | **131** |
| Total (b) | **106** | **471** | **9** | **39** | **625** |

(a) Of which NIS 217 million in Bank Intessa.

(b) 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 in respect of expenses in credit losses and problem debts which came into force on 1 January 2011 and updates thereto since that date. The Bank's practice is to estimate, assess and update the amount of the allowance for credit losses for each calendar year, in accordance with economic forecasts, assessments regarding the various markets and past experience.

The allowance for credit losses in relation to the credit portfolio may be divided into an individual allowance and a collective allowance.

The total allowances for credit losses for 2014 amounted to NIS 472 million, representing a rate of 0.19% of the portfolio of credit to public. The rate is influenced by a number of factors:

- Regulatory provisions, particularly the update to Public Reporting Directives which were published on 19 January 2015, relating to a collective allowance in respect of credit to private individuals.
- A low rate of individual allowances in light of the lack of allowances in respect of prominent customers.
- The rate of collections which is slightly higher in comparison to 2013.
- An increase in the rate of collective allowance, particularly in light of the change in the Public Reporting Directives, noted above.

For further information regarding the provisions governing the measurement and disclosure of impaired debts, credit risk and credit loss allowance, see Chapter "Critical Accounting Policy".

For further information and for a table detailing the credit risk and non-performing assets, see above in the chapter, "Development of Income, Expenses and Provision for Tax".

## 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. During 2014, the Board of Directors approved a Leumi Group's policy of investments and management of market risk for 2014-2015. The policy represents an important tool in defining the Bank's risk appetite in the *nostro* field, dealing rooms and market exposure, in the whole of Bank Leumi, the corporate governance, the organizational division of responsibility and escalation mechanisms.

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 derivative transactions in 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 various risk factors existing in the markets. The system of restrictions 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.

### 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, implementing corporate governance, which includes "three lines of defense", as outlined in the introduction to this chapter.

The Capital Markets Division ("the first line of defense") 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 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. In addition to the control processes within the trading rooms, routine control of activity is exercised – in the aspects of market risks, operating risks and embezzlement and fraud risks, by the Middle Room and the Risk-Management Sub-Division- within the Division

The Risk Management Division ("the second line of defense"), headed by the Chief Risk Officer, independently examines and monitors the extent of the risks and the procedure for managing the risks and prescribes the risk management policy, which is approved by the Board of Directors. A head of a sub-division responsible for market risk management is appointed, who reports to the Chief Risk Officer**.**

**Market risk management is discussed in the following committees:**

- The Risk Management Committee of the Board of Directors – Once every quarter, the Risk Management Committee of the Board of Directors conducts a discussion 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. In addition, the policy for managing market risks is brought for discussion and the approval of the recommendations of the Board of Directors Risk Management Committee are presented for approval by the Board of Directors in plenum.
- The Upper 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, monitor compliance with the aforementioned restrictions, approve the methodology for measuring exposure to market risks in Leumi Group.
- The Assets, Liabilities and Financial Investments Committee (ALCO), headed by the Deputy President and CEO, is responsible for managing the assets and liabilities and financial investments pursuant to the resolutions of the Board of Directors and the management, giving emphasis to the structure of the balance sheet, transfer prices, the required liquidity and liquid reserve investments, capital structure and capital-raising policy and compliance with the restrictions and Group policy

**Reporting**

- The report to the President and CEO and to the management of the Risk Management Division presents a picture of the market risks in Leumi and an outline of the management position. In addition, significant subjects that have arisen in the risk management committees, the various investment committees and the ALCO committee are reported, including dilemmas that have arisen between the Capital Markets Division and the Risk Management Division.
- 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.

**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 asset and liability management.

**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 measured\ 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. It 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 measurement of the VaR is carried out on the overall risk and on the 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), and, 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), as required pursuant to the standardized approach, are presented below. These requirements reflect only a small part of the capital held by Leumi against market risks (First Pillar). 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.

**The following table sets forth the capital requirements in respect of market risks (Table 10 – Basel):**

| | **31 December 2014** | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| **Capital requirements (a) in respect of :** | | |
| Interest risks | **948** | 707 |
| Share price risk | **169** | 127 |
| Exchange rate risk | **200** | 69 |
| Options | **38** | 43 |
| Total capital requirements in respect of market risks | **1,355** | 946 |

a. The capital requirement is computed at 1.5% according to the minimum ratio at 1 January 2015. In 2013, the capital requirement was computed at 9% according to minimum ratio until the end of 2013

**Main focus points in market risks**

The management of market risks in the Group is carried out both from an overall standpoint, examining the total shared effects of all of the Group's market risks, and from an individual point of view of each particular risk. There are holistic risk limitations on the total portfolio and individual limitations for each type of specific risk.

**1. Exposure to interest rates**

Interest risk is the 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 dates of changes in interest rates or the repayment date of the assets and liabilities in each of the linkage segments, whichever is earlier.

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 a corresponding 1% in interest in all the periods is measured, and in various interest scenarios, and its effect on the potential erosion of economic value[1] and financing profit for twelve months forward 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).

[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.

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. In accordance with past experience the Bank considers part of the current account balances as a long-term liability. Against a background of an increasing trend in current account balances, this assumption was reviewed and updated during the third quarter of the year. In addition, there are assumptions relating to early repayments in mortgages.

In May 2013, the Bank of Israel published Proper Conduct of Banking Management Regulation no. 333 regarding "Interest Risk Management" and updated Proper Conduct of Banking Management no. 339 regarding "Market Risk Management", so that it corresponded to the new directive. the interest risk management directive adopts the principles of the Basel document relating to the subject with the necessary adjustments. At the center of the directive is a requirement for qualitative controls, the segregation of duties and the use of stress scenarios and advanced models for interest risk management. The directive came into force on 1 July 2014.

From the beginning of 2014, there was a change in the way interest exposure is measured, whereby interest exposures between the unlinked shekel sector and the index-linked sector are offset, and the exposure limits were revised accordingly.

**The summary of exposures to unexpected changes in interest at Group level (before tax and in NIS millions)* is as follows:**

| | Potential erosion in economic value | |
|---|---|---|
| Effect of immediate parallel change of 1% on the yield curve | Limit | Actual |
| | **31 December 2014** | |
| Banking portfolio | **900** | **506** |
| Trading portfolio | **450** | **220** |
| Total | **1,100** | **705** |
| | Potential erosion in annual Report | |
| | Limit | Actual |
| Total | **500** | **106** |

* The extent of exposure does not take into account the existence of an interest rate floor of 0% on the deposits. The further the interest falls and approximates to zero, the higher the impairment in financial margin, as every interest reduction by the Bank of Israel is reflected only in the lowering of interest rates on credit, and therefore, in the reduction of margins and the erosion of the Bank's profitability.

**The summary of exposures to unexpected changes in interest at Group level (before tax and in NIS millions)* is as follows:**

| Effect of immediate parallel change of 1% on the yield curve | Potential erosion in economic value<br>31 December 2013 | Potential erosion in annual profit<br>31 December 2013 |
|---|---|---|
| Actual | 853** | 184 |
| Limit | 1,100 | 500 |

* The extent of exposure does not take into account the existence of an interest rate floor of 0% on the deposits. The further the interest falls and approximates to zero, the higher the impairment in financial margin – as all of the interest reduction by the Bank of Israel is reflected only in the lowering of the interest rate on the credit and therefore, in the reduction of margins and the erosion of profits in the Bank.

** On the basis of the methodology which was applied from the beginning of 2014, the potential erosion of the economic value to interest stands at NIS 605 million.

In 2014, the potential erosion in economic value ranged from NIS 296 million to NIS 705 million, and in annual profit, from NIS 31 million to NIS 215 million.

In 2014, 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 2014** | | | | |
|---|---|---|---|---|---|
| | Israeli currency | | Foreign currency, including Israeli currency linked to foreign currency | | |
| | Unlinked | CPI-linked | Dollar | Euro | Others |
| | NIS millions | | | | |
| Financial assets | **222,410** | **55,524** | **64,967** | **9,373** | **12,730** |
| Amounts receivable in respect of derivative financial and off-balance sheet instruments | **322,255** | **6,776** | **198,239** | **56,168** | **35,421** |
| Financial liabilities | **182,348** | **50,496** | **87,313** | **15,721** | **9,732** |
| Amounts payable in respect of derivative financial and off-balance sheet instruments | **340,762** | **9,046** | **177,771** | **50,011** | **38,888** |
| Net fair value of financial instruments | **21,555** | **2,758** | **(1,878)** | **(191)** | **(469)** |

| | 31 December 2013 | | | | |
|---|---|---|---|---|---|
| | Israeli currency | | Foreign currency, including Israeli currency linked to foreign currency | | |
| | Unlinked | CPI-linked | Dollar | Euro | Others |
| | NIS millions | | | | |
| Financial assets | 211,239 | 59,960 | 51,750 | 12,220 | 13,830 |
| Amounts receivable in respect of derivative financial and off-balance sheet instruments | 311,649 | 7,098 | 116,357 | 41,980 | 23,574 |
| Financial liabilities | 169,974 | 53,425 | 76,368 | 17,574 | 10,978 |
| Amounts payable in respect of derivative financial and off-balance sheet instruments | 334,405 | 9,844 | 94,024 | 36,403 | 26,209 |
| Net fair value of financial instruments | 18,509 | 3,789 | (2,285) | 223 | 217 |

**The effect of changes in interest rates on the net fair value* of financial instruments (Table 14 – Basel):**

| | **31 December 2014** | | | | | | |
|---|---|---|---|---|---|---|---|
| | 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% | **20,684** | **2,635** | **(2,065)** | **(207)** | **(482)** | **(1,210)** | **(5.56)** |
| Immediate corresponding increase of 0.1% | **21,468** | **2,746** | **(1,897)** | **(193)** | **(470)** | **(121)** | **(0.56)** |
| Immediate corresponding decrease of 1% | **22,516** | **2,911** | **(1,741)** | **(173)** | **(456)** | **1,282** | **5.89** |

| | 31 December 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Fair value, net, of financial instruments after the effect of | | | | | 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% | 17,787 | 3,708 | (2,472) | 228 | 202 | (1,000) | (4.89) |
| Immediate corresponding increase of 0.1% | 18,437 | 3,781 | (2,304) | 224 | 215 | (100) | (0.49) |
| Immediate corresponding decrease of 1% | 19,303 | 3,819 | (2,044) | 237 | 224 | 1,086 | 5.31 |

* 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 2014, 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 2014 | | | 31 December 2013 | | |
|---|---|---|---|---|---|---|
| | Unlinked | CPI-linked | Foreign currency and foreign currency linked | Unlinked | CPI-linked | Foreign currency and foreign currency linked |
| **Average duration in years:** | | | | | | |
| Average duration of assets (a) | **1.03** | **2.96** | **0.96** | 1.19 | 2.94 | 0.86 |
| Average duration of liabilities (a) | **0.92** | **3.00** | **0.83** | 1.10 | 3.21 | 0.74 |
| Duration gap in years | **0.11** | **(0.04)** | **0.13** | 0.09 | (0.27) | 0.12 |
| IRR gap (%) | **2.29** | **1.22** | **1.16** | 2.58 | 0.76 | 1.54 |

(a) Including future transactions and options, and based on fair value data of financial instruments.

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 3.28 years, and the internal rate of return gap (hereinafter "IRR") amounts to 0.94%.

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 2014, according to the original cash flow which does not take into account early repayments, is longer, reaching 3.32 years, and the IRR gap amounts to 0.94%.

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, the basic assumptions of which are regularly updated. Taking these assumptions into account, the average duration of the liability is higher, reaching in unlinked shekels, 1.01 years, and in foreign currency, 0.87 years, and the difference in the IRR amounts to 1.68 and 0.88 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 the 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 in respect thereof. The Bank makes hedging transactions against the tax exposure arising from exchange rate differences in respect of investments abroad which are defined as units whose functional currency is identical to the shekel.

**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 Maximum excess (or deficit) | Actual position **31 December 2014** | 31 December 2013 |
|---|---|---|---|
| | | % | |
| Unlinked | 65% - (65)% | **(1.2)** | (10.2) |
| CPI-linked * | 50% - (50)% | **3.9** | 6.4 |
| Foreign currency | 15% - (15)% | **(2.7)** | 3.8 |

* The exposure does not take into account the effect of the index floor on the capital invested in the sector.

In 2014, the percentage of capital invested on average over the year in the linked segment was 9%. During the year, the percentage ranged from a surplus of 2% to 17% 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 profit was not material.

In 2014, 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 2014. 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 | **-** | **-** | **4** | **(5)** | **-** |
| Increase of 10% in exchange rate | **18** | **(1)** | **8** | **(11)** | **1** |
| Decrease of 5% in exchange rate | **(1)** | **1** | **(5)** | **3** | **-** |
| Decrease of 10% in exchange rate | **4** | **8** | **(11)** | **3** | **-** |

### 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 in the foreign currency and derivatives trading room and as a manager of shekel *nostro* and foreign currency *nostro* positions:**

- The foreign currency trading room – The trading room acts as a market maker in various currencies, interest rates, financial derivatives and in Government of Israel debentures for the provision of immediate services to customers active in the instruments. 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.
- In the *nostro* trading rooms, there is initiated activity in the context of which initiated exposure to interest, foreign currency and marketable credit risk are taken. – In shekel *nostro*, the main exposure is to Government of Israel debentures and in foreign currency *nostro*, most of the exposure is to foreign debentures of countries, banks and companies, as well as asset-backed debentures. This activity is routinely managed and monitored at least once a week, in accordance with the restrictions, some of which have been approved by the Board of Directors and some by the Chief Risk Officer. All of the restrictions have been 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 options 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 global scenario, based on the 2008 crisis), as well as scenarios developed in collaboration between the Risk Management Division and the Economics Department and a uniform scenario circulated once a year by the Bank of Israel to the whole banking system.

**The table below shows the open transactions as at 31 December 2014 compared with the previous year (amounts in NIS millions)**:

| | **31 December 2014** | 31 December 2013 |
|---|---|---|
| | **NIS millions** | |
| Full hedging transactions | **2,468** | 4,007 |
| ALM and other transactions: | | |
| Interest contracts | **348,880** | 349,335 |
| Currency contracts | **350,560** | 230,364 |
| Contracts in respect of shares, share indices and commodities | **112,245** | 86,925 |
| Total | **814,153** | 670,631 |

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.

**4. Aggregate exposure to market risk – interest, basis, shares**

The aggregate exposure to market risks is reviewed using a number of tools. The first and most important is holistic stress scenarios, in which we assume a significant change in a large number of market factors, such as, interest, share price, exchange rates, basis margins, etc., and examine what the Bank's loss and capital impairment will be. The scenarios include historical scenarios, scenarios which have not materialized and scenarios that the regulatory authorities forward to the banking system once a year. As a part of the risk appetite defined by the Board of Directors, there are limitations on losses that the Bank is willing to absorb from the realization of market risks in severe scenarios.

In addition, the Bank reviews the loss that may result in a stress event by means of value-at risk (VaR) model. For this purpose, 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 2014** | 31 December 2013 | **31 December 2014** | 31 December 2013 |
| Actual | **156** | 126 | **42** | 53 |
| Limit | **500** | 500 | **400** | 400 |

In 2014, VaR on the economic value ranged from a maximum of NIS 156 million and a minimum of NIS 94 million, and the VAR on the portfolios remeasured at market value ranged from NIS 68 million to NIS 42 million, respectively.

In 2014, 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, financial institutions and companies 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 for financial institutions and countries headed by the Deputy Head of the Capital Market Division and in collaboration with the Risk Management Division. The committee determines exposure limits for financial institutions and countries on the basis of economic analyses 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 unexpectedly realizing assets within a short period, without incurring any material loss.

**Liquidity risk management policy**

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 a deliberate policy of raising stable and varied funds, with an emphasis on raising deposits from a large number of customers for various terms, including long terms, this, in order to support the activity, while evaluating and limiting losses that may arise from exposure to liquidity risks.

**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 38.9 billion and in securities, some NIS 21.4 billion, principally in government debentures. Surplus liquid means in foreign currency are invested primarily in debentures amounting to some NIS 25.9 billion, and in bank deposits, some NIS 16.2 billion.

The balance of public deposits in the Bank, not including subordinated notes, increased during 2014 by NIS 17.7 billion, (6.2%), and after canceling the effect of exchange rate differentials, the increase was NIS 8.3 billion, 2.9 %. Most of the increase was in the unlinked shekel segment amounting to NIS 10.3 billion, 5.6%, and in the foreign currency and foreign currency linked segment, there was an increase of NIS 7.4 billion, (7.0%), and after canceling the effect of exchange rate differentials, the decrease was NIS 2.0 billion, (1.9%).

### Monitoring liquidity risk

The Bank measures and manages liquidity risk pursuant to a Proper Conduct of Banking Business Management Regulation 342 on "Liquidity Risk" of July 2013, using an internal model under a range of scenarios which check that the liquid resources at the Bank's disposal in foreign currency and Israeli currency are sufficient to address all liquidity requirements in a stress scenario of liquidity lasting one month. The model is based on an assessment of the stability of the public deposits and the turnover and repayment rates of the assets and liabilities. Restrictions of the Board of Directors are provided for the liquidity ratio for a month in foreign currency, including the currencies, which stands at 1. Throughout the year, the Bank complied with a liquidity ratio higher than 1, except for two days in the foreign currency sector.

In addition, the Bank employs forecasts with regard to the current flow of cash, monitoring trends in various segments of deposits, monitoring concentrations of depositors, monitoring the Bank's mobilization costs and the system of warning lights which can indicate a change in the Bank's liquidity position.

With effect from 1 April 2015, the Bank will be required to comply with Proper Conduct of Banking Management Regulation no. 221 – "Liquidity Coverage Ratio", which adopts the Basel III recommendations for calculating the minimum standard for liquidity risk management (liquidity coverage ratio), making adjustments to the Israeli market. This ratio is computed as a proportion of the liquid assets at the Bank's disposal, for example, Bank of Israel deposits and government debentures, and with reference to their haircut rates, divided by the net outflow in a stress scenario during one month. The outflow includes, *inter alia*, a withdrawal of deposits which are based on an assessment of their stability and the utilization of credit lines according to the requirements of the directive. The LCR ratio must not be less that a minimum level of 60% until the end of 2015, 80% in 2016 and 100% from 2017. Simulations are taking place in the Bank to examine the effect of implementation on the Bank's balances and as of the date the report, the Bank will be on the limit provided in the transitional provisions. Proper Conduct of Banking Management Regulation no. 342 "Liquidity Risk" continues to be in force at the same time as this directive. In addition, the Bank has begun to monitor the Net Stable Funding Ratio (NSFR) This index is the ratio between the Bank's total stable financing sources to the total uses that the Bank is expected to continue to finance, assuming a stress scenario with a time horizon of one year. The Bank of Israel does not currently require compliance with a ratio of more than 1 as required by the Basel III directive. The requirements in question have not yet been published.

## 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 18C 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 18C.

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 also based 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 18C to the financial statements show that the fair value of financial assets at the end of 2014 was NIS 1,492 million higher than the balance sheet value (in 2013, higher by NIS 1,591 million), while the fair value of financial liabilities was NIS 4,698 million higher than the balance-sheet value (in 2013, higher by NIS 4,406 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 increase in the fair value of monetary assets and liabilities beyond that recorded in the financial statements in 2014 derives mainly from the decrease in interest rates in the economy, and particularly, in the unlinked shekel segment, similar to 2013.

## 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 focal point of risk in the range of operational risks is data technology risks. The Bank is a progressive and leading bank in technological innovation, with the aim of creating advanced services for its customers. Alongside the business opportunities which are generated with the technological progress the exposure level to cyber risk and to system failure increases, which are liable to expose the Bank to impairment in business activity and to impairment of goodwill.

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 markets of the divisions and subsidiaries (first line of defense) and includes: selecting from the 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 and the Legal Counsel Division in relation to legal risks, 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 Department (coordinators of the subject in the first line of defense units) and officers in charge in the divisions are responsible for the formulation of risk management in the processes under their responsibility. In addition, there are various forums which convene on the subject of operational risk under the leadership of the Operational Risks Manager, in which representatives of the business entities and subsidiaries (control officers), the Legal Counsel Division and the Compliance and Enforcement Department participate. These forums represent a platform for sharing knowledge, the drawing of lessons from failure events inside and outside the organization and discussion on 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 projects and in material new products, assimilation of an operational risk management culture, reporting to the Board of Directors and senior management, and support 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.

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, working processes which are anchored in policy procedures have been determined. Within the Group, procedures supporting the reporting of loss and near-loss events and the examination of the effectiveness of controls have been prepared.

In addition, a methodology for risk management in material new projects and products has been developed, defining a structured process of mapping and risk management in the project and its products.

Throughout the period 2012 – 2014, a operational risk survey was conducted in all of the Bank's units, and an updated map of operational risks was determined. As part of the survey the central risk focal points were identified and a mitigation plan for them was devised.

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.

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 standardized approach. 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).

In the fourth quarter of 2014, an advanced designated system for risk management was assimilated, supporting the documentation of risks, controls and reduction programs. In addition, the system enables the gathering and analysis of internal loss events and those which did not result in a loss. The stored data supports the decision-making process with regard to the management of 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).

The Bank has prepared a policy document 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.

**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.

There is another site in Jerusalem which serves as a third backup for data.

**The Bank prepares itself for disaster recovery and continuity of its business activity. Activity is comprised of three layers:**

- Technological infrastructure;
- Corporate action plans, policies and procedures;
- Periodic emergency drills.

**The main activities in the area of business continuity carried out in 2014 were as follows:**

1. Preparations for an emergency situation through a survey of critical processes in all the Bank's units.
2. Updating policy documents and procedures (business continuity policy, business continuity plan).
3. Conducting training for the various emergency training.
4. Analysis of the business effects in the context of the a consolidated survey in the divisions in accordance with the work program.
5. Conducting technological and individual drills in accordance with annual exercise programs.

**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 and the protection of customer privacy. 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 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.

In recent years, it has been possible to distinguish an increase in the scale of cyber threats worldwide. Attacks are being made on national infrastructures, government bodies and corporations, both in Israel and around the world.

The attacks are being waged out by various factors, from employees in the organizations, through organized crime, to attacks instigated by nations and individuals for political motives.

On 15 November 2014, the Israel Police arrested a number of people, among them, past employees of the company, who attempted to extort the company and obtain payment for the restoration of credit card information and details which were allegedly in their possession. To the best of the company's knowledge, no damage was incurred by its customers as a result of the incident. On 1 January 2015, an indictment was filed against three of the individuals involved in the extortion incident.

The management of data protection risks is carried out on the basis of Leumi's data security policy, and according to an international model for charting and managing risks, the implementation of controls and hedging of risks. In Leumi there are centers for monitoring unusual cyber activity or attacks.

Leumi persists in improving its defensive capability against cyber threats.

## Regulatory and compliance risks

### a. 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. In 2013, changes were made in the organizational structure of the Bank and the compliance function was made subject to the Chief Risk Officer.

The Chief Compliance Officer also acts as the official in charge of the area of securities laws and is the responsible officer for the area of the FATCA as set forth below.

For effective management of the subject, a Compliance and Enforcement Department was established in Leumi, headed by the Chief Compliance Officer. The activity of the Compliance Department is conducted through a professional staff with deep understanding and knowledge in the areas of compliance. and is based on work process, control and automated systems.

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.

On 4 March 2015, a draft of Proper Conduct of Banking Management Regulation no. 308 regarding "Compliance and Compliance Functions in the Banking Corporation" was published. Leumi will prepare for the implementation of the changes requested as a result of the directive, in accordance with the timetables provided therein.

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, including the prohibition of money laundering, the prohibition of financing terrorism, dealing with U.S. customers and other foreign residents. The department operates in accordance with the Group compliance policy document, which is periodically updated in accordance with local and international trends.

Pursuant to the developing trends around the world, the Bank is prepared to deal with the question of "declared money" for tax purposes by customer, in accordance with the risk-based policy approved by the Board of Directors. In this context, policy and work processes have been established with the aim of preventing, as far as possible, the receipt of money undeclared by the customer to the relevant tax authorities in his country of origin.

On 2 August 2014, an amendment to the Prohibition of Money Laundering Order was published in *Reshumot*. When the Order comes into effect, the relevant work procedures in the Bank will be updated accordingly.

In 2014, 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.

### b. Enforcement

In 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, which breaches the relevant provisions.

Further to the law, 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 Securities 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 acts as the officer in charge of enforcement and coordinates the authorities and means to implement the legislative provisions relevant to this area.

On 2 October 2014, the Board of Directors approved the internal enforcement plan, after the plan had been validated by an outside specialist law firm, and after the main enforcement procedures had been reviewed by another outside specialist law firm.

**c. 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. For details, see Chapter, Banking legislation above.

Commencing 30 June 2014, the Bank's FATCA procedure was implemented, reflecting the implementation of the FATCA regulations, with all that it implied from the IGA agreement until the publication of local legislation and defines the work processes for the implementation of the regulations.

As of 31 December 2014, no local legislative provisions had been published. However, pursuant to the directives of the Supervisor of Banks for banks to prepare for the FATCA topic, as a part of the Bank's preparedness for implementing the law in Leumi Group, the Bank has taken steps to circulate procedures and circulars and in assimilating policy regarding the arrangement of the subject of identifying, detecting and dealing with U.S. customers. With effect from 30 June 2014, the Bank's FATCA procedure is being implemented, reflecting the application of the FATCA directives, as far it pertains to the IGA agreement until the publication of local legislation, and specifies the working processes for implementing the regulations.

In order to ensure the compliance of Leumi Group (hereinafter – Leumi) and individuals therein, with the provisions of the FATCA legislation, as adopted by the State of Israel in the inter-governmental agreement, and pursuant to a specific agreement between Leumi Group and the United States Department of Justice, the Bank is taking steps on a number of levels, the most important which are: the appointment of a compliance officer to assume the function of "responsible officer", the adoption of appropriate policy and work procedures, the development of automated tools supporting the working processes, the formulation of training and assimilation, inspection control and operation mechanisms which are required for complying with the directives and instructing the subsidiaries in the Group towards the appropriate preparedness.

**Legal risks**

**Legal risks derive from four main areas:**

- Legislation risks - 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.
- Contractual communication 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.
- Court ruling risks – Risks deriving from the Bank's activity if it does not comply with a precedential court ruling.
- 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 were sent in a consistent format prepared in the Legal Division and updated in 2013. In 2013, the document policy for legal risk management in the overseas units was updated and its assimilation continued in 2014.

**The legal risk management 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 Counsel Division, headed by the Chief Legal Counsel (who is the Legal Risk Officer), 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 balance sheet position, as it appears in Note 16 to the financial statements, is as follows:

| | **As at 31 December 2014** | | | As at 31 December 2013 | | |
|---|---|---|---|---|---|---|
| | Unlinked | CPI-linked | Foreign currency (b) | Unlinked | CPI-linked | Foreign currency (b) |
| | NIS millions | | | | | |
| Total assets (a) | **235,768** | **54,203** | **123,396** | 227,187 | 57,992 | 112,180 |
| Total liabilities (a) | **210,259** | **56,195** | **127,383** | 205,407 | 59,047 | 114,950 |
| Surplus (deficit) of assets in segment | **25,509** | **(1,992)** | **(3,987)** (c) | 21,780 | (1,055) | (2,770)(c) |

(a) Includes future transactions and options.

(b) Includes foreign currency linked.

(c) The excess of liabilities in foreign currency derives mainly from a hedging transaction against the tax exposure in respect of investments in overseas units of the Bank, investment in shares and reserves classified as a noninterest-monetary item, and also in respect of hedging future income in foreign currency.

Day-to-day management and reporting 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 2014, there was a decrease of some NIS 15.6 billion in total deposits from the public (including subordinated notes and capital notes). In total credit to the public, there was an increase of NIS 11.6 billion. Investments in securities and debentures increased by some NIS 12.4 billion, and credit to banks increased by some NIS 15.9 billion.

The main changes that occurred in 2014 in the principal activity divided into linkage segments were as follows:

**The unlinked shekel segment**

The percentage of the financial assets in the unlinked shekel segment to total financial 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 13 billion, some (8.9%).

Total deposits in banks, net, increased by NIS 12 billion, and the total investment in securities decreased by some NIS 15.2 billion.

In 2014, total shekel deposits increased by NIS 11.6 billion, 7.3%. This increase includes the repayment of capital notes and subordinated notes amounting to NIS 2 billion.

Total net balance of derivative transactions in the segment as at 31 December 2014, was some NIS 19 billion, an increase of NIS 4.1 billion compared to December 2013.

**The CPI-linked segment**

In 2014, credit to the public fell by some NIS 2.3 billion, some 4.3%. Total investment in securities fell by NIS 1.1 billion.

Index-linked deposits, including subordinated notes, fell by NIS 3.2 billion.

The net balance of derivative transactions in the segment as at 31 December 2014 amounted to some NIS 2.2 billion, an increase of NIS 0.2 billion compared to December 2013.

**Foreign currency and foreign currency linked segment**

The percentage of financial assets in the foreign currency segment as a percentage of total financial assets is 30%, similar to 2013.

Credit to the public, which constitutes only some 38% of the total deposits of the public in the segment, increased by NIS 1.1 billion, a reduction of 2.7% and after canceling the effect of exchange rate changes. There was no material change in total credit.

Investments in securities in foreign currency amounted to NIS 26 billion, an increase of NIS 3.9 billion in comparison to December 2013.

Deposits in banks, net, increased by some NIS 4 billion.

From the beginning of 2014, total deposits of the public in foreign currency increased by NIS 7.4 billion or 7.3%. The increase derives mainly from the effect of changes in exchange rates.

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.

The balance of future transactions, net, in foreign currency against shekels amounted to some NIS 22.5 billion as of 31 December 2014, a decrease of some NIS 3.3 billion, compared with December 2013.

**B. Repayment periods**

During 2014, 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 raising deposits from a large number of customers for various periods including long-term, and its share of an increase in liquidity surpluses in shekels in the banking system.

Some 26% 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 2014 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 basis of linkage (including derivative instruments and not including non-monetary items)** **(For further information, see Note 17 to the Financial Statements).**

Pursuant to a circular of the Bank of Israel, cash flows in respect of liabilities with a number of repayment dates will be classified according to management's assessment at its discretion or the earliest forecast repayment date.

According to a Bank of Israel circular from September 2013, a banking corporation is required to present the cash flows in respect of assets and liabilities distinguishing between Israeli currency (including Israeli currency linked to foreign currency) and foreign currency. In addition, cash flows in respect of cleared derivative instruments, net, will be classified to Israeli currency or to foreign currency according to the currency in which the clearing was made. Off-balance sheet amounts of these derivative instruments should not be reported.

| | **As at 31 December 2014** | | |
|---|---|---|---|
| Surplus of assets over liabilities* | Israeli currency | Foreign currency | Total |
| Period remaining to maturity: | NIS millions | | |
| Up to 1 month | **(70,498)** | **(37,865)** | **(108,363)** |
| From 1 month to 1 year | **9,990** | **1,555** | **11,345** |
| From 1- 5 years | **50,594** | **14,525** | **65,119** |
| From 5 - 10 years | **25,250** | **8,488** | **33,738** |
| More than 10 years | **38,763** | **8,780** | **47,543** |
| Without maturity date | **1,166** | **548** | **1,714** |
| Total | **55,265** | **(4,169)** | **51,096** |

| | **As at 31 December 2013** | | |
|---|---|---|---|
| Surplus of assets over liabilities* | Israeli currency | Foreign currency | Total |
| Period remaining to maturity: | NIS millions | | |
| Up to 1 month | (78,083) | (36,205) | (114,288) |
| From 1 month to 1 year | 22,649 | 6,695 | 29,344 |
| From 1- 5 years | 39,438 | 22,358 | 61,796 |
| From 5 - 10 years | 27,232 | 5,634 | 32,866 |
| More than 10 years | 39,988 | 2,403 | 42,391 |
| Without maturity date | 724 | (44) | 680 |
| Total | 51,948 | 841 | 52,789 |

* 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" above.

## C. Liquidity Position and Funding

### Liquidity position and raising funds by the Bank

The surplus liquidity of the Israel banking system continued to be high in 2014. In order to absorb the surpluses, each day, week and month, the Bank of Israel holds monetary tenders. This in complementary manner to the short-term loan tenders.

In 2014, the Bank of Israel purchased foreign currency in the amount of US$ 7 billion, of which US$ 3.5 billion was purchased as part of a program to offset the effect of gas royalties on the exchange rate.

The foreign currency purchases have an extensive impact on liquid shekel surpluses in the balance sheet.

The composition 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.

The total balances of the banking system (current accounts and monetary deposits) in the Bank of Israel at the end of December 2014 stood at NIS 146 billion, compared with NIS 127 billion at the end of 2013.

The total balances of Leumi (current accounts and monetary deposits) in the Bank of Israel at the end of December 2014 stood at NIS 39 billion, compared with NIS 27 billion at the end of 2013.

At 31 December 2014, the net balance of cash and deposits with banks amounted to some NIS 48.4 billion, compared with NIS 32.9 billion at the end of 2013, an increase of some 47%.

In addition, the Bank has a securities portfolio of some NIS 44 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 2013 amounting to NIS 57 billion.

During the period under review, the total off-balance sheet monetary assets of the customers increased by NIS 24 billion to NIS 598 billion.

The balance of total deposits of the three largest depositor groups at 31 December 2014 amounted to NIS 22,606 million.

# Legal Proceedings

## 1. Civil Proceedings

**1.1** The Bank is a party to legal proceedings, including petitions for leave to approve derivative claims and petitions 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.

Claims in significant amounts are detailed 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 initiated, *inter alia,* various legal proceedings against debtors and guarantors, as well as 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** In decisions of 1 July 2014 and 24 November 2014, the Tel Aviv District Court approved a compromise arrangement in a request for the approval of a class action which was submitted on 13 July 2011, against Automatic Bank Services Ltd. (hereinafter: "ABS") and against Bank Hapoalim Ltd., the Bank, Bank HaBeinleumi HaRishon Le-Israel Ltd. and Bank Discount Le-Israel Ltd., in a claim, that on withdrawing cash from an automated telling machine operated by ABS, a user is not provided with fair disclosure of the fact that in addition to the commission collected by ABS in respect of the making the withdrawal, the drawer will be charged by the bank a further commission by the bank in which his account is maintained. The amount of the class action is estimated by the petitioners at NIS 153.3 million. According to the compromise agreement, ABS will pay a total of NIS 5.8 million in favor of the public at large. The banks undertook vis-à-vis ABS to participate in the payment of a total of NIS 850 thousand, the Bank's share in the payment being NIS 300 thousand.

1.4 On 23 July 2014, a judgment was handed down by the court, confirming a compromise agreement in a request for approval of a class action which was submitted to the Tel Aviv District Court on 6 May 2008, with a claim that the Bank charges the accounts of customers against which legal proceedings are conducted with legal expenses which have not been approved by the legal system, and collects interest in respect of these expenses at an interest rate which applies in the account and not interest and linkage differences, in accordance with the Interest and Linkage Ruling Law. The compromise agreement provides, *inter alia*, that the Bank would make an initiated amendment of balance of a uniform amount of NIS 2,500 in existing accounts of customers against whom a collection proceeding is being conducted or has been conducted in the past. Customers whose accounts are closed and paid the full amount of their debt to the Bank, without any deletion or forgiveness, will be entitled to apply to the Bank to receive compensation amounting to NIS 2,500, all as set forth in the judgment.

## 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. According to the compromise agreement between the banks and the Antitrust Commissioner, it was agreed that, the ruling will be cancelled and the banks will pay the State Treasury the total of NIS 70 million (the Bank's share is NIS 21 million). The Bank has the option of paying the said amount (and thus also the other banks regarding the amounts relating to them) instead of payment to the Treasury and subject to the conditions stipulated in agreements with the Commissioner, as part of the compromise arrangements in a number of petitions for the approval for class actions pending against the Bank. On 15 June 2014, the Antitrust Court approved the agreements between the parties and gave it the force of an agreed order.

**2.2** 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, which, 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. The appeal was accepted, the case returned to the court of first instance and discussions on the case have begun.

**2.3** On 16 February 2014, a petition was submitted to the Economic Department of the Tel Aviv District Court against the Bank for the disclosure and the review of documents. The petitioner requests the disclosure of various documents relating to the credit allegedly extended by the Bank to Genden Holdings Ltd. ("Genden") in order to finance the purchase of shares of IDB Holdings Ltd. ("IDB"). The disclosure of the documents is requested in light of the petitioner's intention to submit a request for the approval of a derivative action and its claim that, in 2008 and 2009, senior office-holders in the Bank decided, in a way that is contrary to the Bank's interests and out of foreign and wrongful considerations, to permit Genden to have at its disposal dividends that IDB will distribute from that date on, instead of continuing to be received in the Bank for financing the redemption, According to the petitioner, this is a question of a wrongful decision which did not have any economic rationale and as a result of which, the Bank incurred damage amounting hundreds of millions of shekels. It is further alleged that the Bank's auditors were supposed to be aware of the alleged wrongful decision, but were negligent in fulfilling their duty. The Bank has submitted a response, in which it has opposed the petition.

**2.4** On 29 June 2014, a petition was submitted to the Supreme Court, sitting as the High Court of Justice, against the Supervisor of Banks and the Governor of the Bank of Israel, and against four companies from the IDB Group (Tomahawk, Genden Holdings, IDB Holdings, IDB Development), and the banks, Leumi, Poalim, Mizrahi and Discount were also attached as respondents. According to the petitioners, they have applied to the Supervisor several times so that he would examine the conduct of the banking system vis-à-vis the IDB Group, but they allege that they were not answered, and therefore, they are requesting the grant of a conditional order that the Supervisor be instructed to explain why he would not respond to the issue of the petitioners' applications regarding the exercise of his powers in all matters relating to the debt arrangements with the large corporate groups in the economy, in particular, the IDB Group, and why he would not conduct a comprehensive investigation on the matter of the conduct of the banking system in granting credit to the IDB Group, including the granting of securities, guarantees, recycling of loans, decisions of the credit committees and the debt arrangements of the banking system with the group. The petitioners further claimed that the

Supervisor is obliged to draw systematic and personal conclusions from the said investigation, to publish them and take steps according to his power to remedy the deficiencies, including to compel the banks to collect the debts of the IDB Group in their entirety, and to remove those responsible for the deficiencies from their positions.

**2.5** On 1 September 2013, a petition to approve the submission of a derivative claim against former senior officers in the Bank was submitted to the Economic Department of the Tel Aviv District Court. According to the petitioner, as part of the investigations of the tax authorities in the United States, representatives of the Bank and representatives of Bank Leumi USA (hereinafter, "BLUSA") assisted customers who are assessed for tax in the United States to enter into transactions which prevented the tax authorities in the United States from collecting taxes from their citizens. The damage incurred by the Bank, according to the petitioner, stands at hundreds of millions of shekels which the Bank intended to pay to the United States tax authorities, and at this stage, the Bank has put aside the sum of NIS 340 million, with part of the sum paid to advisors and service-providers in connection with the investigations. The petitioner claims that the former officers are responsible for the damage incurred by the Bank when they led it to take part in the illegal activity or at least, did not prevent it. On 6 January 2015, the petitioner submitted an amended request to approve the submission of a derivative action against office holders in the Bank and other corporations under the Bank's control ("Leumi Group") and against the Bank's auditors. According to what is alleged in the amended petition, the damage incurred by Leumi Group due the investigation of the U.S. authorities and arrangements signed with them is NIS 2.1 billion. On 19 February 2015, the Bank submitted a petition to set up a independent special claims committee to review the requirements included in the request for this approval and the request mentioned in 2.7 below, as long as it is not rejected outright, to submit claims against office-holders and the Bank's auditors, and in relation to the legal modus operandi required for the Bank, in view of all of the events that have occurred in connection with the affair concerning its customers who are taxpayers in the United States. On 11 March 2015, the decision of the court was handed down, according to which the court accepted the resolution of the Board of Directors of the Bank to set up an independent claims committee and agreed to the Bank's request to delay the continuation of discussion of the case, for a period of four months from the date of handing the decision (after the resolution of the Board of Directors relating to the committee's findings).

**2.6** On 16 November 2014, an action was submitted to the Economic Department of the Tel Aviv District Court, including a petition for giving various reliefs in connection with the management of contacts vis-à-vis the U.S. authorities and in connection with the engagement in the arrangement with the U.S. authorities, including the avoidance of involvement of certain parties in the contacts, as aforesaid, and the general avoidance of certain provisions in a future agreement with the U.S. authorities. The Bank has submitted a statement of defense, the main point of which is that most of the reliefs requested are already irrelevant, in light of the signing of the arrangements with the U.S. authorities.

**2.7** On 31 December 2014, a petition to approve the submission of a derivative claim against office-holders, both present and past, in the Bank and against the Bank's auditors was submitted to the Economic Department of the Tel Aviv District Court. According to the petitioners, the Bank conducted its business in the United States, both through Bank Leumi USA and through the Bank and its other companies and branches, in way that allowed certain customers of the Bank to conceal monies which had not been reported to the tax authorities in the United States. The petitioners allege that, as a result of investigations conducted by the authorities in the United States in relation to this activity, the Bank incurred damage amounting to NIS 2.37 billion, which is comprised of a penalty and monetary sanction that the Bank is compelled to pay pursuant to arrangements with those authorities, non-recognition of expenses for tax purposes and the costs of the investigation themselves. The petitioners allege that the office-holders are responsible for the damage claimed as a result of the fact that they did not act and failed to do anything to discontinue the wrongful actions and due to the grant of a permit and consent to commit them. It is further claimed that the Bank's auditors could have and should have disclosed the actions or, at least, posed the appropriate questions. The petitioners set the alleged amount of the claim at NIS 1.56 billion, this, from the considerations of fee and the extent of the insurance of the office-holders, except in relation to five former office-holders who are respondents to the approval of another derivative action in relation to the same compromise, in respect of which a derivative claim amounting to NIS 1.220 billion is requested, and this, according to the petitioners, as far as this latter petition will be approved.

**2.8** On 3 March 2015, a petition for a derivative claim on behalf of the Bank and BLUSA was submitted to the New York State Court in the United States by a shareholder in the Bank who is not an Israeli resident against subsidiaries of the Bank and against six directors and officers who, in the past, served and some of who are still serving, in the Bank and subsidiaries of the Bank. The grounds of the claim are the alleged responsibility of the respondents for amounts which the Bank and its subsidiaries have borne as a result of the arrangements signed with U.S. authorities.

**2.9** The Bank has received various applications from shareholders in the Bank, or from persons acting on their behalf, in connection with events which are the subject of the arrangement with the U.S. authorities. The applications including various demands, including, *inter alia*, a demand for a recalculation of the Banks operating results in the relevant years for the arrangements and the submission of a claim against office holders in the Bank for the recovery of bonuses received in those years.

**2.10** On 11 January, 2015, the Ministry of Justice published a notice, according to which the Attorney-General orders a comprehensive review of the Bank's arrangements with the U.S. authorities, and also ordered a combined team to be set up, comprising enforcement and consultative bodies for a thorough examination. The team will present its conclusions to the Attorney-General to consider the matters. On 15 January 2015, the Governess of the Bank of Israel published that the Banking Supervision Department is currently undertaking an examination of the aspects of proper conduct of banking management, as well as aspects of the personal responsibility of employees and office-holders in the matter.

**Arrangement with the U.S. authorities**

In 2011, the Bank was informed that an investigation was being carried out against the Bank Leumi Group by the U.S. Department of Justice (DOJ) in connection with the Group's activity with customers who are taxpayers in the United States (hereinafter: "the U.S. customers") of a suspected breach of Federal law in the United States. As part of the investigation, various orders were issued against the Group to obtain information and documents regarding the U.S. customers. Customers and former employees of banks in the Group were summoned to give testimony and documents in connection with the U.S. customers and banking services provided to them by the Group. The Group cooperated with the U.S. authorities in furnishing information and in the required procedural proceedings, according to that permitted under the law. As a part of this cooperation, and in accordance with DOJ directives, an independent and comprehensive examination of the Group's activity vis-à-vis the U.S. customers was carried out by an international firm of accountants.

In 2014, the Bank was informed that, in addition to the aforesaid investigation, the Securities & Exchange Commission (SEC) also opened an investigation of a suspected breach by the Group of the securities laws in the United States, and an additional investigation was opened by the New York Department of Financial Services (NYDFS) in connection with the Group's activity regarding the U.S. customers.

As a result of the opening of the abovementioned investigations, the Bank included an expense of NIS 396 million in its 2012 financial statements in respect of the expense that was likely to be incurred by the Group as a result of the ongoing investigations by the U.S. authorities regarding the U.S. customers, including the expenses of external consultants and service-providers in connection with the execution of the investigations. The 2013 financial statements included an additional expense of about NIS 236 million and the 2014 financial statements included an expense of some NIS 1,026 million. In total, the Bank included an aggregate of NIS 1,658 million in its financial statements in respect of the aforesaid.

On 22 December 2014, Leumi Group signed arrangements with the DOJ and the DFS, pursuant to which it admitted, inter alia, that from 2000 and until 2010, the Group had willingly assisted in the preparation and submission of false tax returns to the U.S. tax authorities (hereinafter: **"the arrangements"**).

The arrangement with the DOJ was approved by the California Federal Court on 23 December 2014. The arrangement with the DOJ is a deferred prosecution agreement (hereinafter, "DPA"). The arrangement is between the Bank, Bank Leumi Le-Israel Trust Company Ltd, Bank Leumi (Luxembourg) S.A. (Leumi Luxembourg), Leumi Private Bank Ltd. (under its former name of Bank Leumi Switzerland) (hereinafter, "Leumi Switzerland") and Bank Leumi United States (hereinafter, "BLUSA") (all together for the sake of brevity, to be called: "Leumi Group") on the first part, and the United States Department of Justice (hereinafter, "the DOJ") of the second part. Pursuant to the DPA, Leumi Group confirmed that it had willingly assisted U.S. taxpayers who were customers of the Bank in the preparation and submission of false tax returns to the U.S. tax authorities, thereby violating U.S. tax law. Pursuant to the provisions of the DPA, Leumi Group paid an aggregate amount of US$ 270 million, as follows: (a) US$ 71,769,305 as a recovery of unpaid taxes by U.S. customers in respect of interest, dividends and capital gains in relation to the relevant accounts as defined in the agreement, with the recovery amount exceeding the profits earned by Leumi Group in respect of the relevant accts; (b) US$ 157,000,000 as a recovery for Bank Leumi Switzerland in respect of accounts that were maintained with it, this, on the basis of the "Swiss formula"; and (c) a monetary penalty amounting to US$ 41,230,695, in relation to Leumi Group. As part of the DPA, Leumi Group agreed that if it does not meet its obligations according to the DPA within two years of its signing, an indictment will be filed against it. The wording of the indictment was attached to the DPA. Also attached to the DPA was an appendix agreed by Leumi Group of a Statement of Facts. The agreed facts include, *inter alia*: travel by banking officials to the United States through April 2009; the extension of loans by Leumi USA which were collected under a bank guarantee issued by the Bank, Leumi Luxembourg or Leumi Switzerland and secured by deposits which existed in those banks; the provision of services and the maintenance of Hold Mail accounts with a code number, and offshore companies and accounts in trust companies; and the receipt of deposits of U.S. customers who had left Swiss banks in 2009. In addition, in May 2008, when the DOJ's investigation against UBS became public, a number of senior managers in the Bank viewed the exit of UBS Bank from the U.S. international banking business as a golden opportunity to make contact with customers, and they urged bank officials to suggest that they transfer their accounts to the Bank. Pursuant to the DPA, it was agreed that Leumi Group and its employees will be prohibited from making, in a court proceeding or in any other setting, declarations which are contrary to that stated in the agreement or in the "statement of facts". However, it was clarified in the agreement that, the aforesaid undertaking will not restrict an employee or a former employee of Leumi Group or any other entity from making declarations as part of court proceedings (an investigation or a criminal, administrative or civil proceeding) that may be held in the United States or in another country, providing that the employee or former employee is not authorized to make statements on behalf of any of the companies of Leumi Group. Pursuant to the DPA, the U.S. government undertook, subject to Leumi Group's compliance with its obligations under the DPA, not to open investigations or submit further indictments against Leumi Group in relation to the actions which are the subject of the agreement. The DPA does not preclude the submission of civil actions by the United States government against Leumi Group (including in respect of tax indebtedness of Leumi Group in respect of activity which is the subject of the agreement); does not regulate the investigations by other authorities in connection with the activity of Leumi Group vis-à-vis U.S. customers; and does not restrict the United States government from submitting indictments against any person or entity, including officers and employees of Leumi Group.

Pursuant to the DPA agreement, inter alia, Leumi Group undertook, with regard to the following conditions: (a) Leumi Switzerland and Leumi Luxembourg will cease absolutely the provision of banking services to U.S. customers ("the exit plan"), within two years from the date of approval of the DPA by the Federal Court. The Bank will forward to the DOJ, bi-monthly reports regarding the compliance of Leumi Switzerland and Leumi Luxembourg with the "exit plan", commencing two months after the date of court approval; (b) The development and implementation of an effective program to guarantee compliance with the provisions of FATCA in the Bank and in all of its subsidiaries, while assimilating internal controls for the prevention of potential breaches (hereinafter – "the compliance with FATCA plan"); (c) The entry of the Bank and its subsidiaries (except for Leumi USA and as required by the FATCA regulations) into the Foreign Financial Institution (FFI) Agreement or Inter-governmental Agreement (IGA) for the implementation of FATCA; (d) The Bank will ensure that compliance with FATCA will include, inter alia: Appointing a global manager for the subject of cross-border activity, who will report to the Chief Risk Officer or Deputy President and CEO. The Cross Border Activity Manager should periodically report to the Audit Committee of the Leumi Israel Board of Directors on the subject of FATCA. (e) Continuing the employment of a designated coordinator for FATCA matters in the Bank, who will report to the Bank's Chief Compliance Officer; (f) Appointing compliance officers for FATCA in the Bank's offices –The compliance officers for FATCA will report to the compliance officers in each office and those, will report directly to the Risk Management Committee of the Board of Directors. On the basis of the abovementioned reports, the Board of Directors will forward, in each office, a status report in relation to compliance with FATCA in each place to the Board of Directors of the Bank; (g) Continuing development and assimilation of: effective controls intended to identify and prevent material breaches of compliance by Leumi Group of FATCA; an employee training program relating to the FATCA regulations and policy and procedures related to the receipt and examination of claims in relation to material failures in internal control on the matter of FATCA; (h) Implementing an updated corporate governance structure, pursuant to which the Chief Compliance Officer will have administrative responsibility for the functioning of the compliance units in all of the lines of business (including private banking) and joint administrative authority (with the direct managers) in relation to those units. In addition, the Chief Risk Officer will have powers to locate relevant topics at the Leumi Group level and to decide on matters of advancement and remuneration of compliance employees, at the level of each division; (i) Closing all of the accounts of recalcitrant customers in Leumi Group, as defined in the FATCA regulations, and determining and applying procedures for preventing assistance on the part of the employees of the group, to recalcitrant customers, in the processes for closing accounts or transferring their assets; (j) Opening new accounts for U.S. customers only on condition that it is assured that they are declared and they will be available for reporting to the U.S. authorities; (k) Furnishing periodic reports of BLUSA in relation to loans which were extended by it and which are secured in SBLC on behalf of the Bank's offices outside the United States. The reports should include confirmation that BLUSA fully complies with the Prohibition of Money Laundering Regulations connected to these loans and that the relevant office has confirmed that the account extending the guarantee in the office complies with the conditions of FATCA. The first report is to be furnished two months following the date of approving the agreement and thereafter, every 180 days, until two years from the date of approving the agreement; (l) In addition, Leumi Group committed to cooperate fully with the U.S. authorities in the future including the retention of documents relating to the activities which are the subject of the DPA and their submission to the authorities, their translation and submission of information regarding some 1,500 customer accounts of the Bank and the Trust Company, pursuant to appropriate judicial orders.

In accordance with a consent order with the New York State Department of Financial Services (hereinafter: "NYDFS", and "the consent order", respectively), Leumi Group paid DFS a civil monetary penalty amounting to US$ 130 million. The consent order includes a list of facts, similar in nature to those set forth in the declaration of facts which represent an appendix to the DPA, for example: travel for banking purposes to the United States through April 2009; the extension of loans by BLUSA which were collected under a bank guarantee issued by the Bank, Leumi Luxembourg or Leumi Switzerland and secured by deposits which existed in those banks with the names of the U.S. customers not appearing on the correspondence related that activity; the provision of services and the maintenance of numbered Holdmail accounts, code and offshore companies and accounts in trust companies, while collecting commissions in respect of the aforesaid activity. In addition, in May 2008, when the DOJ's investigation against UBS became public, a number of senior managers in the Bank viewed the exit of UBS Bank from the U.S. international banking business as a golden opportunity to make contact with customers, and they urged bank officials to suggest that those customers transfer their accounts to the Bank. In addition, in October 2008, a version of an injunction issued by the U.S. authorities to Bank Mizrahi Tefahot reached managers in BLUSA. Nevertheless, Bank Leumi USA continued to extend SBLC loans, including to past customers of Bank Mizrahi, without checking or leaving records in relation to the securities. The number of senior officials operations, compliance and employees in Leumi Group's legal team knew of the improper conduct and despite this, instead of reporting it, actively supported it.

According to the agreement with the NYDFS, the Bank is obliged to comply with the following conditions: (a) Taking disciplinary steps against certain employees; (b) The compliance officer of BLUSA in the relevant period will not fulfill any position related to compliance; (c) Terminating the employment, subject to Israeli law, of an employee who held a central position in the activity outlined above, who was area manager in the relevant period; (d) In addition, the Bank confirmed that two other employees in key positions in the activity outlined above resigned from the Bank as a result of the investigation carried out by the NYDFS; (e) Appointing an independent monitor in BLUSA for a year, to be selected by the NYDFS, whose function is to examine the Bank's compliance program, including the policy and working processes in this context, in order to ensure their compliance with the requirements of the laws of the United States and the State of New York. Within this framework, the monitor is obliged to examine and report, at least, on the following subjects: (i) the Bank's corporate governance foundations and the involvement of the Bank's employees, including office-holders and Bank employees, past and present, in the violations outlined in the consent arrangement; (ii) the efficiency and effectiveness of the Bank's efforts to remedy the inappropriate behavior in the consent arrangement; (iii) an improvement in the Bank's compliance and reporting programs and plans which will assist the Bank in meeting the requirements of the laws of the United States and the State of New York in the future, and which will secure the Bank's security and strength; (f) The Bank and its management will cooperate fully with the monitor and will assist him, *inter alia*, by allowing access to the relevant Bank employees, files, reports and evidence, whether they are situated in New York, Israel or any other place; (g) Any dispute as regards the extent of authority of the monitor will be settled by the NYDFS after consultation with the Bank and with the monitor; (h) After three months, the monitor is to submit an interim report to the NYDFS and to the Bank, detailing his work and conclusions up to the date of preparing the report. In addition, the monitor is to submit reports to NYDFS and to the Bank at the time intervals to be decided by the NYDFS; (i) After a year, the monitor is to submit the final report, which will include suggestions for improving the Bank's compliance programs in all matters related to the Laws of the USA and New York; (j) Within thirty days from the date of receiving the final report, the Bank is to furnish the NYDFS with a written program for improving its compliance programs in connection with the laws of the USA and

New York. The program should outline the method of implementing the monitor's recommendations or include an explanation of why the recommendations of the monitor have not been implemented.

In order to comply with the provisions of the arrangements as aforesaid, the Bank has appointed a special steering committee which supervises the fulfillment of the Bank's and the offices' undertakings according to the arrangements and submits regular reports thereon to the Bank's management and Board of Directors.

In addition, the Bank has adopted a number of measures which are intended to prevent a breach of the provisions of a foreign law. Pursuant thereto, the Bank has closed almost all of the representative offices which operated abroad and entered into an agreement to dispose of the activity of Leumi Switzerland. Furthermore, during the period, the Bank continued the assimilation of a declared money policy and procedures relating to the limits and rules in connection with the cross-border activity.

As a result of the investigations, a numbers of actions have been served against the Bank and office-holders who served and who are serving in the Bank.

On 15 February 2015, the Board of Directors decided to establish an independent claims committee in order to make recommendations to the Board of Directors of the Bank on the correct legal course of action for the Bank, in view of all of the circumstances and proceedings relating to the events that led to the Bank's undertaking in arrangements with the U.S. authorities, including to examine (a)whether to serve, and in whose name, one or more monetary claims against any office-holder and/or employee, past or present in the Bank Group, in respect of damages caused to the Bank because of the events which are the subject of the arrangements; (b) whether to work towards one or more of the arrangements in the context of legal proceedings which are pending in connection with U.S. customers, and, if so, in whose name and under what conditions; (c) whether to serve, and in whose name, one or more monetary claims against any office-holder and/or employees, past or present, in the Bank Group, for the return of bonuses on the basis of profits which the corporations of the Bank generated over the years from the customers in relation to whom the Bank has arrived at arrangements with the U.S. authorities.

On 11 March 2015, the Tel-Aviv District Court approved the establishment of the independent claims committee and postponed proceedings in the action for four months, in order to enable the committee to complete its work.

As of the date of the Report, to the best of the Bank's knowledge, further examinations on the aforesaid events are being were carried out by the Supervisor of Banks and by the committee that was appointed by the Attorney-General.

As a result of the investigations against the Group, and against the background of the trends outlined in the section "Compliance Risk" in the Chapter on "Exposure to Risks and Methods of Risk Management" above, Leumi Group has taken steps in recent years on a number of planes to minimize the exposures related to customers who are resident abroad. As part of this, the following measures, *inter alia*, have been adopted:

a. All of the private U.S. customers have been contacted in order to obtain their signature on W9 forms, testifying to the fact that they duly declare their funds to the U.S. authorities, and the Bank has taken steps to close the accounts of customers who have not complied with these requirements.

b. The Bank has made preparations to comply with the FATCA principles and the Intergovernmental Agreement (IGA) to guarantee compliance with the U.S. requirements. For further details on these matters, see the Chapter on "Compliance Risk Management" below.

c. The Group has made a decision to exit the overseas units and representative offices which engage in private banking, including closing the large majority of the Bank's representative offices abroad. As part of the process, the Group sold the activity of the Bank's office in Switzerland, and a decision has been made to sell or close the Bank's office in Luxembourg.

d. The Bank has adopted a "declared money" policy which aims to ensure, on the basis of risk indicators, that new foreign resident customers and new funds that are transferred to the Bank from various countries, are declared by the customers in their native countries. In addition, under the said policy, a risk-oriented outline was defined for the handling of longstanding customers of the Bank, in order to obtain details regarding the fact that their funds are declared or are in the process of declaration. This process is complex and may take a long time. The implementation of the said treatment is adapted to regulatory processes defined worldwide to address this subject, particularly the "Automatic exchange of information" agreement of the OECD, which the Finance Ministry in Israel announced that it is joining.

The Bank estimates that, as a result of the above actions, particularly due to the adoption of the "declared money" policy, the Bank's customers, mostly, foreign residents, withdrew monies from the Bank and closed accounts. The Bank's estimate for the amounts withdrawn as a result of the introduction of the declared money policy, since 2011 to immediately prior to the end of the reporting period totals an amount exceeding US$ 3 billion.

## Restrictions on 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 ("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 S.A. 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 above in the chapter, "Business Description of Leumi Group and their Economic Development".

## Material Agreements

**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 2011 onwards.

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 which 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.

**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 and a follow-up letter from the Tax Authority dated 29 June 2014, in connection with an offset in respect of the profits of foreign subsidiaries.

For further details, see Note 26I to the financial statements.

**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.

In December 2013, Union Bank announced that, pursuant to its right according to the agreement, it was postponing the commencement of the project of terminating the engagement with the Bank (as this term is defined in the agreement), such that it will begin at the end of the period of the agreement (31 December 2016). This postponement does not constitute a determination in relation to the question of renewing the agreement between the parties.

On 12 February 2015, the Antitrust Commissioner extended the exemption from the approval of a restrictive arrangement between the Bank and Union Bank, on the matter of computer and operating services, until 31 December 2016, in accordance with the conditions stipulated therein.

**5.** Pursuant to a decision of the Government, it was decided to establish a Government Interior Fund as part of the Tax Authority (hereinafter – the Fund), which will undertake to pay a banking corporation an amount amounting to the VAT component, out of the sum paid by the banking corporation to the purchaser of an apartment, due to the forfeiture of a bank guarantee made by the banking corporation to that purchaser pursuant to the Sale Law (Apartments) (Guarantee of Investments of Purchasers of Apartments), 1974. The terms of the Fund's undertaking to pay the VAT component are set forth in the liability note signed by representatives of the Tax Authority and the Accountant-General, together with the approval of the banking corporation wishing to join the arrangement.

Bank Leumi Le-Israel intends to join in the agreement and sign the liability note, in accordance with the state of the housing market in Israel and the matching needs of the Bank.

**6.** On 21 January 2015, the Bank announced that the Bank management and the Bank employees' organization had reached agreements with regard to a special collective agreement (hereinafter, "the collective agreement"), and these were approved by the Bank's Board of Directors and by the Employees' Council.

For further information regarding the special collective agreement, see Note 15 in the financial statements below.

**7.** Cooperation arrangement with Julius Baer Bank and the sale of operations in Switzerland.

According to the cooperation arrangement, Leumi Group will refer existing and future customers who have a need for private banking in Europe to Julius Baer, and at the same time, the Julius Baer group will refer existing and future customers who have banking requirements in Israel to Leumi.

In addition, in the context of the cooperation, the office in Switzerland, Leumi Private Bank, will sell its assets as defined in the agreement to Julius Baer, for consideration of CHF 10 million, in excess of the net value of the assets transferred, subject to adjustments. At the same time as the completion of the transaction and in coordination with the relevant authorities, Leumi Private Bank will take steps to close its banking activity, and to allocate its shareholders' equity as a dividend to the Bank.

The agreement between Leumi Private Bank and Julius Baer includes an undertaking for various indemnities, most for a period of two years from the date of transferring the assets transferred, and five years on certain grounds, chief of which are fines or settlement amounts imposed on Julius Baer by a any government authority and/or in respect of reasonable costs and expenses which Julius Baer will bear in connection with a claim or investigation by any government authority in connection with businesses transferred to it from Leumi Provision Bank and arising before the date of the transfer. The amount of indemnity is limited to the amount derived from the shareholders' equity of the units in Switzerland and Luxembourg, as at 31 March 2014 (around CHF 250 million). The undertaking for indemnification is backed by a guarantee of the Bank for the event that Leumi Private is unable to fulfill the indemnity undertaking.

According to the Bank's assessment, the transaction will not have a significant impact on the Group's operating results and financial position.

**8**. The Bank has provided office-holders and others with letters of indemnification. For details, see Note 18G 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 or the tax indebtedness in Israel, whichever is lower. According to a letter further to the arrangement, dated 29 June 2014, the Bank may offset an amount of up to US$ 54 million with effect from tax year 2011, but no more than US$ 3 million a year or the tax liability in Israel, whichever is lower. If an amount of less than US$ 3 million is offset in a particular year, it will be possible to transfer the difference between the amount offset and US$ 3 million and to offset it in future years, such that the amount of the offset in the year will be up to US$ 5 million or the tax indebtedness in Israel, whichever is lower. The amounts that have not yet been offset from the tax indebtedness and in respect of which the future tax saving as of as of 31 December 2014 have not been included total US$ 45 million. The utilization of these amounts in the future will be permitted, if the overall tax rate on the income of the Bank in Israel is higher than the tax rate applicable in overseas subsidiaries.

**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 is not in accordance 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 coordination with the tax authorities, the Bank operates on the basis of the draft proposed law, and the tax provisions were made accordingly.

**3.** The profits tax and payroll tax imposed on financial institutions is 18% with effect from 2 June 2013.

The companies tax rate is 26.5% with effect from 1 January 2014 (2013 – 25%).

The statutory rate of tax which is applicable to financial institutions in 2014 and onwards is 37.71% (2013 – 36.21%).

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 economy increased from 5.9% to 6.5%. In addition, it was provided that this rate would increase in January 2014 and January 2015 to 7% and 7.5%, respectively. However, on 27 January 2014, the Reliefs in the Capital Market and Encouragement of Activity Therein Law (Legislative Amendments), 2014, was published, according to which the rate of insurance fees collected from employers in respect of the part of the salary exceeding 60% of the average salary in the economy would be updated in January 2014, January 2015 and January 2016 to 6.75%, 7.25% and 7.5%, respectively.

The current 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 2014 were calculated at the tax rate as determined in the laws referred to above, at the tax rates at the expected date of reversal.

For further details regarding the policy for recording deferred taxes in the Bank, see Note 1S to the financial statements.

**4**. The Bank and the principal consolidated companies have received final assessments up to and including the 2010 tax year.

Further details regarding the tax provision of the Bank and its subsidiaries, final assessments, carryforward tax losses and differences between the statutory tax rate and the effective tax rate, see Note 26 to the financial statements.

## Human Resources

### Number of Personnel

In 2014, the number of positions in the Group decreased by 314 a fall of some 2.4% in relation to the number of positions in 2013. With regard to the average for the year, the number of positions in the Group fell by 308, a fall of 2.3% in relation to the average for 2013. The number of specific positions at the end of 2014 reflects a decrease of 1,001 positions in the space of three years.

The fall in the number of positions derives from a reduction in the workforce in the Bank as part of the streamlining procedures which included structural changes in the activity of the branches and offices, a campaign of early retirement, natural retirement and streamlining measures carried out in the subsidiaries in Israel and abroad.

| | Positions at year end | | Average positions during the year | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| The Bank in Israel | **9,561** | 9,785 | **9,799** | 10,088 |
| Consolidated subsidiaries in Israel | **2,018** | 2,038 | **2,047** | 2,023 |
| Total of the Group in Israel | **11,579** | 11,823 | **11,846** | 12,111 |
| Overseas: Bank branches and representative offices | **6** | 45 | **19** | 47 |
| Consolidated subsidiaries | **1,105** | 1,136 | **1,134** | 1,149 |
| Group total in Israel and overseas | **12,690** | 13,004 | **12,999** | 13,307 |

* Position – means a full time position including specific overtime, working hours of employees from temporary employment agencies and employment of external consultants.

### Streamlining program and early retirement

At the beginning of 2012, it was decided to embark on a streamlining program in the Bank affecting 800 positions over a period of three years until the end of 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; which included, *inter alia*, the merger of Leumi Mortgage Bank, the merger of the Corporate Division and the Commercial Division, the split of the Private and International Banking Division and the streamlining in the Private Banking Department. The preliminary program was originally based on 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.

During 2012, with progress in the streamlining process, it was decided to change the quality mix of the workforce in the streamlining program and direct efforts towards the early retirement of veteran employees. In view of this, a provision of NIS 323 million was made for financing early retirement. With the progress of the early retirement program and the acceleration of the rate of retirements, it was decided to increase the original streamlining target from 800 positions to 1,000, and consequently, an additional sum of NIS 75 million was provided in the last quarter of 2013 to finance the additional retirement.

During 2014, the streamlining measures and process of early retirement continued. In 2012-2014, 670 employees signed for early retirement, most as part of structural change.

### Natural retirement

During 2014, around 119 employees left the Bank by natural retirement.

Over the coming decade, around 2,150 employees are expected to leave by natural retirement, of which 80 employees, in 2015.

### 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

On 21 January 2015, the Bank announced that the Bank management and the Bank employees' organization had reached agreements with regard to a special collective agreement (hereinafter, "the collective agreement"), and these were approved by the Bank's Board of Directors and by the Employees' Council.

For further information regarding the special collective agreement, see Note 15 in the financial statements below.

For details in connection with the remuneration of senior officeholders, see chapter, "Remuneration of Senior Officeholders"

### Labor and Salary Costs (in the Bank)

| | **2014** | 2013 ** | 2012 |
|---|---|---|---|
| | NIS thousands | | |
| Cost per employee position (excluding bonus)* | **344.0** | 339.2 | 330.3 |
| Cost per employee position (including bonus)* | **344.2** | 368.0 | 331.2 |
| Salary per employee position (excluding bonus)* | **225.1** | 222.4 | 219.6 |
| Salary per employee position (including bonus)* | **225.3** | 245.4 | 220.2 |

* Cost per employee position does not include pension expenses, costs of voluntary retirement, retro-severance pay and shares to employees.

** In 2013, the data include the effect of the cost of employees from the Mortgage Department which was merged with the Bank.

### 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 47,144 training days during 2014.

Training activities in 2014 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.

In 2014, a sales and service-focused training tool, representing a platform for improving skills with was built at the state-of-the-art "Simulator" Training Center. As a part of this arrangement, bank officials have attended seminars on sales-focused training.

### Digital learning

The main aim of the digital learning is the maintenance of the high level of skill of employees at low cost. In 2014, the trend of intensifying digital learning in Leumi as a part of the learning culture in the organization continued. In 2014, employees learnt 8 regulations, participated in almost 20,000 hours of learning by video and many systems underwent remote assimilation.

This year saw the opening of a training center in improving the learning experience in classes using innovative digital means, making use of the Internet, cellular devices and tablets. These means encourage employee involvement in the learning, competition, brainstorming, discussion, return and processing of the study material, and thus considerable improve the effectiveness of the learning.

**Knowledge management**

In 2014, the concept of business-supportive knowledge management was formulated and implemented. Within this framework, a number of activities were carried out which were intended to improve the accessibility of application-supportive know-how for employees in real time. During the year, a broad-based process of transferring the knowledge management to the Share Point system was concluded. Pursuant to this, 130 sites were established and 4 knowledge administrations on the topics of the balance sheet, FATCA, 360 and faxes to the Center of Expertise were set up. In addition, knowledge retention processes were carried out for employees before retirement and for unique areas of know-how in Leumi, including international trade, sub-custody and development of technological systems in Leumi.

**Management development**

In 2014, the concept of "corporate leadership" was formulated and a process was begun for refreshing and redefining the model, content and processes of management training, and adapting them to meet the needs of the managers deriving from new management and leadership challenges. An innovative program was developed for developing "corporate leadership" for the forum of branch managers and section heads, which will get underway during 2015. The program which places an emphasis on effective management habits was launched and replaced the 9-10 grade course. In 2014, most managers participated in one of the following frameworks: management courses for a grade, professional courses, business-support activities, branch managers' club, skill development programs and training at various levels. 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 68.5% of all employees at the end of 2014, compared with 66.4% in 2013 and 64.6% in 2012. The percentage of graduates among the managerial staff reached 95.3% in 2015, in comparison with 94.4% in 2013 and 93.4% in 2012.

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.

**Age and number of years of experience in the Bank**

The average age of Bank's employees in the Bank at the end of 2014 was 44.1 years, compared to 44.5 years in 2013 and 45.2 in 2012. The average number of years' experience of persons employed in the Bank at the end of 2014 was 17.9 year, compared with 18.3 in 2013 and 19.2 in 2012.

The fall in the average age and in the average number of years of experience in the Bank among employees in 2014 is mainly due to retirement of veteran employees and the absorption of younger 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 "Leumi Way" Code of Ethics.

In 2013, a process of examination and strategic thinking was carried out in the Bank management, and consequently, the Group's vision was crystallized, core values and strategic goals were examined and reformulated and the ethical code was updated.

The new vision is "*Leading proactive and innovative banking for the customer*" and the new core values are: "*The customers are the core activity. Yes, we can - collaboration, personal example and excellence*!"

In 2014, the vision and new core values were launched in processes throughout the Bank as part of the divisional work program seminars and the balance sheet conference and were assimilated through Bank-wide processes led by the heads of the divisions and departments. At the same time, they continue to operate the ethical institutions: the Ethics Officer, the Ethics Centre, the Inter-divisional Ethics Committee and Divisional Ethics Committee.

In addition, the subject will continue to be examined within the framework of the SOX and Ma'ala's rating and will be a part of Leumi's Corporate Responsibility Report.

**Employee involvement in the community**

Leumi management views the involvement of its employees and managers in the community as a central goal of the Bank 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 2014, some 5,051 employees – from various units within the Bank - engaged in voluntary activity. The total hours of volunteer work by employees from which the community benefited in 2014 was 37,213.

The activities of the unit are based on a network of social leaders in all the divisions and departments of the Bank, numbering some 360 employees representing the various units of the Bank. Their purpose is to promote the subject of voluntary work among employees in their unit, while building an activity-supporting infrastructure and the management of an employee involvement section in the Human Resources Division.

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 impact 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 and accompanying youth groups, 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. In 2014, a food distribution campaign for needy families took place marking the Ramadan festival.

Alongside these many activities, the Bank chose to link with Leumi's vision of strengthening the future generation, through strategic programs, strengthening the connection with associations supported by the "Leumi Tomorrow" organization with various projects, such as "Youth Leading Change". In addition, it is taking part in activity in cooperation with associations, such as "Pa'amonim", "Late Lesson", and more. In the involvement of Leumi employees in the community and the various interfaces with children and youth, care is taken with regard to the contents, including enrichment, the assimilation of values and, gradually, the financial education matching the Bank's core business.

**Positions according to operating segments:**

| | **Average positions in 2014** | | Average positions in 2013 | |
|---|---|---|---|---|
| | Managerial Staff | Clerical Staff | Managerial Staff | Clerical Staff |
| Households | **1,374** | **5,411** | 1,450 | 5,557 |
| Small businesses | **479** | **1,506** | 476 | 1,446 |
| Corporate banking | **407** | **547** | 429 | 605 |
| Commercial banking | **716** | **1,038** | 769 | 1,075 |
| Private banking | **424** | **374** | 419 | 387 |
| Financial management – capital market | **343** | **367** | 313 | 369 |
| Other | **3** | **10** | 3 | 9 |
| Total | **3,746** | **9,253** | 3,859 | 9,448 |

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 operating segments, employees of head office units, who serve all or part of the operating segments of the Bank, have also been taken into account.

## Appointments and Retirements

**Appointments:**

**Mr. Yaakov Haber**, a member of Bank management and Head of the Corporate Division was appointed to the post of Head of the Corporate and Commercial Division, with effect from 1 January 2014.

**Mr. Joel Mintz**, a member of the Bank management and Head of the Structured Finance and Real Estate Division, was appointed Head of the International Credit and Real Estate, with effect from 1 January 2014.

**Mr. Hanan Friedman** was appointed Head of the Legal Division, Chief Legal Counsel and member of Bank management, with effect from 1 September 2014. On 20 August 2014, following the receipt of approval from the Remuneration Committee, the Board of Directors approved the payment of a one-time signing-on bonus to Mr. Friedman, pursuant to the Bank's remuneration policy, which will be granted in his first year of office.

**Mr. Shmuel Arbel** was appointed to the post of Head of the Commercial Department with effect from 1 January 2014.

**Mr. Shaul Schneider** was appointed to the post of Head of the Private Banking Department with effect from 1 February 2014.

**Mr. Zeev Morag** was appointed to the post of Head of the Compliance and Enforcement Department and promoted to the rank of Deputy Vice-President with effect from 1 March 2014.

**Mr. Eli Katsav** was appointed to the post of CEO of Bank Leumi UK, with effect from 1 August 2014.

**Retirements:**

**Mr. Gideon Altman**, a member of Bank management, ceased to serve as Head of the Commercial Banking Division and retired on 31 August 2014, after 35 years employment with the Bank.

**Ms. Nomi Sandhaus**, a member of Bank management, ceased to serve as Chief Legal Counsel and as Head of the Legal Division, and retired on 30 December 2014 after 32 years employment with the Bank.

**Ms. Nitza Russo-Shtauber** ceased to serve as Head of Private Banking on 31 January 2014, and retired after 13 years employment with the Bank.

**Mr. Yitzhak Eyal** ceased to serve as the Chief Executive Officer of Leumi USA and retired on 2 June 2014, after 39 years of employment in the Leumi Group.

**Mr. Aviram Cohen** ceased to serve as Head of the Marketing, Advertising and Spokesperson's Department and retired on 21 August 2014, after nine years of employment with the Bank.

**Ms. Meira Karni** ceased to serve as Head of Compliance and Enforcement, and retired on 30 December 2014, after 32 years employment with the Bank.

**Mr. Malkiel Shahar** ceased to serve as Head of Credit Risks, and will retire on 30 December 2014, after 42 years employment with the Bank

**Mr. Shlomo Pergament** ceased to serve as Deputy Head of Leumi Technologies and retired on 6 November 2014, after 36 years employment with the Bank.

**Mr. Larry Weiss** ceased to serve as Chief Executive Officer of Bank Leumi UK, on 31 July 2014.

# 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 four 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 four lines of business:**

**1.** The **Banking Division** manages the activity of the private and small business customers, who receive the full range of services through 200 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 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 department operates through 110 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 report to the department's management. The department operates a business center which coordinates activity in the area of credit, underwriting and the transfer of loan funds to customers. The department 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.

The **Private Banking Department** is responsible for private banking activity in Israel and around the world. The department has 6 private banking centers in Israel for Israeli residents and foreign residents. In January 2015, an organizational change was made, in the course of which the Private Banking Department was transferred to the responsibility of the Banking Division.

**2**. The **Corporate and Commercial Division** includes two departments, the Business Department and the Commercial Department (as detailed below), the Tel Aviv Central branch and head office units providing service to the whole Corporate and Commercial Division and the International Credit and Real Estate Division. The division is also 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, international trade and finance.

The **Corporate Department** manages the banking activity of the large business companies in the economy on the basis of sector expertise and synergy between industries. The department includes four business sectors: a technology and tourism sector, a sector for chemicals, energy, holding companies and public institutions, a consumption and trade sector and a sector for industry and transport.

The **Commercial Department** manages the activity of middle-market commercial companies, through 22 business branches - organized on a geographical basis into 4 commercial districts and 4 sub-divisions belonging to the Commercial Sub-Division in the Tel Aviv Central branch. The Division's organizational structure is unique in the banking system, providing the customer with a "one-stop-shop" for its comprehensive and extensive services, while broadening its services to business customers through digital channels.

**3.** The **International Credit and Real Estate Division** includes two departments - the Construction and Real Estate Department and the Special Loans Unit (as outlined below). In addition, the Division is engaged in the examination of aspects corporate-commercial loans in the Bank's overseas offices in the United States, United Kingdom and Romania.

The **Construction and Real Estate Department** manages the large building companies, promoters and contractors in the economy (including national infrastructure projects) with specific skill and expertise in all areas of real estate in the economy. The financial services are provided both to finance the activity of the customers in Israel through the Bank's branches, and to fund their activity abroad through the Bank's overseas units. Through the overseas offices, credit is also granted to local entrepreneurs who are active in the field of real estate, hotels and nursing retirement homes.

The **Special Loans Unit** which deals with corporate customers who are in difficulty, while attempting to assist in the recovery of active customers through business help and support or to take steps to collect the dents corporate customers 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.

4. 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 of 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 and banking and 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 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 formulation of concepts, processes and organizational and administrative solutions, the formulation of models for optimization of resources and the direction of overseas units and the analysis of their activity.

The **Procurement, Construction and Logistics Department** is a part of the Finance 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 assimilation 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 directives. From 1 April 2013, the Accounting Division reports to the Finance 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 Department**, 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.

**Leumi Technologies Division** 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, and also support of the overseas units in all matters related to technological services, operation and the receipt of assistance required from Bank Leumi in Israel, 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. In addition, the Division is responsible for Customer Complaints Bureau, whose function is to check customer complaints.

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 system, including: examination of the work and control processes, examination of the method of managing various risks in the Group, maintenance of the Bank's assets, minimization of exposures, compliance with the rules of ethics and proper governance, implementation of the directives of the Board of Directors, the management and the Bank's procedures, and the examination of operational efficiency. In addition, the Audit 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** is responsible for risk management in the Group and in the Bank, and coordinates risk management at the Group level in the main risk areas: credit, market and operations and compliance. 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 Division also includes the Credit Risk Management Units and the Compliance Unit.

The **Credit Risk Management Department** is responsible for the specific analysis of credit risk in excess of NIS 25 million, and for the examination of appropriateness of the classifications and allowances for credit losses. The Department is split into three sections: analysis of corporate credit risk, analysis of credit risk in the real estate sector and commercial credit risk. The analysis of the risks is achieved as part of the process of approving the credit and is presented to the relevant credit committee before making the decisions.

The **Compliance and Enforcement Unit** is responsible for implementing a compliance program 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 Division and the Legal Division).

The **Marketing, Advertising and Spokesperson's Department** is responsible for Bank and Group marketing and marketing communications, the spokesperson's office, regulation and public relations, conventions and events, marketing research, social media and sponsorships. 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 activity and is responsible for organizing conferences and events, for the Bank's employees and customers.

The **Strategy Section** is 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.

**During the year, a number of significant organizational changes were made in Leumi:**

**Corporate and Commercial Division**

On 1 January 2014, an organization structural change was made pursuant to which the Corporate Division and the Commercial Division were consolidated into one division, headed by Mr. Kobi Haber, to whom the Head of the Corporate Department, the Head of the Commercial Department and the Manager of the Tel Aviv Central branch will report**.**

**International Credit and Real Estate Division**

On 1 January 2014, as part of the organizational structural change in Corporate Division, it was decided that Mr. Joel Mintz, would report directly to the President and CEO and would receive responsibility for international credit in the Group, and that the Head of Construction and Real Estate Department and the Head of the Special Loans Unit would report thereto.

**Risk Management Division**

On 1 January 2014, with the aim of complying with the Bank of Israel Regulations (Proper Conduct of Banking Business Management Regulation no. 311), an organizational structural change was made, pursuant to which it was decided that the Credit Risk Management Department would be transferred to the responsibility of the Risk Management Division and will include the corporate, commercial and real estate credit risk management units.

**Private Banking Department**

On 1 January 2015, an organizational change was made in the course of which the Private Banking Department was transferred to the responsibility of the Banking Division.

# Bank Leumi le-Israel B.M.
## Organizational Structure


(1) Member of Management
(2) Serves also as Legal Counsel to the Board of Directors

## 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 topics: ethics, the environment, accessibility and community ties.

In 2014, the Leumi Group published its fifth corporate responsibility report, for 2013, including a report on the diverse activities, initiatives, and achievements of the Leumi Group in the area of socio-environmental responsibility. The report was prepared in accordance with the directives of the Global Reporting Initiative (GRI) and gained an A+ rating, which is the highest rating possible and is evidence of the maximum level of transparency. An examination of the fairness of the reporting was carried out by an independent external expert who examined the manner of compliance of the reporting according to the GRI, the accuracy of the reporting and the way in which the organization conducts itself. The complete Corporate Responsibility Report appears on the Bank's website – plus.leumi.co.il.

The *Ma'ala* rating of corporate responsibility for 2014, published in June, again placed Leumi in the highest rated 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 that 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 volunteering activities of employees.

### "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 eight social bodies and associations, among a range of population sectors throughout Israel. In 2014, 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, enjoy a manager tutoring program (mentoring) given by managers in the Bank and make use of the Bank's infrastructures.

In 2014, support was discontinued for the "Strive" program which operated with the aim of awarding youngsters who were in a work circuit the opportunity of realizing their professional and occupational potential, through training for economic independence and career development. The program, which was set up by the Joint Organization was assimilated into the local employment offices.

During 2014, Leumi management reconsidered the Bank's investment strategy. Leumi chose to expand its social strategy with "Leumi Tomorrow" – Youth Leading Change" associations. As part of the cooperation, the association will increase the scope of its activity in the periphery of the country within three years and expand the educational addresses which it able to offer students, This is alongside a substantial increase in the number of Leumi employees volunteering in Leumi Tomorrow and the establishment of a Friends Organization headed by the President and CEO of the Bank.

## Other programs which Leumi contributes and sponsors

### "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, and the adoption of the program by branches of the Bank throughout Israel, and recruiting volunteer mentors from among employees of the Group.

**Summary of Leumi's Donations and Sponsorships in 2014**

In 2014, the Leumi Group made donations and provided sponsorships for social and community purposes in the amount of some NIS 29.4 million, of which donations amounted to some NIS 20.8 million.

**Set out below is a breakdown by category of total donations and sponsorships in 2014:**

Education, children and youth - NIS 15.0 million

Culture and art - NIS 1.9 million

Community and society - NIS 11.6 million

Health - NIS 0.9 million

In 2015, the budget for contributions and social sponsorships of Leumi Group will be increased to a total of NIS 30 million.

Decisions regarding the designation and amount of donations are made, where applicable, 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 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 occupation 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 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 Regulation 307. 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, while for subjects that involve a lower level of risk, audits will be carried out with a frequency of between two and four 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, as necessary.

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 stated 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 6D 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.

In the material foreign subsidiaries, a local internal auditor is appointed. The Internal Audit Division supervises the work of the local auditor, as provided in paragraph 21(L) of Regulation 307. This is carried out, *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 Bank's internal work-plan includes targeted audits by the Internal Audit Division in Israel of the overseas subsidiaries, and the division of labor among the Israeli and overseas auditors. The internal auditors of the significant 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, 107.1 positions for 2014, as described below:**

| | Average positions of auditors in the Leumi Group in Israel |
|---|---|
| The Bank | 92.8 |
| Subsidiaries in Israel | 10.5 |
| Overseas subsidiaries | 3.8 |
| Total | 107.1 * |

(*) Of which 3.5 positions on average are maternity leave / unpaid vacation.

In addition, 2.1 positions were invested on an outsourcing basis.

Furthermore, local auditors are employed in overseas subsidiaries in 20.6 positions (including outsourcing).

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 2014 to the Chief Internal Auditor: (NIS thousands)**

| 2014 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Holding in the capital of the Bank | Remuneration for services | | | | Other remuneration | | Loans given on beneficial terms | | | |
| | Salary | Bonuses** | Social benefit provisions | Share-based payments | Value of the benefit | Total * | Balance as at 31 December 2013 | Average period until maturity (years) | Benefit provided over the year | Loans granted on regular terms |
| | NIS thousands | | | | | | | | | |
| **0.003** | **1,280** | **-** | **123** | **-** | **121** | **1,524** | **51** | **0.42** | **2** | **5** |

* Excluding salary tax.

** Estimate – see Note 15G 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 remuneration paid to him do not affect the exercise of his professional discretion.

The Chief Internal Auditor operates in accordance with the professional standards of the Institute of Internal Auditors in Israel and the 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 examination's findings 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 and records of the examination's findings 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 to the Chairman of the Board of Directors, the President and Chief Executive Officer and the Chairman of the Audit Committee reports summarizing the audit operations. 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 to the Chairman of the Board of Directors, the President and Chief Executive Officer and the Chairman of the Audit Committee an annual report summarizing the audit operations during the course of the entire year, which also includes monitoring the performance of the annual work plan and an assessment of the effectiveness the Bank's internal control framework.

The work program of the Internal Audit Division for 2014 was submitted to the Audit Committee on 23 December 2013 and approved in the Committee on 26 December 2013, and was submitted to the Board of Directors on 16 January 2014 and approved in the Board of Directors on 19 January 2014.

The Internal Auditor's report for the first half of 2014 was submitted to the Audit Committee on 17 August 2014 and was discussed by the Committee on 26 August 2014.

The Internal Auditor's report for the second half of 2014 was submitted to the Audit Committee on 19 February 2015 and was discussed by the Committee on 23 February 2015.

The Internal Auditor's annual report for 2014 was submitted to the Audit Committee on 26 February 2015 and was discussed by the Committee on 3 March 2015, and submitted to the Board of Directors on 11 March 2015 and discussed in the Board of Directors on 15 March 2015.

The work program of the Internal Audit Division for 2015 was submitted to the Audit Committee on 23 December 2014 and approved in the Committee on 30 December 2014, and submitted to the Board of Directors on 19 January 2015 and approved in the Board of Directors on 10 February 2015.

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 directives of the Supervisor of Banks apply the requirements of Sections 302 and 404 of the SOX Act to banking corporations. With regard to these sections, the SEC and the Public Company Accounting Oversight Board have provided directives as to management's responsibility for the determination and existence of controls and procedures with regard to disclosure and existence of internal control over financial reporting and the external auditors' opinion with regard to the audit of the internal control over financial reporting.

**The Supervisor's directives provide that:**

- Banking corporations shall apply the requirements of Sections 302 and 404 and also the SEC's directives that were published by virtue thereof.
- 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) 1992 model meets the requirements and can be used to assess the internal control.

The Bank implements the directives in the Leumi Group on a day-to-day basis and in the process of adopting the new COSO model.

In 2014, the Bank carried out a validation and update of material control processes and checks of the effectiveness of the entire internal control system on financial reporting.

**Assessment of controls and procedures with regard to disclosure**

The management of the Bank, together with the President and Chief Executive Officer, the Head of the Finance Division and the Chief Accounting Officer, has 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, the Head of the Finance Division 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 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.

### Changes in internal control

During the quarter ended 31 December 2014, no material change to the internal control over 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 control over the financial reporting.

With regard to the procedure for approving the financial statements, see the corporate governance questionnaire in the periodic report.

## Remuneration policy for officeholders and key employees

On 31 March 2015, the Board of Directors of the Bank, after the approval of the Remuneration Committee, approved an update in the terms of employment of key employees (as defined in Directive 301A of the Supervisor of Banks, and in the Remuneration Policy of the Bank by virtue of the said Directive 301A) and of office holders in the Bank, including the President and Chief Executive Officer, as follows:

1. Cancellation in full of the entitlement of office holders and key employees, including the President and Chief Executive Officer, to jubilee (long-service) bonuses and jubilee vacations (benefits to which office holders in the Bank are entitled according to the provisions of the employment agreements between them and the Bank), with effect from 31 December 2014, as follows:

   The accumulated rights for each office holder and key employee in respect of jubilee (long-service) bonuses and jubilee vacations, during the period of their employment in the Bank until the date of cancellation of the entitlement, namely, until 31 December 2014, will be reduced, without any compensation and/or consideration, by about 45% (in a similar manner to the reduction carried out in the collective agreement for all employees of the Bank).

   The balance of the said accumulated rights for the office holder or key employee, as applicable, will be cancelled against payment of one-time compensation, in an amount equal to the balance of the accounting provision remaining in the books of the Bank at 31 December 2014, after the reduction, in respect of that office holder or key employee, as applicable. Subject to the aforesaid, the entitlement of office holders and key employees to jubilee (long-service) bonuses and jubilee vacations will be cancelled in full and the employment agreement of office holders and key employees will be amended accordingly. Accordingly, after cancelation of the said entitlements, the Bank will discontinue recording a current expense in respect of accumulating rights to jubilee bonuses and vacations for office holders and key employees.

   The decision to cancel jubilee (long-service) bonuses and jubilee vacations for office holders and key employees in the Bank, as stated above, was made in consideration of the provisions of Proper Conduct of Banking Business Directive No. 301A on Remuneration Policy in a Banking Corporation. This does not allow granting a variable bonus which is independent of performance and only conditional on employment (for office holders in the Bank). Pursuant to the transitional provisions of the said directive, it was possible to amend employment agreements with office holders and key employees in this matter as required in Directive 301A until the end of 2016. However, because of the arrangement with the other employees of the Bank in the framework of the collective agreement signed recently in the Bank, in which the employees to which the collective agreement applies waived their entitlement to jubilee (long-service) bonuses and jubilee vacations, it was decided to cancel, already at this stage, the entitlement of office holders and key employees in the Bank to jubilee (long-service) bonuses and jubilee vacations. In this connection, it should be noted that the payment of reduced compensation to office holders and key employees against cancellation of their entitlement to jubilee (long-service) bonuses and jubilee vacations, as explained above, does not create an accounting expense for the bank, since a salary expense was recorded over the years for office holders and key employees in the Bank for jubilee (long-service) bonuses and jubilee vacations, and, as described above, the compensation mechanism will grant office holders and key employees a payment that represents about half the accounting reserve recorded in the books of the Bank. Furthermore, in light of the cancellation of the entitlement to jubilee (long-service) bonuses and jubilee vacations for office holders and key employees, the Bank will discontinue recording a current expense in respect of the accumulation of the said rights. Pursuant to the cancelation of the entitlement to jubilee bonuses and jubilee vacations, the cancelation of an expense amounting to NIS 16 million will be recorded in the Bank's books in 2015, and an annual current expense of NIS 3 million, in respect of office-holders and key employees, will be saved.

2. The increase in the salary of office holders in the Bank who are not directors is in effect as of 1 January 2015. Included in this, it was approved that the salary of the President and Chief Executive Officer of the Bank will be increased at the rate of approximately 4% of the total cost of the terms of employment of the President and CEO in the Bank. The salary of the President and CEO of the Bank after the said update will be NIS 195,400. The said update of the terms of employment was made in accordance with the Bank's Remuneration Policy and after the Remuneration Committee and the Board of Directors reviewed the normal cost of employment of holders of equivalent positions in comparable companies, and after they have examined the contribution of the said office holders and of the President and CEO to the activity of the Bank.

   For further details regarding the term of office of employment of the President and CEO, including pursuant to the Sixth Schedule of the Regulations, see Note 15 to the financial statements.

3. Similar to normal practice in the Bank for all the employees, by virtue of the collective agreements, the increase in the rate of the Bank's contributions to provident funds (the employer's contribution) for key employees and office holders of the Bank, including the long-serving office holders in the Bank who previously waived their entitlement to be included in first-generation terms and transferred to second-generation terms, including for the President and CEO of the Bank, will be such that the rate of contributions by the Bank to provident funds (the employer's contribution) is 7.5% of the employee's salary for contributions (instead of 5%). The said increase in the rate of contributions to provident funds is only in respect of the part of the salary of the office holders that is not paid under first-generation terms (if relevant). In other words, the increment will be added to the external fund without rights to a non-contributory pension from the Bank, and only the part of the salary not included in first-generation terms.

   The Remuneration Committee and the Board of Directors of the Bank approved that the abovementioned update to the terms of employment constitutes an insignificant update in relation to the existing terms of office and employment of office holders in the Bank, including the President and Chief Executive Officer, as stated in Section 272(D) of the Companies Law, and that updating the said terms of employment is in the interests of the Bank, taking into consideration the contribution of the office holders and the importance of their remuneration in a manner giving them motivation to continue in their position over time. The Remuneration Committee and the Board of Directors were also of the opinion that the updates determined in the updated terms of engagement with office holders in the Bank, as set forth above, would encourage these office holders to continue investing their best efforts in the interest of the Bank, taking into account the challenges facing the management of the Bank in the short and the long term, and considering the workload placed upon them as part of coping on an ongoing basis with these challenges.

**Remuneration Policy for Office-holders**

On 11 February 2014, following the approval of the Board of Directors, pursuant to the approval and recommendations of the Remuneration Committee, the General Meeting of the Bank approved the remuneration policy for office-holders in the Bank in respect of the years 2013-2016. The remuneration policy is based on the provisions of Amendment 20 of the Companies Law with regard to the conditions of the term of office and employment of the office-holders in the Bank and the provisions of the new Proper Conduct of Banking Business Management Regulation 301A "Remuneration Policy in a Banking Corporation".

The remuneration policy is intended for the remuneration of office-holders in the Bank in accordance with the Bank's performances and profits over time, and in accordance with the Bank's and the Group's long-term targets, and the actual contribution of the office-holders to achieve these performances and targets. The remuneration policy includes, *inter alia*, consideration of the salary component, fringe benefits, retirement terms and the component of the annual bonuses.

**Remuneration policy of key employees who are not office-holders (holders of personal contracts)**

On 8 April 2014, the Board of Directors, after receiving the approval and recommendation of the Remuneration Committee of the Board of Directors, approved a remuneration policy which applies to "key employees" in the Bank who are not office-holders, pursuant to the provisions of and as required by Proper Conduct of Banking Business Management Regulation No. 301A.

The aforesaid remuneration policy for "key employees" provides the framework for the remuneration of key employees, and includes, *inter alia*, consideration of the salary component, the related conditions, the terms of retirement and the annual bonus component. This policy was devised paying attention to the principles of the remuneration policy for office-holders in the Bank, *mutatis mutandis*.

**Transition to the second generation with effect from 2014**

Holders of personal contracts in the Bank (who are not members of management), who had a first-generation employee agreement with the Bank, transferred, with effect from 2014, to the employment terms of a second-generation agreement, as follows: their rights to a non-contributory pension from the Bank pursuant to their rights as first-generation will be only in respect of the frozen salary level (the salary at the date of the transfer from first-generation to second-generation plus linkage to the consumer price index) with the rights in respect of the salary increment in excess of the frozen salary level being in accordance with the second-generation conditions (provisions for provident fund without the rights to non-contributory pension from the Bank).

For further details, see Note 15 to the financial statements, below.

# Remuneration of Senior Office-holders

**For the year ended 31 December 2014**

Below are details of the benefits and amounts which were paid or provided in the years 2014 and 2013 to the Chairman of the Board of Directors and to the five recipients of the 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 awarded benefits that are similar to those granted to Bank employees and in some cases, even exceed them.

| 2014 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Details of recipient of remuneration (1) | | | Remuneration for services | | | Other remuneration | | | Loans given on beneficial terms (16) | | | |
| Name | Position | Holding in the capital of the Bank | Salary | Bonuses | Social benefit provisions (3) | Share-based payment | Value of the benefit (4) | Total (2) | Balance as at 31.12. 2014 | Average period until maturity (years) | Benefit provided over the year | Loans granted on regular terms |
| | | % | NIS thousands | | | | | | | | | |
| Mr. David Brodet (5) | Chairman of the Board of Directors | **0.001** | **2,186** | **-** | **733** | **-** | **159** | **3,078** | **-** | **-** | **-** | **-** |
| Ms. Rakefet Russak-Aminoach (6) | President and CEO | **0.003** | **2,679** | **-** | **1,291** | **-** | **160** | **4,130** | **-** | **-** | **-** | **20** |
| Ms. Nomi Sandhaus (10) | Executive Vice-President, Head of Legal Division (formerly) | **-** | **2,051** | **-** | **5,617** | **-** | **101** | **7,769** | **106** | **2.37** | **7** | **-** |
| Mr. Yaron Bloch (15) | General Manager, Leumi Partners | **-** | **1,546** | **949** | **2,412** | **-** | **119** | **5,026** | **-** | **-** | **-** | **-** |
| Mr. Paul Hurd (13) | Chief Executive, Leumi ABL | **-** | **863** | **3,301** | **129** | **-** | **89** | **4,382** | **-** | **-** | **-** | **-** |
| Mr. Paul Woodward (14) | Managing Director, Leumi ABL | **-** | **789** | **3,301** | **118** | **-** | **93** | **4,301** | **-** | **-** | **-** | **-** |
| Mr. Larry Weiss (12) | General Manager, Leumi UK (formerly) | **-** | **973** | **-** | **2,859** | **-** | **72** | **3,904** | **-** | **-** | **-** | **-** |
| Mr. Avner Mendelson (11) | CEO, Bank Leumi USA | **-** | **1,455** | **-** | **402** | **-** | **1,731** | **3,588** | **-** | **-** | **-** | **-** |
| Professor Daniel Tsiddon (8) | Deputy Chief Executive Officer | **-** | **1,516** | **-** | **927** | **-** | **113** | **2,556** | **82** | **0.42** | **4** | **-** |
| Mr. Dan Yerushalmi (9) | Executive Vice-President, Head of Leumi Technologies Division | **-** | **1,404** | **-** | **667** | **258** | **20** | **2,349** | **-** | **-** | **-** | **-** |

1. Those receiving remuneration hold full-time positions.
2. Excluding salary tax.
3. Social benefit provisions include provisions for severance pay, provident funds, pension, supplementary training fund, vacations, jubilee bonus, non-competition period, and national insurance, as well as supplemental reserves in respect of the above, due to salary changes during the accounting year.
4. The value of the benefit includes, *inter alia*, a car and telephone expenses.
5. On 4 November 2010, the General Meeting of the Bank, after the approval of the Board of Directors and the Audit Committee, 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 15B.4 to the Financial Statements. On 11 February 2014, following the approval of the Board of Directors and the Remuneration Committee, the General Meeting approved a resolution that the Chairman of the Board of Directors is entitled to a performance-contingent annual bonus, subject to the provisions of the remuneration policy for office-holders in the Bank for each of the years 2013, 2014, 2015 and 2016. For a summary of the details of the Bonus Plan, see Note 15G, to the financial statements.
6. Ms. Rakefet Russak-Aminoach serves as President and CEO 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 15B.3a. The President and CEO, who had a first-generation employee agreement with the Bank, transferred, with effect from 2013, to the employment terms of a second-generation agreement, as follows: the rights of the President and CEO to a non-contributory pension from the Bank pursuant to her rights as first-generation, will be only in respect of the frozen salary level (the salary of the President and CEO at the date of the transfer from first-generation to second-generation plus linkage to the consumer price index) with her rights with regard to the salary increment in excess of the frozen salary level being according to the second-generation conditions (provisions for provident fund without the rights to non-contributory pension from the Bank). On 11 February 2014, following the approval of the Board of Directors and the Remuneration Committee, the General Meeting of the Bank approved an update of the retirement terms of the President and CEO, as detailed in Note 15B.3a to the financial statements. The General Meeting also approved, following the approval of the Board of Directors and the Remuneration Committee, that the President and CEO is entitled to a performance-contingent annual bonus and to a fixed annual bonus in accordance with and subject to the provisions of the office-holders in the Bank's remuneration policy, for each of the years 2013, 2014, 2015 and 2016. For a summary of the details of the Bonus Plan, see Note 15G, to the financial statements. It should be noted that, pursuant to the remuneration policy, officeholders in the Bank, including the President and CEO, are not entitled to a variable annual bonus for 2014.

   As set forth above, on 31 March 2015, the Board of Directors of the Bank, after the approval of the Remuneration Committee, approved an update in the terms of employment of office holders in the Bank, including the President and CEO. Pursuant thereto, the entitlement of the President and CEO to jubilee bonuses and jubilee vacations was canceled, with effect from 31 December 2014, and compensation representing 45% of the amount that was recorded in the Bank's books in respect of this liability will be paid. In addition, in light of the cancelation of the entitlement, as aforesaid, no expense in respect of the liability for jubilee bonuses and jubilee vacations will be recorded in the future. In addition, the Board of Directors approved an update, in effect from 1 January 2015, in the regular salary of the President and CEO of 4% of the cost of the terms of employment of the President and CEO of the Bank.

**An assessment of the cost of the employment of the President and CEO in 2015, in light of the abovementioned update, is as follows:**

| | | | Remuneration for services | | | | Other remuneration | | Loans given on beneficial terms | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Name | Position | Rate of holding capital of Bank | Salary | Bonuses | Social benefit provisions | Share-based payments | Value of the benefit | Total * | Balance as at 31 December 2015 | Average period until maturity (years) | Benefit provided over the year | Loans granted on regular terms |
| | | % | NIS in thousands | | | | | | | | | |
| Ms. Rakefet Russak Aminoach | President and CEO | **0.003** | **2,804** | **-*** | **1,196**** | **-** | **160** | **4,160** | **-** | **-** | **-** | **20** |

* Since the bonuses are contingent on results, at this stage, they cannot be assessed.

** Including a non-recurring item of NIS 260 thousand in respect of the update of accrued rights, as outlined in the above table, the total cost in respect of 2014, stood at NIS 4,130 thousand. The estimate of the total cost in 2014, net of the non-recurring effects which occurred in 2014, is NIS 3,470 thousand.

**7.** Senior employees of the Bank have special personal employment agreements with the Bank. For further details regarding the retirement conditions of senior officers and entitlement to advance notice on terminating employment, see Note 15B.3c to the financial statements.

Members of the Bank management who had a first-generation employee agreement in the Bank with effect from 2013 have transferred to the employment terms of a second-generation agreement, as follows: their rights to a non-contributory pension from the Bank pursuant to their rights as first-generation will be only in respect of the frozen salary level (the salary at the date of the transfer from first-generation to the second-generation plus linkage to the consumer price index), with the rights with regard to the salary increments in excess of the frozen salary being in accordance with the second-generation conditions (provisions for provident fund without the rights to a non-contributory pension from the Bank).

The maximum additional expense that the Bank may incur, in the event of the abovementioned employees being immediately dismissed, amounts to NIS 349 million (2013 – NIS 372 million) These amounts are before tax and include salary tax on the pension obligation. Since it is not likely that all the said employees will be dismissed immediately, a global provision of 25% of the above amount has been made, amounting to NIS 88 million (2013 - NIS 93 million). These amounts also relate to members of management and to the President and CEO. Following the amendment to the personal contracts of the members of management, as set forth in Note 15B.3c 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 11 million as of 31 December 2014; in 2013 – NIS 14 million.

On 11 February 2014, the General Meeting of the Bank approved the remuneration policy for office-holders in the Bank in respect of the years 2013 – 2016, following the approval of the Board of Directors in accordance with the approval and recommendations of the Remuneration Committee. The remuneration policy is based on the provisions of Amendment 20 to the Companies Law with regard to the term of office and employment of office-holders in the Bank and the provisions of the new Proper Conduct of Banking Business Management Regulation no. 301A regarding Remuneration Policy in a Banking Corporation. For details, see Note 15G to the financial statements. Pursuant to the remuneration policy, officeholders in the Bank, including the President and CEO, are not entitled to a variable annual bonus for 2014.

It should be further noted that the accumulated conditions, pursuant to the provisions in the remuneration policy for the vesting of the first third of the PSU (which were allocated in respect of half of the bonus for 2013) to shares, are being fulfilled, and accordingly, the office-holders in the Bank (to whom the PSU units were allocated, as aforesaid) are entitled to a third of the aforementioned PSU units vesting to shares. According to the provisions of the remuneration policy, these shares will be deposited with a trustee of the plan and will be blocked for one year. For further details, see Note 15G to the financial statements.

**8.** Professor Daniel Tsiddon serves as Deputy CEO in the Bank. The salary of Professor Tsiddon, as set forth in the table above, is in accordance with the Bank's remuneration policy as regards the remuneration of senior officers in the Bank. For details regarding the retirement terms of senior officers in the Bank and their entitlement to early notice on termination of employment – see Note 15B.3c to the financial statements.

9, Mr. Dan Yerushalmi serves as the Head of the Leumi Technologies Division in the Bank. Mr. Yerushalmi's salary as set forth in the table above is in accordance with the Bank's remuneration policy on the matter of the salary of senior officers in the Bank. For details regarding the terms of retirement of senior officers in the Bank and their entitlement to early notice on the termination of employment relations – see Note 15B.3c to the financial statements. The Board of Directors of the Bank and the Remuneration Committee have decided to award Mr. Yerushalmi, in accordance with the Bank's remuneration policy, a recruitment bonus amounting to 10 salaries (half in respect of the commencement of his term of office in the Bank in 2013 and half at the end of the first year of his term of office in the Bank at the end February 2014).

**10.** Ms. Nomi Sandhaus ceased to serve as Deputy CEO, member of management, Chief Legal Counsel and Head of the Legal Department and Legal Risk Officer on 31 August 2014. The terms of retirement and early notice to which Ms. Sandhaus is entitled are according to the retirement conditions of the senior officers in the Bank who have an employment agreement - see Note 15B.3c to the financial statements.

**11.** Mr. Avner Mendelson serves as General Manager of Bank Leumi USA (Leumi USA), a wholly-owned and controlled subsidiary of the Bank with effect from 1 September 2013. Mr. Mendelson's salary, as set forth in the table above, is determined in accordance with the remuneration policy [of Leumi USA] and the remuneration policy for companies in the Leumi Group and in accordance with customary practice for general managers of banks of a similar size and activity in the United States. Mr. Mendelson's salary includes additional related expenses, for example, rent for a general manager in the United States.

For details regarding the retirement conditions of senior officers in the Bank, including Mr. Mendelson and his entitlement to early notice on termination of employment, see Note 15B3.c to the financial statements.

**12.** Mr. Larry Weiss ceased to serve as General Manager of Bank Leumi UK plc. ("Leumi UK"), a subsidiary under the full control of the Bank, on 31 July 2014, Mr. Weiss's salary for his term of office as General Manager of Leumi UK was determined in accordance with the remuneration policy of Leumi UK and the remuneration for companies in the Leumi Group and in accordance with customary practice for general managers of banks of a similar size and activity in the United Kingdom. The retirement terms to which Mr. Weiss is entitled are in accordance with those stipulated in an employment contract signed between him and Bank Leumi UK.

**13.** Mr. Paul Hird serves as Chief Executive of Leumi ABL Ltd. (Leumi ABL), a wholly-owned subsidiary of Leumi UK since 2006. Paul was appointed at the initiative of the subsidiary, jointly with Bank Leumi UK. and Mr. Hird's salary in respect of his term of office as Chief Executive of Leumi ABL is determined in accordance with the terms of the agreement the Bank signed with him, under which he is entitled, in addition to his annual salary, to an annual variable payment based on a fixed formula, according to the company's net profit after taxes.

**14.** Mr. Phil Woodward serves as Managing Director of Leumi ABL, a wholly-owned subsidiary of Leumi UK since 2006. Mr. Woodward was appointed at the initiative of the subsidiary, jointly with Bank Leumi UK. and Mr. Woodward's salary in respect of his term of office as Managing Director of Leumi ABL is determined in accordance with the terms of the agreement the Bank signed with him, under which he is entitled, in addition to his annual salary, to an annual variable payment based on a fixed formula, according to the company's net profit after taxes.

**15.** Mr. Yaron Bloch serves as General Manager of Leumi Partners Ltd ("Leumi Partners"), a wholly owned and controlled subsidiary of the Bank, with effect from 1 January 2011. The annual bonus to Mr. Bloch, as set forth in the table above, has been approved by the Remuneration Committee and the Board of Directors of Leumi Partners, in accordance with the provisions of his employment agreement and pursuant to the remuneration policy for officeholders in Leumi Partners which was approved in 2014. The annual bonus is comprised of a fixed annual bonus which is included in the above table of salary data and a variable annual bonus. According to the employment agreement, each party may terminate the agreement at any time, on duly giving prior notice. On the termination of Mr. Bloch's employment, due to resignation or dismissal, he will be entitled to an adaptation bonus equal to the cost of annual employment. In addition, in the event of termination of employment relations between the parties, he will be entitled to all of the monies which have accrued to his credit in the managers insurance policy maintained for him, including the amounts in respect of severance pay, and a supplement in respect of the difference, if applicable, between the severance pay due to him according the law and the severance pay accrued to his account in the severance pay component in the managers insurance policy.

**16.** Loans granted under terms generally excepted for all employees in the Bank and their amounts have been determined according to consistent criteria.

**17.** 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 proportional insurance premium paid is not included in the above tables, as it is insignificant. The total premium amounted to NIS 3,219 thousand and relates to all officers in the insured group.

**18.** 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 2014, and after noting the Bank's group remuneration policy and the remuneration policy in the Group companies, as well as the performance and activity of each senior officer in the Bank or in the Group, the Board of Directors believes that the remuneration to abovementioned senior officers, as set out in the table and the explanations above, represents remuneration that in no way exceeds fair and reasonable remuneration under the circumstances, taking into consideration the contribution of each of the officeholders, as stated in the Bank's operating results.

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

| 2013 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Details of recipient of remuneration | | | Remuneration for services | | | Other remuneration | | | 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 2013 | 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** | **2,164** | **962** | **997** | **962** | **156** | **5,241** | **-** | **-** | **-** | **-** |
| Ms. Rakefet Russak-Aminoach | President and CEO | **0.003** | **2,360** | **1,453** | **1,178** | **1,153** | **141** | **6,285** | **91** | **1.42** | **4** | **25** |
| Professor Daniel Tsiddon | Former Deputy CEO | **-** | **1,500** | **669** | **439** | **669** | **111** | **3,388** | **81** | **1.42** | **3** | **50** |
| Mr. Gidon Altman | Formerly, Executive Vice-President, Head of the Commercial Banking Division | **0.001** | **1,353** | **599** | **8,229** | **599** | **118** | **10,898** | **-** | **-** | **-** | **13** |
| Mr. Yitzhak Eyal | Former General Manager of Bank Leumi (USA) | **0.002** | **1,546** | **849** | **1,386** | **-** | **718** | **4,499** | **94** | **1.21** | **5** | **5** |
| Mr. Yaron Bloch | General Manager, Leumi Partners | **-** | **1,212** | **2,000** | **314** | **-** | **123** | **3,649** | **-** | **-** | **-** | **-** |
| Mr. Dan Yerushalmi | Executive Vice-President, Leumi Technologies Division | **-** | **1,137** | **1,248** | **537** | **702** | **14** | **3,638** | **-** | **-** | **-** | **-** |

* Excluding salary tax.

## Auditors' Fees (a)(b)(c)

| | Consolidated | | Bank | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| | NIS thousands | | | |
| For auditing activity: (d) | | | | |
| Joint auditors | **30,889** | 28,895 | **15,514** | 14,345 |
| Other auditors | **4,019** | 4,058 | **27** | 271 |
| Total | **34,908** | 32,953 | **15,541** | 14,616 |
| For audit related services: (f) | | | | |
| Joint auditors | **630** | 343 | **266** | 64 |
| Other auditors | | | | |
| For tax services: (e) | | | | |
| Joint auditors | **1,438** | 1,549 | **508** | 506 |
| Other auditors | **538** | 592 | **-** | - |
| For other services: | | | | |
| Joint auditors | **4,391** | 2,230 | **2,438** | 1,586 |
| Other auditors | **715** | 1,493 | **246** | 1,211 |
| Total | **7,712** | 6,241 | **3,458** | 3,367 |
| Total auditors' fees | **42,620** | 39,194 | **18,999** | 17,983 |
| Joint auditors' fees from other engagements (g) | **-** | - | **-** | - |

(a) 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.

(b) Auditors' fees include payments to partnerships and corporations under their control and also payments required by the VAT Law.

(c) Including fees paid and accumulated fees.

(d) Audit of annual financial statements and review of interim reports.

(e) Services provided related to routine tax auditing.

(f) 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.

(g) As reported by the joint 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.

## Members of the Board of Directors

The Board of Directors number 15 directors. The legal quorum for discussions is the majority of the directors, with a third being external 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 the related regulations, the Board of Directors of the Bank resolved that the minimum number of directors with "accounting and financial expertise", who will serve on the Board of Directors of the Bank at any time, and who will participate in the discussions and approval in the plenum of the Board of Directors on the draft financial statements, will be three, 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.

Most of the directors serving on the Board of Directors comply with the definition of a director with accounting and financial expertise.

With effect from 1 January 2013, and pursuant to Proper Conduct of Banking Business Directive No. 301 of the Supervisor of Banks, the discussions relating to the financial statements are held in the Audit Committee of the Board of Directors. Pursuant to the directives of the Bank of Israel, the Board of Directors has determined that at least three "directors with accounting and financial expertise" will serve on the Audit Committee of the Board of Directors at all times. In fact, most of the directors serving on the Audit Committee have accounting and financial expertise. 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 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, of which six are external directors, including three directors who are external directors pursuant to the provisions of the Companies Law.

| Name of Director | Membership in the committees of the Board of Directors, is the director independent / an external director as defined in the Companies Law / Proper Conduct of Banking Business Management no. 301 – Yes/no? | Education and employment in the past five years, giving details of professions or areas in which education has been acquired, the institution in which the academic degree or professional certificate which he holds was acquired, and details of the corporations in which he acts as director | Does the company regard him/her as having accounting and financial expertise? |
|---|---|---|---|
| **David Brodet** | Chairman of the Board of Directors, chairman of the following committees: Credit, Risk Management, Resources, Procedure, Examining Conflicts of Interests, Investment Prospectuses, Logo Strategy and member of Foreign Customers Committee<br><br>Not an independent/external director | Academic education – B.A. in Economics and Political Science and M.A. in Economics, The Hebrew University of Jerusalem.<br>Chairman of the Board of Directors – Bank Leumi Le-Israel B.M. and Bank Leumi United States, owner of David Brodet Ltd. (in suspension), Chairman of the Executive Committee of the Jerusalem Foundation, the Hadassah Academic College. and the Economic Research Institute of Dr. Yeshayahu Forder (R.A.),<br>member of the Managing Committee of the Jerusalem Institute for Israel Studies and of the Cameri Theater.<br>Chairman, member of the Board of Trustees of the Fund for Treatment of Sheltered Persons.<br>Lecturer at the National Security College (Haifa University) and, till December 2014, President of the Union of Banks in Israel (R.A.)<br>Till December 2012, Chairman of the Public Council for Statistics; till August 2011, member of the committee for locating a manager for the Income Tax Authority; till July 2010, external director in the Israeli Corporation Ltd., Chairman of the Executive Committee in the Maurice Falk Institute for Economic Research in Israel Ltd., member of the Executive Committee in Mishkenot Sha'ananim and member of the Advisory Committee in the Samuel Neeman Institute for Advanced Studies at the Technion Israel Institute of Technology; till June 2010, chairman of the Israeli Committee for Democracy Chairman of the Advisory Committee for Exemptions and Mergers with the Antitrust Commissioner; till May 2010; Chairman of the Executive Committee in Ben Gurion University, till March 2010, lecturer at the College of Business and Law, Ramat Gan, till January 2010, Chairman of the Investment Committee in the Insurance Fund for Employees in the Remuneration and Pension Fund of the Histadrut and Mivtachim Institute for Social Insurance of Employees Ltd., External director in Alony Hetz Properties and Investments Ltd., lecturer in the Inter-Disciplinary Center, Herzlia (Business Management and Governance). | YES.<br>Chairman of the Board of Directors of the Bank since August 2010.<br>B.A. in Economics and Political Science and M.A. in Economics, Hebrew University, Jerusalem.<br>VP Finance of Israel Aircraft Industries 1987-1991.<br>Budgets Director in the Ministry of Finance 1991-1994.<br>Director-General, Ministry of Finance 1995-1997<br>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. |

| Name of Director | Membership in the committees of the Board of Directors, is the director independent / an external director as defined in the Companies Law / Proper Conduct of Banking Business Management no. 301 – Yes/no? | Education and employment in the past five years, giving details of professions or areas in which education has been acquired, the institution in which the academic degree or professional certificate which he holds was acquired, and details of the corporations in which he acts as director | Does the company regard him/her as having accounting and financial expertise? |
|---|---|---|---|
| **David Avner** | Member of the following committees: Credit, Resources, the Committee for Examining Conflicts of Interests, Strategy, for Examining a Claim (*ad hoc*) and Logo<br><br>Not an independent/external director | Academic education - B.A. in Mathematics, Computer Sciences and Philosophy, Haifa University, and M.B.A, Haifa Technion<br>Chief Executive Officer and Owner of N.S.Y. Avner Ltd.<br>Member of the Executive Committee in the Technion – Israel Institute of Technology<br>Lecturer in the Kiryat Ono College in the Business Administration Faculty<br>Till 2010, CEO of Partner Communications Ltd. | YES<br>B.A. in Mathematics and Philosophy, Haifa University, and M.B.A, Haifa Technion,<br>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** | External director<br>Member of the following committees: Credit, Audit, Procedure and Strategy<br>Independent and external director pursuant to Proper Conduct of Banking Business Management Regulation 301 | Academic education - M.B.A in Business Administration and Public Administration and B.A. in Economics and Political Science, The Hebrew University of Jerusalem. Member of Research Team, Computer Systems Management, Stanford University and Stanford Research Institute. Doctorate studies – Hebrew University, Jerusalem. Chairman of the Executive Committee, from 1993, President of the Association of Beit Zvi – School for Performing Arts from 2002, director in Ampa Capital Ltd., Tower Semiconductor Ltd., owner and general manager and director of Rami Guzman Initiation and Advice Ltd., 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. Member of Exposure Committee, B.S.S.CH., – The Israeli Credit Insurance Company Ltd., member of the Executive Committee in the Israel-America Bureau and Member of the Executive Committee Chairman of the Executive Committee of the Zeev Gorodetsky Scholarship Fund., Consultant in Opala Selfsafe Ltd. Till October 2014, director in the academic stream of the College for Management founded by the Tel Aviv Clerks Organization Public Benefit Company Ltd. Until August 2014, Director in Gmul Investment Company Ltd. Until 2012, director and member of finance committees in Epcon Electro Mechanics Ltd. (Epcon Technologies Ltd.) in Africa-Israel Investments Ltd. and member in the Appeals Committee to the Encouragement of Investments Law. Till 2011, director in Bank Leumi Le-Israel Ltd, in Adamind Ltd. | YES<br>B.A. in Economics and Politics and M.B.A in Public Administration, The Hebrew University of Jerusalem. Member of Research Team, Computer Systems Management, Stanford University and Stanford Research Institute.<br>Various economic and technological positions in the Ministry of Finance, 1962-1969,<br>Information Technology Supervisor in Government Administration, 1971-1977<br>CFO in Electrochemical Industries and Frutarom, 1977-1981. CFO of Elscint 1981-1982, CEO of Dikla Holdings, 1983-1985, CFO in Motorola Communications and Motorola Israel, 1985-2004, Vice-President Motorola Inc., 2001-2005, Director in Bank Leumi, 2005-2011. |

| Name of Director | Membership in the committees of the Board of Directors, is the director independent / an external director as defined in the Companies Law / Proper Conduct of Banking Business Management no. 301 – Yes/no? | Education and employment in the past five years, giving details of professions or areas in which education has been acquired, the institution in which the academic degree or professional certificate which he holds was acquired, and details of the corporations in which he acts as director | Does the company regard him/her as having accounting and financial expertise? |
|---|---|---|---|
| **Prof. Arieh Gans** | External director.<br>Member of the following committees: Credit, Audit, Prospectuses and Committee for Examining Conflicts of Interests<br>Independent and external director pursuant to Proper Conduct of Banking Business Management Regulation no. 301 | Academic education – C.P.A. (Isr.), B.A. in Accounting, The Hebrew University of Jerusalem (Tel Aviv Branch)<br>Professor of Accounting, Tel Aviv University and Company Director.<br>Till November 2014, member of Professional Committee in the Israeli Accounting Standards Board.<br>Till November 2013, member of Finance and Audit Committee, Middle East Tube Company Ltd. | YES<br>C.P.A. (Isr.), B.A. in Accounting, The Hebrew University of Jerusalem (Tel Aviv Branch), Professor of Accounting, Tel Aviv University.<br>Held various accounting positions with Koor Industries Ltd., 1978-1998, including Vice President Accounting and Control and Head of Accounting Division.<br>Kesselman & Kesselman, Certified Public Accountants (Isr.), 1961-1977.<br>Member of various committees of the Israeli Institute of Certified Public Accountants, the Israeli Accounting Standards Board and Senior Examiner of the Auditors' Council.<br>Director of various companies. |
| **Moshe Dovrat** | Member of the following committees: Risk Management, Resources and Investments<br><br>Not an independent/external director | Academic education - B.A. in Economics and Political Science and M.B.A., The Hebrew University of Jerusalem<br>CEO, Director and Owner of Dovrat (M.H.) Investments and Business Initiatives Ltd. and Beit Meniv Funding Ltd.<br>Member of Executive Committee of the Ra'anana Symphonette Orchestra, Member of the General Assembly and one of the founders of the Macro Center for Political Economics and Sustainable Eco-Tourism in Israel, Member of the Public Council and the Audit Committee of the Batsheva Dance Company. Member of the Public Council and Finance Committee for the Council for a Beautiful Israel.<br>Member of the General Assembly of the Ramat Gan College and the Academic Israel College in Ramat Gan, Member of Management of Kfar Blum Holdings – Agricultural Cooperative Society (Pastoral Hotel),<br>Member of the Israel - Czech Republic Chamber of Commerce –and director in the Review of Members of the Institute of Certified Public Accountants in Israel Ltd. and in Kfar Blum Kayaks and Bet Hillel. Till November 2014, director in Theracoat Ltd. Till July 2012, Director in director in The Jewish-Arab Center for Economic Development. | YES<br>B.A. in Economics and Political Science and M.B.A., The Hebrew University of Jerusalem<br>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.<br>Chairman of the Board of Directors, member of Board of Directors, and CEO of various companies. |

| Name of Director | Membership in the committees of the Board of Directors, is the director independent / an external director as defined in the Companies Law / Proper Conduct of Banking Business Management no. 301 – Yes/no? | Education and employment in the past five years, giving details of professions or areas in which education has been acquired, the institution in which the academic degree or professional certificate which he holds was acquired, and details of the corporations in which he acts as director | Does the company regard him/her as having accounting and financial expertise? |
|---|---|---|---|
| **Dr. Samer Haj Yehia** | Member of the following committees: Risk Management, Prospectuses, Procedure and Strategy<br><br>Not an independent/external director | Academic education – Doctorate in Economics specializing in Econometrics and Finance from the Massachusetts Institute of Technology, United States, MBA specializing in Banking and Finance from the Hebrew University in Jerusalem, LLB, specializing in Capital Market and Banking from the Hebrew University in Jerusalem. M.A. in Economics specializing in Macroeconomics and International Trade from the Hebrew University in Jerusalem, B.A. in Accounting and Economics from the Hebrew University in Jerusalem. Fourth year training in Auditing, specializing in Taxation and Audit of Financial Statements, from the Tel Aviv University, CFA in Monetary and Financial Analysis from the CFA Institute, Massachusetts, USA, lecturer in the Inter-Disciplinary Center (Public Benefit Company). Till 2013, commercial strategist in Grantham Mayo van Otterloo; till 2012, Vice-President Financial Engineering in Fidelity Capital Markets. | YES – Education and professional experience and skill in banking, finance and economics. Business manager, risk, management, commerce, accounting, law regulations and financial technology. |
| **Professor Haim Levy** | External director<br>Member of the following committees: Risk management, Investment and Strategy<br>Independent and external director pursuant to Proper Conduct of Banking Business Management Regulation no. 301 | Academic education – Graduate in Economic and Statistics, Qualified in Statistics and Business Administration, specializing in Finance, PhD in Finance in Economics from the Hebrew University in Jerusalem.<br>Chairman of the Knesset Public Committee for Determining the Terms of Employment of Knesset Members and their Assistants, researcher and lecturer (voluntary) in the Hebrew University in Jerusalem. Till 2014, Director in Harel Portfolio Management. Till 2013, Dean and Professor in the Academic Centre in Ramat Gan. Till June 2012, Advisor in Kanat Investment Funds, Till June 2011, Director in Menorah – Emda Mutual Funds | YES – Relevant professional experience in economics, risk management and finance |
| **Shay Shachnai Hermesh** | Member of the following committees: Resources, Procedure, Investments and Strategy<br><br>Not an independent/external director | Academic education – B.A. in Business Administration at the Hebrew University, Jerusalem, specializing in employment relations and finance, Hebrew University in Jerusalem. Chairman of the Israeli Management, World Deputy President and member of the Steering Committee in the World Jewish Congress and director in Kafrit Industries (Public corporation). Member of the Board of Trustees in Sapir Academic College, member of the Association of Friends of the Yiddishshpiel Theatre, Deputy General Manager of the Mishke Hanegev Organization – Central Cooperative Union Ltd., member of the board of the Chen Hanegev Association.<br>Till 2013, Chairman of the Executive Committee in Sapir College of Education and member of Knesset. | YES – Treasurer in Kibbutz Kfar Aza, Head of Sha'ar Hanegev Regional Council. (including treatment with banks according to the Kibbutz Arrangement), Chairman of the Sha'ar Hanegev Regional Plants Finance Committee, Chief Financial Officer of Kafrit Industries (Public corporation), Treasurer of the Jewish Agency and Zionist Histadrut, member of Knesset Finance Committee (2006-2013), member of the Financial Statements Committee (formerly) – "Frutarom", Kafrit, Chairman of the Executive Committee, Sapir College and Head of the Investment Committee, Academic background in the field: B.A. in Economics and Business Administration. specializing in employment relations and finance, Hebrew University, Jerusalem |

| Name of Director | Membership in the committees of the Board of Directors, is the director independent / an external director as defined in the Companies Law / Proper Conduct of Banking Business Management no. 301 – Yes/no? | Education and employment in the past five years, giving details of professions or areas in which education has been acquired, the institution in which the academic degree or professional certificate which he holds was acquired, and details of the corporations in which he acts as director | Does the company regard him/her as having accounting and financial expertise? |
|---|---|---|---|
| **Yoav Nardi** | Member of the following committees: Credit, Audit, Committee for Examining Conflicts of Interests, Foreign Customers and Committee for Examining a Claim (*ad hoc*)<br><br>Not an independent/external director | Academic education - B.A. in Economics and M.B.A. (Finance), The Hebrew University in Jerusalem.<br>Chairman of Investments Committee of the National Library Ltd. and Yad Sarah (R.A.)<br>Director and Owner of Nardi Consultants and Risk Management Ltd. Till 2010, Jerusalem Bank, advisor to the General Manager, assistant to the General Manager, and member of management, Head of Risk and Nostro Section and Financial Risk Manager. Director in Jerusalem Capital Markets Funds (1980) Ltd. Ir Shalem Insurance Agency (1996) Ltd. and Jerusalem Bank Trust Company Ltd, and Chairman of the board of directors in Jerusalem Finance and Issues (2005) Ltd. and Jerusalem Financial Operation (2005) Ltd. | YES - B.A. in Economics and M.B.A. (Finance), The Hebrew University in Jerusalem.<br>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 was involved on an ongoing basis in monitoring the preparing the Financial Statements of Bank Jerusalem, including the Directors Report. |
| **Haim Samet** | External director Chairman of the Remuneration Committee, and member of the following committees: Audit, Resources, Prospectuses, Investment, Logo and Committee for Examining a Claim (*ad hoc*).<br>Independent and external director as defined the Companies Law and Proper Conduct of Banking Business Management Regulation no. 301 | Academic education – .LLB in Law from the Hebrew University in Jerusalem, Tel Aviv branch<br>Lawyer, Joint Senior Partner in law firm: Schnitzer, Gottlieb Samet & Co., Owner and director in Keren Ya'ar Investments Ltd., in H.Y.D.A. Holdings Ltd. in H. Samet Attorneys, Director and Deputy Chairman in Tel Aviv Museum of the Arts Ltd., Director in Tekoa Mushroom Farm Ltd., in H.Y.D. Properties Ltd., in H.Y.D.A. Holdings Ltd. in H. Samet Attorneys Ltd., Member of Board of Trustees and Chairman of the Audit Committee in Tel Aviv University. Till December 2013, director in H.Y.D. Trustees (1991) Ltd. in H.Y.D. Services (1991) Ltd. | YES - B.A. in Law from the Hebrew University in Jerusalem.<br>Director in Bank Leumi. Served as member of the Credit and Audit Committee of the Bank, 1995-2000.<br>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. |
| **Nurit Segal** | Member of the following committees: Credit, Risk Management, Prospectuses, Committee to Examine Conflicts of Interests, Investment Committee<br>Not an independent/external director | Academic education – B.A. in Economics and Statistics – Hebrew University in Jerusalem<br>M.Sc. in Performance Investigation in Case Western Reserve University, Cleveland, Ohio, USA.<br>Management company and Chairman of the Finance Committee in the Helicon Society for the Advancement of Poetry in Israel.<br>Till September 2014, Director in Aspen Group Ltd., till February 2012, director in Olympia – Real Estate Holdings Ltd., till August 2011, external director in King Ltd. till July 2010, director in Bank Leumi Le-Israel Ltd. | YES - B.A. in Economics and Statistics – Hebrew University, Jerusalem<br>Term of office in the boards of public companies including the balance sheet committees and chairman of the balance sheet committee. Monitoring developments in financial reporting by means of seminars of accounting firms and email updates |

| Name of Director | Membership in the committees of the Board of Directors, is the director independent / an external director as defined in the Companies Law / Proper Conduct of Banking Business Management no. 301 – Yes/no? | Education and employment in the past five years, giving details of professions or areas in which education has been acquired, the institution in which the academic degree or professional certificate which he holds was acquired, and details of the corporations in which he acts as director | Does the company regard him/her as having accounting and financial expertise? |
|---|---|---|---|
| **Zipporah Samet** | External director.<br>Chairman of the Audit Committee and member of the following committees: Credit, Risk Management, Remuneration, Resources and Committee for Examining Conflicts of Interests<br><br>Independent and external director as defined in the Companies Law and Proper Conduct of Banking Business Management Regulation no. 301 | Academic education – B.A. in Economics and Mathematics and MBA (Economics), Hebrew University in Jerusalem.<br>Owner, Chairman of the Board of Directors and CEO in Merav Yaniv Financial Consulting Ltd. since 2003,<br>External director in Africa Israel Investments Ltd.<br>Director and shareholder in Bio-Plasmar Ltd.<br>Chairman of "IsraelGives" Or Ad - Association for the Prevention and Treatment of Behavioral and Functional Changes in Senior Citizens (R.A.).<br>Till 2014, External Director in Shahar Hadash Group Ltd., till December 2012, chairman of the board of directors of Capital Israeli Company for the Location of Money Ltd., till 2012, external director in Ophir Optronics Ltd., till 2010, external director in Menora Mivtachim Gemel Ltd., in Menora Mivtachim Pension Ltd. and chairman of investments committee in Avner Ltd. | YES - B.A. in Economics and Mathematics and MBA (Economics), Hebrew University in Jerusalem.<br>Senior Economist in the Bank Research Unit in the Bank of Israel<br>Head of Pricing Monitoring and Control Team, 1983-1995.<br>Senior Deputy to the Supervisor of Capital Markets, Insurance and Saving in the Finance Ministry, 1995-1998.<br>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. |
| **Prof. Efraim Sadka** | External director<br>Member of the following committees: Remuneration, Risk Management, Resources, Investments, and Foreign Customers.<br><br>Independent and external director as defined in the Companies Law and Proper Conduct of Banking Business Management Regulation no. 301 | Academic education - Ph.D. in Economics, Massachusetts Institute of Technology. B.A. in Economics and Statistics, Tel Aviv University.<br>Professor of Economics, Tel Aviv University Professor of Economics and Holder of the Henry Kaufman Chair of International Capital Markets, Tel Aviv University.<br>Chairman of the Babylonian Jewry Heritage Center.<br>Chairman of the Advisory Committee of Poalim Real Estate Fund<br>External Director of Paz Oil Co. Ltd.<br>Chairman of the Executive Board, The Pinhas Sapir Center for Development, Tel Aviv University.<br>Member of the Executive Board of the Sapir Forum, Member of the Association and Chairman of the Audit Committee of the Israel Democracy Institute, Deputy Editor of international professional periodicals, member of the Professional Committee of the Israel Accounting Standards Board. Director in Atidim Ltd. and Rabad Ltd., Owner and Director of A.Z. Eretz Ratz Ltd., Director in Sports Center.<br>Till June 2014, Chairman of the Advisory Committee in Poalim Real Estate Fund and Editor of the Economic Quarterly. Till 2012, chairman of the Bora salary committee (Committee of Heads of Higher Educational Institutions Committees) and director in B. Gaon Holdings Ltd. Till 2011, member of management of Association for Encouragement of Research into Literature and Arts – Achi – Foundation of Iraqi Immigrants to Israel and member of Committee for Examining the Raising of the Retirement Age for Women. Till 2010, member of the Public Committee for Re-examination of the Formula Used in the Allocation of Balancing Grants.<br>Till 2009, Visiting Professor in the Academic Stream of the College of Administration. | YES - .B.A. in Economics and Statistics, Tel Aviv University. Ph.D. in Economics, Massachusetts Institute of Technology.<br>Professor of Economics, Tel Aviv.<br>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.<br>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.<br>Previously, member and chairman of various boards of directors. |

| Name of Director | Membership in the committees of the Board of Directors, is the director independent / an external director as defined in the Companies Law / Proper Conduct of Banking Business Management no. 301 – Yes/no? | Education and employment in the past five years, giving details of professions or areas in which education has been acquired, the institution in which the academic degree or professional certificate which he holds was acquired, and details of the corporations in which he acts as director | Does the company regard him/her as having accounting and financial expertise? |
|---|---|---|---|
| **Prof. Yedidya Stern** | External director<br>Chairman of the Committee for Examining a Claim (*ad hoc*).<br>Member of the following committees: Audit, Prospectuses, Procedure, Logo and Investments<br><br>Independent and external director as defined in Proper Conduct of Banking Business Management Regulation no. 301. | Academic education – .B.A. in Law, Bar Ilan University, M.A. in Law, Harvard University, United States.<br>Professor of Law in Bar-Ilan University, Deputy President for Research in Israeli Democracy Institute .and member and founder of "Tekana Forum" for the Prevention of Sexual Harassment in the Religious Public.<br>Member of She'arim Committee – Association for the Empowerment and Jewish Renewal in Israel (R.A.).<br>Chairman of the Executive Committee in Volunteering in the Gefen Fund Association (R.A.).<br>Till 2014, member of the Committee for Governance in the Higher Education System.<br>To 2012- member of the Public Committee for the Promotion of Equality of Burden.<br>Till 2011, External lecturer in Kiryat Academit Ono, Visiting Professor in University of Monash and Chairman of the Professional Committee for Civics Studies in the State of Israel in the Ministry of Education. | NO |
| **Prof. Gabriella Shalev** | External director<br>Chairman of the Foreign Customers Committee and member of the following committees: Audit, Remuneration, Resources, Procedure, Strategy and Logo<br>Independent and external director as defined in the Companies Law and Proper Conduct of Banking Business Management Regulation no. 301. | Academic education – 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<br>Post-doctoral training in Law- Harvard University, USA.<br>President of the Senior Academic Council and Senior Lecturer in the Ono Academic College.<br>Shareholder in Din Publishing, Management and Services Ltd.<br>Owner and director in E.N. Shalom Ltd. Chairman of the Committee for the Appointment of Professors in the Field of Social Sciences, Management and Law in the Higher Education Council.<br>Member of the Yitzhak Rabin Israel Research Council. Chairman of the Executive Committee in the Kibbutz Dance Troupe. Till 2014, member of the Public Committee for Granting the "Efficiency Medal" for Associations, Corporations and Private Investors in Midot, member of the steering team for formulating a the concept of national security, Chairman of the Jury for the Sapir Literature Prize in Mifal Hapayis. President of the Supreme Academic Council in the Kiryah Academit, Kiryat Ono.<br>Till 2010, Israel Ambassador at the United Nations | YES - 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.<br>Served for lengthy periods on Boards of Directors of public companies and banks. In some of these companies, served as external director.<br>Served as Director and Head of Audit Committee in Bank Hapoalim. |

## Board of Directors

During 2014 and until the publication of the Report, the following changes took place in the composition of the Board of Directors:

On 25 July 2014, Ms. Miri Katz, Ms. Zipporah Samet and Mr. David Avner terminated their term of office as directors in the Bank, and on 31 October 2014, Mr. Amos Sapir terminated his term of office as director in the Bank.

On 6 August 2014, the Annual General Meeting of the Bank was held, with the following subjects on appearing on the agenda, *inter alia*: (1) the election of two directors for a term of office on the Board of Directors of the Bank; (2) the election of one external director pursuant to Regulation 301 of the Supervisor of Banks; and (3) the election of one external director pursuant to the Companies Law.

At the Annual General Meeting, the following serving directors were re-elected, Ms. Zipporah Samet, as external director pursuant to the Companies Law for a period of three years, and Mr. David Avner. In addition, Professor Haim Levy, as external director pursuant to Regulation 301 of the Supervisor of Banks, and Dr. Samer Haj Yehia, were elected as directors.

The Board of Directors currently numbers 15 directors.

During 2014, the Board of Directors held 45 plenary meetings and 111 committee meetings.

At the Meeting of the Board of Directors that took place on 31 March 2015, it was decided to approve and publish the audited consolidated financial statements of the Group as at 31 December 2014 and for the period ended on that date.

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

31 March 2015

**Below are tables of detailed financial information by subjects, segments and periods:**

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Consolidated Balance Sheet as at end of years 2010-2014

### Exhibit A

| | **2014** | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| | NIS millions | | | | |
| **Assets** | | | | | |
| Cash and deposits with banks | **60,615** | 44,351 | 54,621 | 53,044 | 30,052 |
| Securities | **52,113** | 63,735 | 56,408 | 47,936 | 55,791 |
| Securities borrowed or purchased under agreements to resell | **2,000** | 1,360 | 1,435 | 1,225 | 1,190 |
| Credit to the public | **256,468** | 244,757 | 245,378 | 245,287 | 234,255 |
| Allowance for credit losses | **(3,988)** | (3,883) | (4,114) | (3,967) | (10,274) |
| Credit to the public, net | **252,480** | 240,874 | 241,264 | 241,320 | 223,981 |
| Credit to governments | **528** | 558 | 442 | 448 | 379 |
| Investments in companies included on equity basis | **2,216** | 1,689 | 2,129 | 2,270 | 1,924 |
| Buildings and equipment | **3,729** | 3,638 | 3,705 | 3,653 | 3,638 |
| Intangible assets and goodwill | **43** | 99 | 189 | 181 | 45 |
| Assets in respect of derivative instruments | **16,909** | 13,054 | 11,438 | 11,573 | 8,717 |
| Other assets | **5,501** | 5,182 (a) | 4,714 (a) | 4,204 | 2,605 |
| Total assets | **396,134** | 374,540 | 376,345 | 365,854 | 328,322 |
| **Liabilities and equity** | | | | | |
| Deposits of the public | **303,397** | 286,003 | 289,538 | 279,404 | 249,584 |
| Deposits from banks | **4,556** | 4,310 | 4,073 | 5,056 | 2,691 |
| Deposits from governments | **467** | 397 | 451 | 519 | 660 |
| Securities lent or sold under agreements to repurchase | **1,238** | 624 | 1,007 | 442 | 1,006 |
| Debentures, bonds and subordinated notes | **23,678** | 25,441 | 27,525 | 29,999 | 26,939 |
| Liabilities in respect of derivative instruments | **15,650** | 13,487 | 12,762 | 12,069 | 9,985 |
| Other liabilities | **18,715** | 17,809 (a) | 16,092 (a) | 14,737 | 13,846 |
| Total liabilities | **367,701** | 348,071 | 351,448 | 342,226 | 304,711 |
| Non-controlling interests | **340** | 340 | 307 | 254 | 318 |
| Equity attributable to shareholders of the banking corporation | **28,093** | 26,129 (a) | 24,590 (a) | 23,374 | 23,293 |
| Total equity | **28,433** | 26,469 | 24,897 | 23,628 | 23,611 |
| Total liabilities and equity | **396,134** | 374,540 | 376,345 | 365,854 | 328,322 |

(a) Restated pursuant to a change in accounting method for accumulating employee rights – see Note 1.R.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Consolidated Statement of Profit and Loss for the years 2010-2014

### Exhibit B

| | **2014** | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| | (NIS millions) | | | | |
| Interest income | **10,012** | 12,134 | 13,507 | 14,283 | 12,489 |
| Interest expenses | **2,649** | 4,777 | 6,099 | 7,176 | 5,517 |
| Net interest income | **7,363** | 7,357 | 7,408 | 7,107 | 6,972 |
| Expenses in respect of credit losses | **472** | 268 | 1,236 | 734 | 584 |
| Net interest income after expenses in respect of credit losses | **6,891** | 7,089 | 6,172 | 6,373 | 6,388 |
| **Non-interest income** | | | | | |
| Non-interest financing income | **795** | 1,127 | 444 | 11 | 475 |
| Commissions | **4,167** | 4,188 | 4,199 | 4,116 | 4,129 |
| Other income | **211** | 202 | 131 | 48 | 163 |
| Total non-interest income | **5,173** | 5,517 | 4,774 | 4,175 | 4,767 |
| **Operating and other expenses** | | | | | |
| Salaries and related expenses | **4,968** | 5,133 (a) | 5,310 (a) | 5,061 | 4,686 |
| Building and equipment maintenance and depreciation | **1,778** | 1,833 | 1,819 | 1,704 | 1,591 |
| Amortization of intangible assets and goodwill | **58** | 88 | 23 | 2 | 80 |
| Other expenses | **2,507** | 1,838 | 1,968 | 1,574 | 1,604 |
| Total operating and other expenses | **9,311** | 8,892 | 9,120 | 8,341 | 7,961 |
| Profit before taxes | **2,753** | 3,714 | 1,826 | 2,207 | 3,194 |
| Provision for taxes on profit | **1,281** | 1,397 (a) | 800 (a) | 418 | 1,241 |
| Profit after taxes | **1,472** | 2,317 | 1,026 | 1,789 | 1,953 |
| Banking corporation's share in profits (losses) of companies included on equity basis after tax | **42** | (293) | (67) | 148 | 420 |
| **Net profit:** | | | | | |
| Before attributing to non-controlling interests | **1,514** | 2,024 | 959 | 1,937 | 2,373 |
| Attributed to non-controlling interests | **(12)** | (42) | (37) | (46) | (39) |
| Attributed to shareholders of the banking corporation | **1,502** | 1,982 | 922 | 1,891 | 2,334 |
| **Basic and diluted earnings per share:** | | | | | |
| Net profit attributed to shareholders of the banking corporation (in NIS) | **1.02** | 1.35 | 0.63 | 1.28 | 1.58 |

(a) Restated pursuant to a change in accounting method for accumulating employee rights – see Note 1.R.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Rates of income and expenses[(a)] and analysis of changes in interest income and expenses

### Exhibit C

**Part A** – Average balances and interest rates - assets

| | **2014** | | | 2013 (j) | | | 2012 (j) | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Average balance (b)** | **Interest income** | **Rate of income** | Average balance (b) | Interest income | Rate of income | Average balance (b) | Interest income | Rate of income |
| | (NIS millions) | | % | (NIS millions) | | % | (NIS millions) | | % |
| **Interest-bearing assets** | | | | | | | | | |
| Credit to the public (c) | | | | | | | | | |
| In Israel | **216,805** | **8,108** | **3.74** | 209,967 | 9,700 | 4.62 | 211,870 | 10,512 | 4.96 |
| Outside Israel | **23,025** | **945** | **4.10** | 25,799 | 978 | 3.79 | 27,543 | 1,066 | 3.87 |
| Total (i) | **239,830** | **9,053** | **3.77** | 235,766 | 10,678 | 4.53 | 239,413 | 11,578 | 4.84 |
| Credit to the government | | | | | | | | | |
| In Israel | **464** | **18** | **3.88** | 453 | 23 | 5.08 | 412 | 21 | 5.10 |
| Outside Israel | **42** | **-** | **-** | 24 | - | - | 8 | - | - |
| Total | **506** | **18** | **3.56** | 477 | 23 | 4.82 | 420 | 21 | 5.00 |
| Deposits in banks | | | | | | | | | |
| In Israel | **8,387** | **57** | **0.68** | 7,182 | 62 | 0.86 | 6,606 | 76 | 1.15 |
| Outside Israel | **1,518** | **25** | **1.65** | 2,403 | 13 | 0.54 | 3,013 | 19 | 0.63 |
| Total | **9,905** | **82** | **0.83** | 9,585 | 75 | 0.78 | 9,619 | 95 | 0.99 |
| Deposits in central banks | | | | | | | | | |
| In Israel | **24,651** | **136** | **0.55** | 21,638 | 309 | 1.43 | 21,861 | 513 | 2.35 |
| Outside Israel | **5,376** | **10** | **0.19** | 4,343 | 7 | 0.16 | 4,388 | 2 | 0.05 |
| Total | **30,027** | **146** | **0.49** | 25,981 | 316 | 1.22 | 26,249 | 515 | 1.96 |
| Securities borrowed or purchased under resale agreements | | | | | | | | | |
| In Israel | **1,668** | **11** | **0.66** | 1,362 | 20 | 1.47 | 1,819 | 45 | 2.47 |
| Outside Israel | **-** | **-** | **-** | - | - | - | - | - | - |
| Total | **1,668** | **11** | **0.66** | 1,362 | 20 | 1.47 | 1,819 | 45 | 2.47 |
| Bonds available for sale (d) | | | | | | | | | |
| In Israel | **35,451** | **517** | **1.46** | 41,254 | 771 | 1.87 | 38,816 | 925 | 2.38 |
| Outside Israel | **4,473** | **76** | **1.70** | 3,940 | 43 | 1.09 | 4,208 | 41 | 0.97 |
| Total | **39,924** | **593** | **1.49** | 45,194 | 814 | 1.80 | 43,024 | 966 | 2.25 |
| Bonds for trading (d) | | | | | | | | | |
| In Israel | **10,249** | **106** | **1.03** | 9,742 | 206 | 2.11 | 10,277 | 266 | 2.59 |
| Outside Israel | **166** | **3** | **1.81** | 314 | 2 | 0.64 | 313 | 21 | 6.71 |
| Total | **10,415** | **109** | **1.05** | 10,056 | 208 | 2.07 | 10,590 | 287 | 2.71 |
| **Total interest-bearing assets** | **332,275** | **10,012** | **3.01** | 328,421 | 12,134 | 3.69 | 331,134 | 13,507 | 4.08 |
| Receivables for non-interest bearing credit cards | **7,396** | | | 7,037 | | | 6,144 | | |
| Other non-interest bearing assets (e) | **38,111** | | | 30,706 | | | 28,626 | | |
| **Total assets** | **377,782** | **10,012** | | 366,164 | 12,134 | | 365,904 | 13,507 | |
| Total income-bearing assets attributable to activity outside Israel | **34,600** | **1,059** | **3.06** | 36,823 | 1,043 | 2.83 | 39,473 | 1,149 | 2.91 |

See notes on page 263 below.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Rates of income and expenses[(a)] and analysis of changes in interest income and expenses (cont'd)

## Exhibit C (cont'd)

**Part B –** Average balances and interest rates – liabilities and equity

| | **2014** | | | 2013 (j) | | | 2012 (j) | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Average balance (b)** | **Interest expenses** | **Rate of expenses** | Average balance (b) | Interest expenses | Rate of expenses | Average balance (b) | Interest expenses | Rate of expenses |
| | (NIS millions) | | % | (NIS millions) | | % | (NIS millions) | | % |
| **Interest- bearing liabilities** | | | | | | | | | |
| Deposits of the public | | | | | | | | | |
| In Israel | **210,458** | **(1,447)** | **(0.69)** | 212,077 | (2,974) | (1.40) | 223,593 | (4,190) | (1.87) |
| On demand | **48,914** | **(96)** | **(0.20)** | 41,228 | (195) | (0.47) | 40,225 | (288) | (0.72) |
| Fixed term | **161,544** | **(1,351)** | **(0.84)** | 170,849 | (2,779) | (1.63) | 183,368 | (3,902) | (2.13) |
| Outside Israel | **16,479** | **(138)** | **(0.84)** | 17,876 | (175) | (0.98) | 18,764 | (251) | (1.34) |
| On demand | **2,779** | **(7)** | **(0.25)** | 2,923 | (11) | (0.38) | 3,073 | (1) | (0.03) |
| Fixed term | **13,700** | **(131)** | **(0.96)** | 14,953 | (164) | (1.10) | 15,691 | (250) | (1.59) |
| Total | **226,937** | **(1,585)** | **(0.70)** | 229,953 | (3,149) | (1.37) | 242,357 | (4,441) | (1.83) |
| Deposits of the government | | | | | | | | | |
| In Israel | **144** | **(6)** | **(4.17)** | 224 | (8) | (3.57) | 316 | (14) | (4.43) |
| Outside Israel | **245** | **-** | **-** | 233 | - | - | 141 | - | - |
| Total | **389** | **(6)** | **(1.54)** | 457 | (8) | (1.75) | 457 | (14) | (3.06) |
| Deposits from central banks | | | | | | | | | |
| In Israel | **61** | **-** | **-** | - | - | - | - | - | - |
| Outside Israel | **-** | **-** | **-** | - | - | - | - | - | - |
| Total | **61** | **-** | **-** | - | - | - | - | - | - |
| Deposits from banks | | | | | | | | | |
| In Israel | **4,147** | **(26)** | **(0.63)** | 3,256 | (35) | (1.07) | 2,460 | (52) | (2.11) |
| Outside Israel | **94** | **(20)** | **(21.28)** | 195 | (2) | (1.03) | 847 | (6) | (0.71) |
| Total | **4,241** | **(46)** | **(1.08)** | 3,451 | (37) | (1.07) | 3,307 | (58) | (1.75) |
| Securities lent or sold under resale agreements | | | | | | | | | |
| In Israel | **876** | **(9)** | **(1.03)** | 728 | (13) | (1.79) | 1,028 | (29) | (2.82) |
| Outside Israel | **-** | **-** | **-** | 28 | (1) | (3.57) | 58 | (2) | (3.45) |
| Total | **876** | **(9)** | **(1.03)** | 756 | (14) | (1.85) | 1,086 | (31) | (2.85) |
| Bonds | | | | | | | | | |
| In Israel | **24,503** | **(1,003)** | **(4.09)** | 26,884 | (1,568) | (5.83) | 27,953 | (1,553) | (5.56) |
| Outside Israel | **10** | **-** | **-** | 10 | (1) | (10.00) | 434 | (2) | (0.46) |
| Total | **24,513** | **(1,003)** | **(4.09)** | 26,894 | (1,569) | (5.83) | 28,387 | (1,555) | (5.48) |
| **Total interest-bearing liabilities** | **257,017** | **(2,649)** | **(1.03)** | 261,511 | (4,777) | (1.83) | 275,594 | (6,099) | (2.21) |
| Non-interest bearing deposits of the public | **59,070** | | | 47,890 | | | 40,259 | | |
| Payables for non-interest bearing credit cards | **8,009** | | | 7,565 | | | 5,501 | | |
| Other non-interest bearing liabilities (f) | **26,465** | | | 23,849 | | | 20,423 | | |
| **Total liabilities** | **350,561** | **(2,649)** | | 340,815 | (4,777) | | 341,777 | (6,099) | |
| **Total capital means** | **27,221** | | | 25,349 | | | 24,127 | | |
| **Total liabilities and capital means** | **377,782** | **(2,649)** | | 366,164 | (4,777) | | 365,904 | (6,099) | |
| **Interest margin** | | **7,363** | **1.98** | | 7,357 | 1.87 | | 7,408 | 1.87 |
| **Net yield (g) on interest-bearing assets** | | | | | | | | | - |
| In Israel | **297,675** | **6,462** | **2.17** | 291,598 | 6,493 | 2.23 | 291,661 | 6,520 | 2.24 |
| Outside Israel | **34,600** | **901** | **2.60** | 36,823 | 864 | 2.35 | 39,473 | 888 | 2.25 |
| Total | **332,275** | **7,363** | **2.22** | 328,421 | 7,357 | 2.24 | 331,134 | 7,408 | 2.24 |
| Total interest-bearing liabilities attributable to activity outside Israel | **16,828** | **(158)** | **(0.94)** | 18,342 | (179) | (0.98) | 20,244 | (261) | (1.29) |

See notes on page 263 below.

## Bank Leumi le-Israel B.M. and its Consolidated Companies
### Rates of income and expenses[(a)] and analysis of changes in interest income and expenses (cont'd)

### Exhibit C (cont'd)

**Part C** – Average balances and interest rates – additional information on interest-bearing assets and liabilities attributable to activity in Israel

| | **2014** | | | 2013 (j) | | | 2012 (j) | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Average balance (b)** | **Interest income (expenses)** | **Rate of income (expenses)** | Average balance (b) | Interest income (expenses) | Rate of income (expenses) | Average balance (b) | Interest income (expenses) | Rate of income (expenses) |
| | (NIS millions) | | % | (NIS millions) | | % | (NIS millions) | | % |
| **Index-linked Israeli currency** | | | | | | | | | |
| Total interest-bearing assets | **56,436** | **1,890** | **3.35** | 59,223 | 3,206 | 5.41 | 62,006 | 3,182 | 5.13 |
| Total interest-bearing liabilities | **48,374** | **(1,418)** | **(2.93)** | 49,671 | (2,580) | (5.19) | 49,897 | (2,434) | (4.88) |
| Interest margin | | | **0.42** | | | 0.22 | | | 0.25 |
| **Unlinked Israeli** | | | | | | | | | |
| Total interest-bearing assets | **200,542** | **6,178** | **3.08** | 189,342 | 6,976 | 3.68 | 182,267 | 7,973 | 4.37 |
| Total interest-bearing liabilities | **152,607** | **(906)** | **(0.59)** | 145,862 | (1,752) | (1.20) | 149,905 | (2,829) | (1.89) |
| Interest margin | | | **2.49** | | | 2.48 | | | 2.49 |
| **Foreign currency** | | | | | | | | | |
| Total interest-bearing assets | **40,697** | **885** | **2.17** | 43,033 | 909 | 2.11 | 47,388 | 1,203 | 2.54 |
| Total interest-bearing liabilities | **39,208** | **(167)** | **(0.43)** | 47,636 | (266) | (0.56) | 55,548 | (575) | (1.04) |
| Interest margin | | | **1.75** | | | 1.55 | | | 1.50 |
| **Total activity in Israel** | | | | | | | | | |
| Total interest-bearing assets | **297,675** | **8,953** | **3.01** | 291,598 | 11,091 | 3.80 | 291,661 | 12,358 | 4.24 |
| Total interest-bearing liabilities | **240,189** | **(2,491)** | **(1.04)** | 243,169 | (4,598) | (1.89) | 255,350 | (5,838) | (2.29) |
| Interest margin | | | **1.97** | | | 1.91 | | | 1.95 |

See notes on page 263 below.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Rates of income and expenses[a] and analysis of changes in interest income and expenses (cont'd)

## Exhibit C (cont'd)

**Part D** – Analysis of changes in interest income and interest expenses

| | **2014 compared to 2013** | | | 2013 compared to 2012 (j) | | |
|---|---|---|---|---|---|---|
| | Increase (decrease) due to change (h) | | Net change | Increase (decrease) due to change (h) | | Net change |
| | Amount | Price | | Amount | Price | |
| | (NIS millions) | | | | | |
| **Interest-bearing assets** | | | | | | |
| Credit to the public | | | | | | |
| In Israel | **256** | **(1,848)** | **(1,592)** | (88) | (724) | (812) |
| Outside Israel | **(114)** | **81** | **(33)** | (66) | (22) | (88) |
| Total | **142** | **(1,767)** | **(1,625)** | (154) | (746) | (900) |
| Other interest-bearing assets | | | | | | |
| In Israel | **(8)** | **(538)** | **(546)** | 31 | (486) | (455) |
| Outside Israel | **5** | **44** | **49** | (5) | (13) | (18) |
| Total | **(3)** | **(494)** | **(497)** | 26 | (499) | (473) |
| **Total interest income** | **139** | **(2,261)** | **(2,122)** | (128) | (1,245) | (1,373) |
| **Interest-bearing liabilities** | | | | | | |
| **Deposits of the public** | | | | | | |
| In Israel | **(11)** | **(1,516)** | **(1,527)** | (161) | (1,055) | (1,216) |
| Outside Israel | **(12)** | **(25)** | **(37)** | (9) | (67) | (76) |
| Total | **(23)** | **(1,541)** | **(1,564)** | (170) | (1,122) | (1,292) |
| Other interest-bearing liabilities | | | | | | |
| In Israel | **(48)** | **(532)** | **(580)** | (35) | 11 | (24) |
| Outside Israel | **(7)** | **23** | **16** | (9) | 3 | (6) |
| Total | **(55)** | **(509)** | **(564)** | (44) | 14 | (30) |
| **Total interest expenses** | **(78)** | **(2,050)** | **(2,128)** | (214) | (1,108) | (1,322) |

See notes on page 263 below.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Rates of income and expenses[(a)] and analysis of changes in interest income and expenses (cont'd)

## Exhibit C (cont'd)

**Notes:**

(a) The data in these tables are after the effect of derivative instruments.

(b) Based on monthly opening balances, except for the unlinked Israeli currency sector in which the average balance is based on daily figures, and before deduction of the average book balance of allowances for credit losses, overseas subsidiaries on the basis of quarterly opening balances.

(c) Before deduction of the average balance of allowances for credit losses. Including impaired debts not accruing interest income.

(d) From the average balance of the assets there has been deducted (added) the average balance of unrealized profits (losses) from adjustments to fair value of debentures held for trading and available for sale, in the various sectors, the amount of NIS 428 million (31 December 2013 – NIS 403 million).

(e) Including book balances of derivative instruments, other non-interest bearing assets, non-monetary assets and after deducting the allowance for credit losses.

(f) Including book balances of derivative instruments, and non-monetary liabilities.

(g) Net return – net interest income divided by total interest-bearing assets.

(h) The calculation of the allocation between a change in amount and a change in price is made as follows: change in price - the change in price is multiplied by the book balance for the corresponding period; change in amount – the change in book balance is multiplied by the price for the current period.

(i) Commissions in the amount of NIS 487 million were included in interest income from credit to the public (31 December 2013 – NIS 273 million).

(j) Reclassified.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Exposure to Interest Rate Fluctuations
## Exhibit D

| | 31 December 2014 | | | | |
|---|---|---|---|---|---|
| | 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 |
| | NIS millions | | | | |
| **Israeli currency - unlinked** | | | | | |
| **Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments** | | | | | |
| Financial assets (a) | 172,851 | 7,621 | 19,668 | 8,574 | 5,898 |
| Derivative financial instruments (excluding options) | 63,787 | 92,168 | 60,312 | 43,888 | 24,533 |
| Options (in terms of the underlying asset) (d) | 3,783 | 1,896 | 3,487 | 1,078 | 1,164 |
| Off-balance sheet financial instruments | - | - | - | - | - |
| Total fair value | 240,421 | 101,685 | 83,467 | 53,540 | 31,595 |
| **Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments** | | | | | |
| Financial liabilities (a) | 161,327 | 6,987 | 3,915 | 6,383 | 3,202 |
| Derivative financial instruments (excluding options) | 65,620 | 101,976 | 72,393 | 41,000 | 22,722 |
| Options (in terms of the underlying asset) (d) | 3,662 | 1,696 | 3,920 | 1,096 | 3 |
| Off-balance sheet financial instruments | - | - | 29 | - | - |
| Total fair value | 230,609 | 110,659 | 80,257 | 48,479 | 25,927 |
| **Financial instruments, net** | | | | | |
| Exposure to interest rate changes in the segment | 9,812 | (8,974) | 3,210 | 5,061 | 5,668 |
| Accumulated exposure in the sector | 9,812 | 838 | 4,048 | 9,109 | 14,777 |
| **Israeli currency – linked to the CPI** | | | | | |
| **Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments** | | | | | |
| Financial assets (a) | 1,745 | 3,439 | 12,634 | 17,683 | 12,369 |
| Derivative financial instruments (excluding options) | 44 | 253 | 1,733 | 1,514 | 1,570 |
| Options (in terms of the underlying asset) (d) | - | - | - | - | - |
| Off-balance sheet financial instruments | - | - | - | - | - |
| Total fair value | 1,789 | 3,692 | 14,367 | 19,197 | 13,939 |
| **Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments** | | | | | |
| Financial liabilities (a) | 3,471 | 3,912 | 8,478 | 16,134 | 7,246 |
| Derivative financial instruments (excluding options) | 532 | 625 | 1,905 | 2,260 | 1,440 |
| Options (in terms of the underlying asset) (d) | - | - | - | - | - |
| Off-balance sheet financial instruments | - | - | 145 | - | - |
| Total fair value | 4,003 | 4,537 | 10,528 | 18,394 | 8,686 |
| **Financial instruments, net** | | | | | |
| Exposure to interest rate changes in the segment | (2,214) | (845) | 3,839 | 803 | 5,253 |
| Accumulated exposure in the sector | (2,214) | (3,059) | 780 | 1,583 | 6,836 |

See notes on page 268.

| Over five years to ten years | Over ten years to twenty years | Over twenty years | Without fixed maturity | Total fair value | Internal rate of return | Average effective duration (b) | 31 December 2013<br>Total fair value | Internal rate of return | Average effective duration (b) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | (%) | (Years) | | (%) | (Years) |
| **4,931** | **2,379** | **231** | **257** | **222,410** | **2.83** | **0.63** | 211,239 | 3.51 | 0.59 |
| **24,788** | **604** | **-** | **-** | **310,080** | **-** | **1.37** | 303,155 | - | 1.63 |
| **734** | **33** | **-** | **-** | **12,175** | **-** | **-** | 8,494 | - | - |
| **-** | **-** | **-** | **-** | **-** | **-** | **-** | - | - | - |
| **30,453** | **3,016** | **231** | **257** | **544,665** | **2.83** | **1.03** | 522,888 | 3.51 | 1.19 |
| **449** | **82** | **-** | **3** | **182,348** | **0.54** | **0.26** | 169,974 | 0.93 | 0.23 |
| **26,128** | **489** | **28** | **-** | **330,356** | **-** | **1.31** | 328,510 | - | 1.56 |
| **-** | **-** | **-** | **-** | **10,377** | **-** | **-** | 5,868 | - | - |
| **-** | **-** | **-** | **-** | **29** | **-** | **0.50** | 27 | - | 0.50 |
| **26,577** | **571** | **28** | **3** | **523,110** | **0.54** | **0.92** | 504,379 | 0.93 | 1.10 |
| **3,876** | **2,445** | **203** | | | | | | | |
| **18,653** | **21,098** | **21,301** | | | | | | | |
| **5,753** | **1,646** | **241** | **14** | **55,524** | **2.07** | **2.92** | 59,960 | 2.03 | 2.93 |
| **1,617** | **45** | **-** | **-** | **6,776** | **-** | **3.27** | 7,098 | - | 3.03 |
| **-** | **-** | **-** | **-** | **-** | **-** | **-** | - | - | - |
| **-** | **-** | **-** | **-** | **-** | **-** | **-** | - | - | - |
| **7,370** | **1,691** | **241** | **14** | **62,300** | **2.07** | **2.96** | **67,058** | 2.03 | 2.94 |
| **10,119** | **831** | **305** | **-** | **50,496** | **0.85** | **2.96** | 53,425 | 1.27 | 3.36 |
| **1,975** | **164** | **-** | **-** | **8,901** | **-** | **3.30** | 9,744 | - | 2.47 |
| **-** | **-** | **-** | **-** | **-** | **-** | **-** | - | - | - |
| **-** | **-** | **-** | **-** | **145** | **-** | **-** | 100 | - | - |
| **12,094** | **995** | **305** | **-** | **59,542** | **0.85** | **3.00** | 63,269 | 1.27 | 3.21 |
| **(4,724)** | **696** | **(64)** | | | | | | | |
| **2,112** | **2,808** | **2,744** | | | | | | | |

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Exposure to Interest Rate Fluctuations (cont'd)
## Exhibit D (cont'd)

| | 31 December 2014 | | | | |
|---|---|---|---|---|---|
| | 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 |
| | NIS millions | | | | |
| **Foreign currency and foreign currency linked** | | | | | |
| **Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments** | | | | | |
| Financial assets (a) | 46,291 | 14,257 | 6,660 | 7,982 | 5,301 |
| Derivative financial instruments (excluding options) | 76,018 | 86,475 | 64,739 | 19,295 | 11,143 |
| Options (in terms of the underlying asset) (d) | 3,470 | 1,278 | 6,717 | 4,283 | 650 |
| Off-balance sheet financial instruments | - | - | - | - | - |
| Total fair value | 125,779 | 102,010 | 78,116 | 31,560 | 17,094 |
| **Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments** | | | | | |
| Financial liabilities (a) | 77,737 | 16,467 | 13,256 | 3,994 | 1,078 |
| Derivative financial instruments (excluding options) | 65,357 | 80,219 | 50,652 | 21,873 | 12,257 |
| Options (in terms of the underlying asset) (d) | 2,989 | 1,538 | 6,321 | 4,299 | 1,749 |
| Off-balance sheet financial instruments | - | - | 13 | - | - |
| Total fair value | 146,083 | 98,224 | 70,242 | 30,166 | 15,084 |
| **Financial instruments, net** | | | | | |
| Exposure to interest rate fluctuations | (20,304) | 3,786 | 7,874 | 1,394 | 2,010 |
| Accumulated exposure in the sector | (20,304) | (16,518) | (8,644) | (7,250) | (5,240) |
| **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) | 220,887 | 25,317 | 38,962 | 34,239 | 23,568 |
| Derivative financial instruments (excluding options) | 139,849 | 178,896 | 126,784 | 64,697 | 37,246 |
| Options (in terms of the underlying asset) (d) | 7,253 | 3,174 | 10,204 | 5,361 | 1,814 |
| Off-balance sheet financial instruments | - | - | - | - | - |
| Total fair value | 367,989 | 207,387 | 175,950 | 104,297 | 62,628 |
| **Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments** | | | | | |
| Financial liabilities (a) (c) | 242,535 | 27,366 | 25,649 | 26,511 | 11,526 |
| Derivative financial instruments (excluding options) | 131,509 | 182,820 | 124,950 | 65,133 | 36,419 |
| Options (in terms of the underlying asset) (d) | 6,651 | 3,234 | 10,241 | 5,395 | 1,752 |
| Off-balance sheet financial instruments | - | - | 187 | - | - |
| Total fair value | 380,695 | 213,420 | 161,027 | 97,039 | 49,697 |
| **Financial instruments, net** | | | | | |
| Exposure to interest rate fluctuations | (12,706) | (6,033) | 14,923 | 7,258 | 12,931 |
| Accumulated exposure in the sector | (12,706) | (18,739) | (3,816) | 3,442 | 16,373 |

See notes on page 268.

| Over five years to ten years | Over ten years to twenty years | Over twenty years | Without fixed maturity | Total fair value | Internal rate of return | Average effective duration (b) | 31 December 2013<br>Total fair value | Internal rate of return | Average effective duration (b) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | (%) | (Years) | | (%) | (Years) |
| 5,864 | 353 | 171 | 191 | 87,070 | 2.05 | 1.07 | 77,800 | 2.40 | 0.99 |
| 14,091 | 374 | 28 | 169 | 272,332 | - | 0.99 | 168,127 | - | 0.87 |
| 1,009 | 89 | - | - | 17,496 | - | - | 13,784 | - | - |
| - | - | - | - | - | - | - | - | - | - |
| 20,964 | 816 | 199 | 360 | 376,898 | 2.05 | 0.96 | 259,711 | 2.40 | 0.86 |
| 170 | 54 | 1 | 9 | 112,766 | 0.89 | 0.28 | 104,920 | 0.86 | 0.27 |
| 16,911 | 458 | 67 | 169 | 247,963 | - | 1.14 | 140,853 | - | 1.17 |
| 1,709 | 89 | - | - | 18,694 | - | - | 15,769 | - | - |
| - | - | - | - | 13 | - | 0.50 | 14 | - | 0.50 |
| 18,790 | 601 | 68 | 178 | 379,436 | 0.89 | 0.83 | 261,556 | 0.86 | 0.74 |
| 2,174 | 215 | 131 | | | | | | | |
| (3,066) | (2,851) | (2,720) | | | | | | | |
| 16,548 | 4,378 | 643 | 5,561 | 370,103 | 2.34 | 1.08 | 353,432 | 2.62 | 1.08 |
| 40,496 | 1,023 | 28 | 1,787 | 590,806 | - | 1.21 | 479,943 | - | 1.39 |
| 1,743 | 122 | - | 93 | 29,764 | - | - | 22,294 | - | - |
| - | - | - | - | - | - | - | - | - | - |
| 58,787 | 5,523 | 671 | 7,441 | 990,673 | 2.34 | 1.13 | 855,669 | 2.62 | 1.23 |
| 10,738 | 967 | 306 | 426 | 346,024 | 0.58 | 0.66 | 328,960 | 1.46 | 0.75 |
| 45,014 | 1,111 | 95 | 3,096 | 590,147 | - | 1.27 | 481,033 | - | 1.47 |
| 1,709 | 89 | - | 93 | 29,164 | - | - | 21,637 | - | - |
| - | - | - | 169 | 356 | - | 0.06 | 289 | - | 0.09 |
| 57,461 | 2,167 | 401 | 3,784 | 965,691 | 0.58 | 1.01 | 831,919 | 1.46 | 1.14 |
| 1,326 | 3,356 | 270 | | | | | | | |
| 17,699 | 21,055 | 21,325 | | | | | | | |

# Bank Leumi le-Israel B.M. and its Consolidated Companies
**Exposure to Interest Rate Fluctuations (cont'd)**
**Exhibit D (cont'd)**

**Notes:**

(a) Excluding book balances of derivative financial instruments, fair value of off-balance sheet financial instruments, and fair value of complex financial instruments. In the "Without fixed maturity" column are reported non-discounted book balances, including balances after their repayment date in the amount of NIS 455 million.

(b) Weighted average according to fair value of effective duration.

(c) Including non-monetary items shown in the "Without fixed maturity" column.

(d) Duration less than 0.05 years.

**General notes:**

(1) In this table, the data by periods represent the present value of future cash flows, discounted at the internal rate of return used for discounting to the fair value included in respect of the financial instrument, consistent with the assumptions used in calculating the fair value of the financial instrument. For further details regarding the assumptions used in the calculation of the fair value of the financial instruments, see Note 18 in the Annual Financial Report.

(2) The internal rate of return is the interest rate for discounting the cash flows expected from a financial instrument to the fair value included in respect of it.

(3) The effective duration of a group of financial instruments constitutes an approximation of the percentage change in the fair value of the group of financial instruments that would be caused as a result of a small change (an increase of 0.1%) in the internal rate of return of each of the financial instruments.

(4) The effect of hedging transactions is included in total assets or total liabilities, as applicable.

(5) In calculating the duration of assets and liabilities in the CPI-linked segment an estimate was taken into account of early redemptions and withdrawals at exit points in savings plans, in accordance with a model estimating expected early redemptions based on the behavior of savers. The duration of total assets according to the original cash flow of the savings plans is higher and reached 3.32 years, the duration of total liabilities reaches 3.28 years, and the gap in the internal rate of return (hereinafter – IRR) amounts to 0.94%. The change in fair value in total assets is NIS 791 million and in total liabilities NIS 13 million.

(6) Further details of the exposure to interest rate fluctuations for each segment of financial assets and financial liabilities by the various balance sheet headings, will be supplied on request.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Overall credit risk to the public by sector of the economy
## Exhibit E

| | 31 December 2014 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Overall credit risk (a) | | | Debts (b) and off-balance sheet credit risk (excluding derivatives) (c) | | | | | | |
| | | | | | [1]Of which: | | | Credit losses (d) | | |
| | Total | Credit performance rating | Problematic (e) | Total[1] | Debts (b) | Problematic (e) | Impaired | Expenses in respect of credit losses | Net accounting write-offs | Balance of allowance for credit losses |
| | (NIS millions) | | | | | | | | | |
| **Activities of borrowers in Israel** | | | | | | | | | | |
| Agriculture | **2,251** | **2,129** | **122** | **2,241** | **1,898** | **118** | **46** | **(1)** | **26** | **(19)** |
| Industry | **30,588** | **28,329** | **2,259** | **29,234** | **19,245** | **2,249** | **548** | **(132)** | **(81)** | **(500)** |
| Construction and real estate - construction | **46,446** | **45,045** | **1,401** | **46,373** | **16,196** | **1,399** | **748** | **(299)** | **(146)** | **(283)** |
| Construction and real estate - real estate activity | **25,341** | **23,413** | **1,928** | **25,253** | **22,422** | **1,920** | **1,375** | **159** | **(2)** | **(683)** |
| Electricity and water | **4,570** | **4,569** | **1** | **4,025** | **3,391** | **1** | **-** | **(1)** | **1** | **(10)** |
| Commerce | **24,432** | **22,821** | **1,611** | **24,187** | **19,619** | **1,583** | **237** | **77** | **102** | **(355)** |
| Hotels, accomodation and food services | **2,938** | **2,737** | **201** | **2,918** | **2,608** | **201** | **165** | **(50)** | **(44)** | **(28)** |
| Transport and storage | **6,386** | **5,877** | **509** | **6,326** | **5,449** | **509** | **316** | **(39)** | **17** | **(50)** |
| Communications and computer services | **5,553** | **5,092** | **461** | **5,268** | **4,024** | **458** | **203** | **(61)** | **10** | **(144)** |
| Financial services | **24,913** | **24,844** | **69** | **17,481** | **10,031** | **53** | **20** | **253** | **(92)** | **(310)** |
| Other business services | **9,032** | **8,823** | **209** | **9,000** | **6,982** | **209** | **114** | **22** | **14** | **(84)** |
| Public and community services | **8,066** | **7,961** | **105** | **8,018** | **6,650** | **105** | **14** | **42** | **-** | **(58)** |
| **Total commercial** | **190,516** | **181,640** | **8,876** | **180,324** | **118,515** | **8,805** | **3,786** | **(30)** | **(195)** | **(2,524)** |
| Private individuals - housing loans | **76,680** | **75,906** | **774** | **76,679** | **74,240** | **774** | **-** | **22** | **7** | **(495)** |
| Private individuals - other | **66,027** | **65,587** | **440** | **66,000** | **34,472** | **440** | **102** | **355** | **171** | **(638)** |
| **Total public** | **333,223** | **323,133** | **10,090** | **323,003** | **227,227** | **10,019** | **3,888** | **347** | **(17)** | **(3,657)** |
| **Israeli banks** | **6,814** | **6,814** | **-** | **1,658** | **1,581** | **-** | **-** | **(1)** | **-** | **-** |
| **Government of Israel** | **24,497** | **24,497** | **-** | **294** | **294** | **-** | **-** | **-** | **-** | **-** |
| **Total activity in Israel** | **364,534** | **354,444** | **10,090** | **324,955** | **229,102** | **10,019** | **3,888** | **346** | **(17)** | **(3,657)** |

See comments on next page.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Overall credit risk to the public by sector of the economy
## Exhibit E (cont'd)

| | 31 December 2014 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Overall credit risk (a) | | | Debts (b) and off-balance sheet credit risk (excluding derivatives) (c) | | | | | | |
| | | | | | | | | Credit losses (d) | | |
| | | | | | Of which:[1] | | | | | |
| | Total | Credit performance rating | Problematic (e) | Total[1] | Debts (b) | Problematic (e) | Impaired | Expenses in respect of credit losses | Net accounting write-offs | Balance of allowance for credit losses |
| | (NIS millions) | | | | | | | | | |
| **Activity of borrowers abroad** | | | | | | | | | | |
| Agriculture | **77** | **74** | **3** | **72** | **62** | **3** | **3** | **1** | **-** | **(2)** |
| Industry | **9,065** | **8,608** | **457** | **7,801** | **4,702** | **457** | **205** | **(34)** | **58** | **(143)** |
| Construction and real estate - construction | **11,636** | **11,077** | **559** | **11,190** | **8,571** | **559** | **502** | **39** | **101** | **(305)** |
| Electricity and water | **379** | **379** | **-** | **118** | **32** | **-** | **-** | **-** | **7** | **-** |
| Commerce | **8,166** | **7,997** | **169** | **8,120** | **5,416** | **169** | **162** | **63** | **102** | **(133)** |
| Hotels, accomodation and food services | **1,553** | **1,510** | **43** | **1,552** | **1,379** | **43** | **43** | **3** | **1** | **(13)** |
| Transport and storage | **378** | **354** | **24** | **229** | **222** | **24** | **24** | **4** | **-** | **(14)** |
| Communications and computer services | **610** | **608** | **2** | **290** | **65** | **2** | **2** | **1** | **-** | **(2)** |
| Financial services | **17,780** | **17,677** | **103** | **2,936** | **1,880** | **103** | **103** | **19** | **1** | **(56)** |
| Other business services | **3,781** | **3,588** | **193** | **3,287** | **2,109** | **193** | **168** | **11** | **23** | **(100)** |
| Public and community services | **3,117** | **3,107** | **10** | **2,994** | **2,710** | **10** | **1** | **13** | **1** | **(25)** |
| **Total commercial** | **56,542** | **54,979** | **1,563** | **38,589** | **27,148** | **1,563** | **1,213** | **120** | **294** | **(793)** |
| Private individuals - housing loans | **1,203** | **1,149** | **54** | **1,203** | **1,204** | **54** | **34** | **2** | **3** | **(18)** |
| Private individuals - other | **1,071** | **1,030** | **41** | **1,052** | **889** | **41** | **31** | **1** | **25** | **(14)** |
| **Total public** | **58,816** | **57,158** | **1,658** | **40,844** | **29,241** | **1,658** | **1,278** | **123** | **322** | **(825)** |
| **Foreign banks** | **32,527** | **32,527** | **-** | **19,045** | **17,555** | **-** | **-** | **3** | **-** | **(4)** |
| **Foreign governments** | **5,648** | **5,648** | **-** | **429** | **234** | **-** | **-** | **-** | **-** | **-** |
| **Total activity abroad** | **96,991** | **95,333** | **1,658** | **60,318** | **47,030** | **1,658** | **1,278** | **126** | **322** | **(829)** |
| **Total** | **461,525** | **449,777** | **11,748** | **385,273** | **276,132** | **11,677** | **5,166** | **472** | **305** | **(4,486)** |

(a) 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 debt limitations in the sum of NIS 276,132, 47,420, 2,000, 16,908, 119,065 million, respectively.

(b) Credit risk to the public, credit to governments, deposits with banks (in 2013 except for deposits in the Bank of Israel) and other debts, except for bonds and securities borrowed or purchased under agreements to resell.

(c) Credit risk of off-balance sheet financial instruments as calculated for the purpose of single borrower debt limitation, except in respect of derivative instruments.

(d) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other liabilities").

(e) Impaired, substandard, or special mention balance sheet credit risk, 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
## Overall credit risk to the public by sector of the economy
## Exhibit E (cont'd)

| | 31 December 2013 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Overall credit risk (a) | | Debts (b) and off-balance sheet credit risk (excluding derivatives) (c) | | | | | | |
| | | | | | | | Credit losses (d) | | |
| | | | | [1]Of which: | | | | | |
| | Total | Problematic (e) | Total[1] | Debts (b) | Problematic (e) | Impaired | Expenses in respect of credit losses | Net accounting write-offs | Balance of allowance for credit losses |
| | (NIS millions) | | | | | | | | |
| **Activities of borrowers in Israel** | | | | | | | | | |
| Agriculture | 2,125 | 113 | 2,116 | 1,823 | 113 | 51 | - | (5) | (45) |
| Industry | 29,219 | 2,256 | 27,673 | 18,592 | 2,218 | 580 | 36 | 8 | (523) |
| Construction and real estate - construction | 41,188 | 1,687 | 41,096 | 14,720 | 1,667 | 574 | (59) | (19) | (386) |
| Construction and real estate - real estate activity | 25,758 | 1,706 | 25,650 | 23,374 | 1,703 | 1,416 | (44) | (21) | (546) |
| Electricity and water | 4,471 | 1 | 3,876 | 3,530 | 1 | 1 | (11) | - | (4) |
| Commerce | 22,400 | 1,123 | 21,995 | 18,144 | 1,122 | 525 | (27) | 102 | (351) |
| Hotels, accomodation and food services | 2,924 | 316 | 2,887 | 2,622 | 316 | 233 | (14) | (6) | (26) |
| Transport and storage | 5,805 | 532 | 5,738 | 5,005 | 522 | 314 | (28) | 5 | (93) |
| Communications and computer services | 5,512 | 588 | 5,313 | 4,270 | 588 | 268 | 11 | (6) | (153) |
| Financial services | 29,434 | 218 | 19,122 | 10,678 | 208 | 197 | (118) | 240 | (146) |
| Other business services | 8,258 | 153 | 8,158 | 6,362 | 153 | 123 | 5 | 16 | (83) |
| Public and community services | 7,451 | 56 | 7,413 | 6,109 | 56 | 14 | 18 | 13 | (13) |
| **Total commercial** | 184,545 | 8,749 | 171,037 | 115,229 | 8,667 | 4,296 | (231) | 327 | (2,369) |
| Private individuals - housing loans | 70,787 | 803 | 70,787 | 68,592 | 803 | - | 46 | 22 | (479) |
| Private individuals - other | 61,782 | 418 | 61,747 | 31,458 | 418 | 109 | 177 | 73 | (456) |
| **Total public** | 317,114 | 9,970 | 303,571 | 215,279 | 9,888 | 4,405 | (8) | 422 | (3,304) |
| **Israeli banks** | 7,509 | - | 1,890 | 1,688 | - | - | 1 | - | (1) |
| **Government of Israel** | 39,536 | - | 338 | 338 | - | - | - | - | - |
| **Total activity in Israel** | 364,159 | 9,970 | 305,799 | 217,305 | 9,888 | 4,405 | (7) | 422 | (3,305) |

See comments on next page.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Overall credit risk to the public by sector of the economy (cont'd)
## Exhibit E (cont'd)

| | 31 December 2013 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Overall credit risk (a) | | Debts (b) and off-balance sheet credit risk (excluding derivatives) (c) | | | | | | |
| | | | | | | | Credit losses (d) | | |
| | | | | [1]Of which: | | | | | |
| | Total | Problematic (e) | Total[1] | Debts (b) | Problematic (e) | Impaired | Expenses of credit losses | accounting write-offs | Balance of for credit losses |
| | (NIS millions) | | | | | | | | |
| **Activity of borrowers abroad** | | | | | | | | | |
| Agriculture | 62 | 4 | 57 | 48 | 4 | 4 | (2) | - | (1) |
| Industry | 9,526 | 447 | 8,569 | 5,764 | 447 | 331 | 57 | 16 | (230) |
| Construction and real estate | 11,400 | 891 | 10,671 | 7,667 | 891 | 724 | 82 | 10 | (386) |
| Electricity and water | 411 | - | 175 | 37 | - | - | - | - | - |
| Commerce | 7,851 | 234 | 7,761 | 5,337 | 234 | 201 | 18 | 6 | (125) |
| Hotels, accomodation and food services | 1,900 | 212 | 1,899 | 1,847 | 212 | 45 | 28 | 18 | (13) |
| Transport and storage | 491 | 27 | 358 | 347 | 27 | 26 | - | (1) | (15) |
| Communications and computer services | 636 | - | 438 | 138 | - | - | - | - | (2) |
| Financial services | 17,211 | 94 | 3,450 | 2,344 | 92 | 74 | 3 | 27 | (36) |
| Other business services | 2,995 | 198 | 2,781 | 1,947 | 198 | 197 | 70 | 3 | (109) |
| Public and community services | 2,118 | 2 | 2,004 | 1,767 | 2 | 2 | 5 | (1) | (15) |
| **Total commercial** | 54,601 | 2,109 | 38,163 | 27,243 | 2,107 | 1,604 | 261 | 78 | (932) |
| Private individuals - housing loans | 1,198 | 69 | 1,198 | 1,198 | 69 | 49 | 7 | 7 | (19) |
| Private individuals - other | 1,281 | 41 | 1,249 | 1,037 | 41 | 41 | 5 | 7 | (40) |
| **Total public** | 57,080 | 2,219 | 40,610 | 29,478 | 2,217 | 1,694 | 273 | 92 | (991) |
| **Foreign banks** | 32,646 | - | 14,408 | 13,016 | - | - | 2 | 5 | (1) |
| **Foreign governments** | 5,190 | - | 318 | 220 | - | - | - | - | - |
| **Total activity abroad** | 94,916 | 2,219 | 55,336 | 42,714 | 2,217 | 1,694 | 275 | 97 | (992) |
| **Total** | 459,075 | 12,189 | 361,135 | 260,019 | 12,105 | 6,099 | 268 | 519 | (4,297) |

(a) 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 debt limitations in the sum of NIS 260,019, 59,816, 1,360, 12,969, 124,911 million, respectively.

(b) 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.

(c) Credit risk of off-balance sheet financial instruments as calculated for the purpose of single borrower debt limitations, except in respect of derivative instruments.

(d) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other liabilities").

(e) Impaired, substandard, or special mention balance sheet credit risk, 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.

## Exposure to Foreign Countries

## Exhibit F

**Part A –** Information on total exposure to foreign countries and on exposure to countries whose total individual exposure exceeds 1% of total assets or exceeds 20% of total equity for purposes of calculating capital ratios, whichever the lower.

| | **31 December 2014** | | | | | |
|---|---|---|---|---|---|---|
| | Balance sheet exposure (a) | | | | | |
| | Cross-Border Balance Sheet Exposure | | | Balance sheet exposure of foreign offices of the banking corporation to local | | |
| | To governments (c) | To banks | To others | Balance sheet exposure before deducting local liabilities | Deduction for local liabilities | Net balance sheet exposure after deducting local liabilities |
| | NIS millions | | | | | |
| Country | | | | | | |
| United States | **3,631** | **6,906** | **10,722** | **18,365** | **9,246** | **9,119** |
| United Kingdom | **240** | **5,028** | **4,759** | **6,961** | **2,081** | **4,880** |
| France | **-** | **1,645** | **644** | **-** | **-** | **-** |
| Switzerland | **-** | **749** | **1,090** | **2,343** | **1,035** | **1,308** |
| Germany | **-** | **2,263** | **2,635** | **-** | **-** | **-** |
| Belgium | **236** | **782** | **136** | **-** | **-** | **-** |
| Italy | **-** | **223** | **50** | **-** | **-** | **-** |
| Netherlands | **-** | **78** | **865** | **-** | **-** | **-** |
| Others | **545** | **5,891** | **4,358** | **1,516** | **767** | **749** |
| Total exposure to foreign countries | **4,652** | **23,565** | **25,259** | **29,185** | **13,129** | **16,056** |
| Total exposure to LDC countries | **247** | **1,513** | **1,588** | **1,370** | **714** | **656** |
| Total exposure to GIIPS countries (d) | **-** | **226** | **360** | **-** | **-** | **-** |

See notes on page 277.

# Bank Leumi le-Israel B.M. and its Consolidated Companies

**Exposure to Foreign Countries (cont'd)**

**Exhibit F (cont'd)**

**Part A –** Information on total exposure to foreign countries and on exposure to countries whose total individual exposure exceeds 1% of total assets or exceeds 20% of total equity for purposes of calculating capital ratios, whichever the lower (cont'd).

| | **31 December 2014** | | | | | | |
|---|---|---|---|---|---|---|---|
| | Balance sheet exposure (a) | | | Off-balance sheet exposure (a) (b) | | | |
| | | | | | | Cross-Border Balance Sheet Exposure | |
| | | | | | | Repayment period | |
| | Total balance sheet exposure | Balance sheet problem credit risk | Of which: 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 | **30,378** | **615** | **349** | **6,279** | **-** | **6,205** | **15,054** |
| United Kingdom | **14,907** | **424** | **385** | **3,339** | **9** | **3,910** | **6,117** |
| France | **2,289** | **11** | **8** | **1,151** | **-** | **76** | **2,213** |
| Switzerland | **3,147** | **-** | **-** | **398** | **-** | **1,483** | **356** |
| Germany | **4,898** | **2** | **2** | **292** | **-** | **3,618** | **1,280** |
| Belgium | **1,154** | **-** | **-** | **74** | **-** | **871** | **283** |
| Italy | **273** | **-** | **-** | **27** | **-** | **210** | **63** |
| Netherlands | **943** | **61** | **61** | **206** | **-** | **771** | **172** |
| Others | **11,543** | **462** | **425** | **1,495** | **-** | **6,255** | **4,539** |
| Total exposure to foreign countries | **69,532** | **1,575** | **1,230** | **13,261** | **9** | **23,399** | **30,077** |
| Total exposure to LDC countries | **4,004** | **406** | **371** | **984** | **-** | **810** | **2,538** |
| Total exposure to GIIPS countries (d) | **586** | **-** | **-** | **39** | **-** | **493** | **93** |

See notes on page 277.

# Bank Leumi le-Israel B.M. and its Consolidated Companies

**Exposure to Foreign Countries (cont'd)**

**Exhibit F (cont'd)**

**Part A –** Information on total exposure to foreign countries and on exposure to countries whose total individual exposure exceeds 1% of total assets or exceeds 20% of total equity for purposes of calculating capital ratios, whichever the lower (cont'd).

| | 31 December 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Balance sheet exposure (a) | | | | | |
| | Cross-Border Balance Sheet Exposure | | | Balance sheet exposure of foreign offices of the banking corporation to local | | |
| | To governments (c) | To banks | To others | Balance sheet exposure before deducting local liabilities | Deduction for local liabilities | Net balance sheet exposure after deducting local liabilities |
| | NIS millions | | | | | |
| Country | | | | | | |
| United States | 3,092 | 5,074 | 10,340 | 16,219 | 8,365 | 7,854 |
| United Kingdom | 457 | 3,702 | 3,552 | 7,433 | 2,188 | 5,245 |
| France | - | 1,957 | 839 | - | - | - |
| Switzerland | - | 378 | 757 | 2,238 | 463 | 1,775 |
| Germany | - | 2,783 | 2,262 | - | - | - |
| Belgium | 427 | 129 | 144 | - | - | - |
| Italy | - | 264 | 64 | - | - | - |
| Netherlands | - | 847 | 1,533 | - | - | - |
| Others | 290 | 2,306 | 3,027 | 2,237 | 770 | 1,467 |
| Total exposure to foreign countries | 4,266 | 17,440 | 22,518 | 28,127 | 11,786 | 16,341 |
| Total exposure to LDC countries | 149 | 680 | 1,143 | 1,605 | 735 | 870 |
| Total exposure to GIIPS countries (d) | - | 278 | 491 | - | - | - |

See notes on page 277.

## Bank Leumi le-Israel B.M. and its Consolidated Companies

**Exposure to Foreign Countries (cont'd)**

**Exhibit F (cont'd)**

**Part A –** Information on total exposure to foreign countries and on exposure to countries whose total individual exposure exceeds 1% of total assets or exceeds 20% of total equity for purposes of calculating capital ratios, whichever the lower (cont'd).

| | 31 December 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Balance sheet exposure (a) | | | Off-balance sheet exposure (a) (b) | | Cross-Border Balance Sheet Exposure | |
| | | | | | | Repayment period | |
| | Total balance sheet exposure | Balance sheet problem credit risk | Of which: 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 | 26,360 | 522 | 390 | 9,243 | 16 | 6,160 | 12,346 |
| United Kingdom | 12,956 | 750 | 581 | 5,543 | - | 3,595 | 4,116 |
| France | 2,796 | 9 | 1 | 1,923 | - | 1,001 | 1,795 |
| Switzerland | 2,910 | 21 | 21 | 773 | - | 862 | 273 |
| Germany | 5,045 | 161 | - | 1,028 | - | 3,305 | 1,740 |
| Belgium | 700 | - | - | 183 | - | 302 | 398 |
| Italy | 328 | - | - | 35 | - | 145 | 183 |
| Netherlands | 2,380 | 55 | 47 | 139 | - | 1,182 | 1,198 |
| Others | 7,090 | 523 | 489 | 1,459 | - | 4,339 | 1,284 |
| Total exposure to foreign countries | 60,565 | 2,041 | 1,529 | 20,326 | 16 | 20,891 | 23,333 |
| Total exposure to LDC countries | 2,842 | 508 | 480 | 1,072 | - | 1,708 | 264 |
| Total exposure to GIIPS countries (d) | 769 | - | - | 70 | - | 462 | 307 |

See notes on page 277.

Notes:

(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 debt limitations.
(c) Including governments, official institutions and central banks.
(d) Exposure to GIIPS countries includes: Portugal, Ireland, Italy, Greece and Spain.

In accordance with the Directive of the Supervisor of Banks, exposure to foreign countries 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** – On 31 December 2014 and 31 December 2013, there was no aggregate amount of balance sheet exposure to foreign countries whose total individual exposure was between 0.75% and 1% of the total consolidated assets or between 15% and 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 1,712 million and relates to 15 countries (at 31 December 2013, this totaled NIS 1,803 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

| | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | 4 | 3 | 2 | 1 | 4 | 3 | 2 | 1 |
| | (NIS millions) | | | | | | | |
| **Assets** | | | | | | | | |
| Cash and deposits with banks | 60,615 | 54,612 | 49,902 | 44,162 | 44,351 | 40,202 | 42,754 | 53,933 |
| Securities | 52,113 | 46,058 | 49,713 | 60,481 | 63,735 | 60,984 | 57,580 | 53,378 |
| Securities borrowed or purchased under agreements to resell | 2,000 | 2,019 | 1,634 | 1,370 | 1,360 | 1,098 | 1,973 | 854 |
| Credit to the public | 256,468 | 253,206 | 248,172 | 245,111 | 244,757 | 244,736 | 242,425 | 242,695 |
| Allowance for credit losses | (3,988) | (3,725) | (3,787) | (3,838) | (3,883) | (3,844) | (3,942) | (4,081) |
| Credit to the public, net | 252,480 | 249,481 | 244,385 | 241,273 | 240,874 | 240,892 | 238,483 | 238,614 |
| Credit to governments | 528 | 510 | 483 | 487 | 558 | 533 | 478 | 423 |
| Investments in companies included on equity basis | 2,216 | 2,062 | 1,641 | 1,630 | 1,689 | 1,944 | 1,978 | 2,122 |
| Buildings and equipment | 3,729 | 3,627 | 3,625 | 3,626 | 3,638 | 3,647 | 3,639 | 3,685 |
| Intangible assets and goodwill | 43 | 42 | 85 | 96 | 99 | 103 | 182 | 185 |
| Assets in respect of derivative instruments | 16,909 | 16,227 | 11,860 | 12,303 | 13,054 | 10,966 | 11,915 | 11,839 |
| Other assets | 5,501 | 5,482 (a) | 5,420 (a) | 5,272 (a) | 5,182 (a) | 5,234 (a) | 4,914 (a) | 4,680 (a) |
| Total assets | 396,134 | 380,120 | 368,748 | 370,700 | 374,540 | 365,603 | 363,896 | 369,713 |
| **Liabilities and equity** | | | | | | | | |
| Deposits of the public | 303,397 | 286,632 | 279,861 | 282,732 | 286,003 | 279,839 | 275,448 | 278,820 |
| Deposits from banks | 4,556 | 4,781 | 5,201 | 4,367 | 4,310 | 3,805 | 4,245 | 7,579 |
| Deposits from governments | 467 | 391 | 359 | 435 | 397 | 437 | 455 | 473 |
| Securities loaned or sold under agreements to repurchase | 1,238 | 1,172 | 747 | 540 | 624 | 404 | 1,327 | 735 |
| Debentures, bonds and subordinated notes | 23,678 | 23,932 | 24,509 | 24,484 | 25,441 | 25,596 | 27,587 | 27,542 |
| Liabilities in respect of derivative instruments | 15,650 | 15,702 | 12,153 | 12,861 | 13,487 | 12,078 | 12,656 | 12,879 |
| Other liabilities | 18,715 | 19,103 (a) | 18,574 (a) | 18,227 (a) | 17,809 (a) | 17,337 (a) | 16,597 (a) | 16,415 (a) |
| Total liabilities | 367,701 | 351,713 | 341,404 | 343,646 | 348,071 | 339,496 | 338,315 | 344,443 |
| Non-controlling interests | 340 | 334 | 323 | 341 | 340 | 331 | 318 | 308 |
| Equity attributable to shareholders of the banking corporation | 28,093 | 28,073 (a) | 27,021 (a) | 26,713 (a) | 26,129 (a) | 25,776 (a) | 25,263 (a) | 24,962 (a) |
| Total equity | 28,433 | 28,407 | 27,344 | 27,054 | 26,469 | 26,107 | 25,581 | 25,270 |
| Total liabilities and equity | 396,134 | 380,120 | 368,748 | 370,700 | 374,540 | 365,603 | 363,896 | 369,713 |

(a) Restated pursuant to a change in accounting method for accumulating employee rights – see Note 1.R.

# Bank Leumi le-Israel B.M. and its Consolidated Companies

## Quarterly Consolidated Statements of Profit and Loss – Multi-Quarter Data

## Exhibit H

| | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | **4** | **3** | **2** | **1** | 4 | 3 | 2 | 1 |
| | **(NIS millions)** | | | | | | | |
| Interest income | **2,334** | **2,665** | **2,812** | **2,201** | 2,614 | 3,466 | 3,191 | 2,863 |
| Interest expenses | **532** | **766** | **907** | **444** | 804 | 1,520 | 1,352 | 1,101 |
| Interest income, net | **1,802** | **1,899** | **1,905** | **1,757** | 1,810 | 1,946 | 1,839 | 1,762 |
| Expenses (income) in respect of credit losses | **483** | **56** | **(16)** | **(51)** | 155 | (44) | 84 | 73 |
| expenses in respect of credit losses | **1,319** | **1,843** | **1,921** | **1,808** | 1,655 | 1,990 | 1,755 | 1,689 |
| **Non-interest income** | | | | | | | | |
| Non-interest financing income | **76** | **224** | **172** | **323** | 238 | 266 | 212 | 411 |
| Commissions | **1,054** | **1,033** | **1,040** | **1,040** | 1,084 | 1,050 | 1,029 | 1,025 |
| Other income | **91** | **71** | **38** | **11** | 98 | 66 | 5 | 33 |
| Total non-interest income | **1,221** | **1,328** | **1,250** | **1,374** | 1,420 | 1,382 | 1,246 | 1,469 |
| **Operating and other expenses** | | | | | | | | |
| Salaries and related expenses | **1,263** | **1,227** (a) | **1,177** (a) | **1,301** (a) | 1,329 (a) | 1,327 (a) | 1,205 (a) | 1,272 (a) |
| Building and equipment maintenance and depreciation | **449** | **451** | **436** | **442** | 452 | 443 | 489 | 449 |
| Amortization of intangible assets and goodwill | **-** | **44** | **11** | **3** | 3 | 79 | 3 | 3 |
| Other expenses | **523** | **737** | **880** | **367** | 460 | 583 | 472 | 323 |
| Total operating and other expenses | **2,235** | **2,459** | **2,504** | **2,113** | 2,244 | 2,432 | 2,169 | 2,047 |
| Profit before taxes | **305** | **712** | **667** | **1,069** | 831 | 940 | 832 | 1,111 |
| Provision for taxes on profit | **157** | **362** (a) | **373** (a) | **389** (a) | 301 (a) | 346 (a) | 286 (a) | 464 (a) |
| Profit after taxes | **148** | **350** | **294** | **680** | 530 | 594 | 546 | 647 |
| Banking corporation's share in profits of companies included on equity basis, after tax | **(252)** | **345** | **(14)** | **(37)** | (165) | (17) | (54) | (57) |
| **Net profit (loss):** | | | | | | | | |
| Before attributiing to non-controlling interests | **(104)** | **695** | **280** | **643** | 365 | 577 | 492 | 590 |
| Attributed to non-controlling interests | **(7)** | **(11)** | **17** | **(11)** | (9) | (12) | (10) | (11) |
| Attributable to shareholders of the banking corporation | **(111)** | **684** | **297** | **632** | 356 | 565 | 482 | 579 |
| **Basic and diluted earnings per share:** | | | | | | | | |
| Net profit (loss) attributable to shareholders of the banking corporation (in NIS) | **(0.07)** | **0.46** | **0.20** | **0.43** | 0.25 | 0.38 | 0.33 | 0.39 |

(a) Restated pursuant to a change in accounting method for accumulating employee rights – see Note 1.R.

## 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 2014 (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 regarding 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; and

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.

31 March 2015

**Rakefet Russak-Aminoach**
President and Chief Executive Officer

## Certification

I, Ron Fainaro, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2014 (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 regarding 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; and

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.

31 March 2015

**Ron Fainaro**
Executive Vice President,
Head of Finance Division

## Certification

I, Shlomo Goldfarb, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2014 (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 regarding 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; and

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.

31 March 2015

Shlomo Goldfarb
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 2014, 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 2014, 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 2014 was audited by the Bank's Auditors, Kost Forer Gabbay & Kasierer and Somekh Chaikin, as stated in their Report on page 285, which includes an unqualified opinion regarding the effectiveness of the Bank's internal control over financial reporting as at 31 December 2014.

31 March 2015

**David Brodet**
Chairman of the Board of Directors

**Rakefet Russak-Aminoach**
President and Chief Executive Officer

**Ron Fainaro**
Executive Vice President
Head of Economics and Finance Division

**Shlomo Goldfarb**
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 2014, 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 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 at 31 December 2014, 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 2014 and 2013, the consolidated statements of profit and loss, the consolidated statements of comprehensive income, the consolidated statements of changes in equity, and the consolidated statements of cash flows for each of the three years ended 31 December 2014, and our report of 31 March 2015 included an unqualified opinion on those financial statements, as well as drawing attention to that stated in Notes 18.D paragraph 2, 18.I, paragraph 1, and 18.J, paragraph 4.

**Somekh Chaikin**
Certified Public Accountants (Isr.)

**Kost Forer Gabbay & Kasierer**
Certified Public Accountants (Isr.)

Joint Auditors

31 March 2015

## 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 2014 and 2013, 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 2014. 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 1.5% and 1.9% of the total consolidated assets as at 31 December 2014 and 2013, respectively, and whose net interest income before expenses for credit losses included in the consolidated statements of profit and loss constitutes about 0.6%, 0.7% and 0.7% of the total consolidated interest income before expenses for credit losses for the years ended 31 December 2014, 2013, and 2012, 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 financial position of the Bank as at 31 December 2014 and 2013, and the results of operations, changes in shareholders' equity and cash flows of the Bank for each of the three years the last of which ended 31 December 2014, 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 made against the Bank including petitions for their approval as class actions.
2. that stated in Note 18(I) paragraph 1, regarding matters concerning a company included on equity basis and its investee companies.
3. that stated in Note 18(J)paragraph 4, regarding an investigation 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 2014, 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 31 March 2015 included an unqualified opinion on the effectiveness of internal control on financial reporting by the Bank.

**Somekh Chaikin**
Certified Public Accountants (Isr.)

**Kost Forer Gabbay & Kasierer**
Certified Public Accountants (Isr.)

Joint Auditors

31 March 2015

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Consolidated Balance Sheet as at 31 December 2014

| | Note | 31 December 2014 | 31 December 2013 |
|---|---|---|---|
| | | (NIS millions) | |
| **Assets** | | | |
| Cash and deposits with banks | **2,14** | **60,615** | 44,351 |
| Securities | **3,14** | **52,113** | 63,735 |
| Securities borrowed or purchased under agreements to resell | | **2,000** | 1,360 |
| Credit to the public | **4** | **256,468** | 244,757 |
| Allowance for credit losses | **4** | **(3,988)** | (3,883) |
| Credit to the public, net | | **252,480** | 240,874 |
| Credit to governments | **5** | **528** | 558 |
| Investments in companies included on equity basis | **6** | **2,216** | 1,689 |
| Buildings and equipment | **7** | **3,729** | 3,638 |
| Intangible assets and goodwill | **6E** | **43** | 99 |
| Assets in respect of derivative instruments | **18B** | **16,909** | 13,054 |
| Other assets | **8** | **5,501** | 5,182(a) |
| Total assets | | **396,134** | 374,540 |
| **Liabilities and equity** | | | |
| Deposits of the public | **9** | **303,397** | 286,003 |
| Deposits from banks | **10** | **4,556** | 4,310 |
| Deposits from governments | | **467** | 397 |
| Securities lent or sold under agreements to repurchase | | **1,238** | 624 |
| Debentures, bonds and subordinated notes | **11** | **23,678** | 25,441 |
| Liabilities in respect of derivative instruments | **18B** | **15,650** | 13,487 |
| Other liabilities | **12** | **18,715** | 17,809(a) |
| Total liabilities | | **367,701** | 348,071 |
| Non-controlling interests | | **340** | 340 |
| Equity attributable to shareholders of the banking corporation | **13** | **28,093** | 26,129 (a) |
| Total equity | | **28,433** | 26,469 |
| Total liabilities and equity | | **396,134** | 374,540 |

(a) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

The accompanying notes are an integral part of these condensed financial statements.
For the condensed financial statements of the Bank only – see Note 30.

**David Brodet**
Chairman of the Board of Directors

**Prof. Efraim Sadka**
Director

**Zipporah Samet**
Director

**Rakefet Russak-Aminoach**
President and Chief Executive Officer

**Ron Fainaro**
Executive Vice President,
Head of Finance Division

**Shlomo Goldfarb**
Executive Vice President,
Chief Accounting Officer,
Head of Accounting Division

Date of approval of the financial statements: 31 March 2015

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Consolidated Statement of Profit and Loss
## for the year ended 31 December 2014

| | Note | 2014 | 2013 | 2012 |
|---|---|---|---|---|
| | | (NIS millions) | | |
| Interest income | **20** | **10,012** | 12,134 | 13,507 |
| Interest expenses | **20** | **2,649** | 4,777 | 6,099 |
| Interest income, net | **20** | **7,363** | 7,357 | 7,408 |
| Expenses in respect of credit losses | **4** | **472** | 268 | 1,236 |
| Net interest income after expenses in respect of credit losses | | **6,891** | 7,089 | 6,172 |
| **Non-interest income** | | | | |
| Non-interest financing income | **21** | **795** | 1,127 | 444 |
| Commissions | **22** | **4,167** | 4,188 | 4,199 |
| Other income | **23** | **211** | 202 | 131 |
| Total non-interest income | | **5,173** | 5,517 | 4,774 |
| **Operating and other expenses** | | | | |
| Salaries and related expenses | **24** | **4,968** | 5,133 (a) | 5,310 (a) |
| Building and equipment maintenance and depreciation | **7** | **1,778** | 1,833 | 1,819 |
| Amortization and impairment of intangible assets and goodwill | **6e** | **58** | 88 | 23 |
| Other expenses | **25** | **2,507** | 1,838 | 1,968 |
| Total operating and other expenses | | **9,311** | 8,892 | 9,120 |
| Profit before taxes | | **2,753** | 3,714 | 1,826 |
| Provision for taxes on profit | **26** | **1,281** | 1,397 (a) | 800(a) |
| Profit after taxes | | **1,472** | 2,317 | 1,026 |
| Share of the banking corporation share in profits (losses) of companies included on equity basis, after tax | **6** | **42** | (293) | (67) |
| **Net profit:** | | | | |
| Before attributing to non-controlling interests | | **1,514** | 2,024 | 959 |
| Attributed to non-controlling interests | | **(12)** | (42) | (37) |
| Attibuted to shareholders of the banking corporation | | **1,502** | 1,982 | 922 |
| **Basic and diluted earnings per share (in NIS):** | | | | |
| Net profit attibuted to shareholders of the banking corporation | | **1.02** | 1.35 (a) | 0.63 (a) |
| **Weighted average of the number of shares for calculation (in thousands of shares)** | | **1,473,551** | 1,473,551 | 1,473,551 |

(a) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only – see Note 30.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Consolidated Statement of Comprehensive Income
## for the year ended 31 December 2014

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| | (NIS millions) | | |
| Net profit before attribution to non-controlling interests | **1,514** | 2,024 (c) | 959 (c) |
| Net profit attributed to non-controlling interests | **(12)** | (42) | (37) |
| Net profit attributed to shareholders of the Bank | **1,502** | 1,982 | 922 |
| **Other comprehensive income (loss), before taxes:** | | | |
| Adjustments for showing securities available for sale at fair value, net | **355** | (518) | 1,067 |
| Adjustments for translation of financial statements, net (a), after the effect of tax and hedges (b) | **192** | (115) | (55) |
| Share of the banking corporation in other comprehensive income of companies included on equity basis | **(108)** | (6) | (1) |
| **Other comprehensive income (loss), before taxes** | **439** | (639) | 1,011 |
| Relevant tax effect | **(53)** | 147 | (354) |
| **Other comprehensive income (loss) before attribution to non-controlling interests, after taxes** | **386** | (492) | 657 |
| Less other comprehensive income attributed to non-controlling interests | **-** | 3 | - |
| Other comprehensive income (loss) attributed to shareholders of the banking corporation, after taxes | **386** | (489) | 657 |
| Comprehensive income before attribution to non-controlling interests | **1,900** | 1,532 | 1,616 |
| Comprehensive income attributed to non-controlling interests | **(12)** | (39) | (37) |
| **Comprehensive income attributed to shareholders of the Bank** | **1,888** | 1,493 | 1,579 |

(a) Adjustments for translation of financial statements of foreign operations whose functional currency differs from the functional currency of the Bank, including adjustments in respect of companies included on equity basis.
(b) Hedges – profits (losses) net in respect of hedging a net investment in foreign currency.
(c) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Statement of Changes in Shareholders' Equity
## for the year ended 31 December 2014

| | | Capital reserves | | |
|---|---|---|---|---|
| | Share capital | Premium | Share-based payment transactions and others (a) | Total share capital and capital reserves |
| | (NIS millions) | | | |
| Balance as at 1 January 2012 | 7,059 | 1,129 | 23 | 8,211 |
| Adjustment of opening balances in respect of first time implementation IFRS Standards (b) and change in accounting method (c) | - | - | - | - |
| Net profit (c) | - | - | - | - |
| Dividend paid by consolidated companies | - | - | - | - |
| Adjustments in respect of companies included on equity basis, net | - | - | - | - |
| Other comprehensive income, net after the effect of tax | - | - | - | - |
| Changes in non-controlling interests | - | - | - | - |
| Balance as at 31 December 2012 | 7,059 | 1,129 | 23 | 8,211 |
| Net profit (c) | - | - | - | - |
| Dividend paid by consolidated companies | - | - | - | - |
| Adjustments in respect of companies included on equity basis, net | - | - | - | - |
| Employee benefit from share-based payment transactions | - | - | 10 | 10 |
| Other comprehensive income, net after the effect of tax | - | - | - | - |
| Other adjustments in respect of companies included on equity basis | - | - | - | - |
| Loans to employees for purchase of the Bank's shares | - | - | - | - |
| Balance as at 31 December 2013 | 7,059 | 1,129 | 33 | 8,221 |
| Net profit | - | - | - | - |
| Dividend paid by consolidated companies | - | - | - | - |
| Adjustments in respect of companies included on equity basis, net | - | - | - | - |
| Other comprehensive income, net after the effect of tax | - | - | - | - |
| Changes in non-controlling interests | - | - | - | - |
| Balance as at 31 December 2014 | **7,059** | **1,129** | **33** | **8,221** |

(a) Including NIS 10 million other capital reserves.

(b) In 2012 in respect of implementation of IAS 12, an amount of NIS 42 million.

(c) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

| Accumulated other comprehensive profit (loss) | Retained earnings (d) | Loans to employees for purchase of the Bank's shares | Total | Non-controlling interests | Total capital |
|---|---|---|---|---|---|
| (199) | 15,406 | (44) | 23,374 | 254 | 23,628 |
| - | (348) | - | (348) | - | (348) |
| - | 922 | - | 922 | 37 | 959 |
| - | - | - | - | (8) | (8) |
| - | (9) | - | (9) | - | (9) |
| 657 | - | - | 657 | - | 657 |
| - | (6) | - | (6) | 24 | 18 |
| 458 | 15,965 | (44) | 24,590 | 307 | 24,897 |
| - | 1,982 | - | 1,982 | 42 | 2,024 |
| - | - | - | - | (6) | (6) |
| - | 24 | - | 24 | - | 24 |
| - | - | - | 10 | - | 10 |
| (489) | - | - | (489) | (3) | (492) |
| - | 11 | - | 11 | - | 11 |
| - | - | 1 | 1 | - | 1 |
| (31) | 17,982 | (43) | 26,129 | 340 | 26,469 |
| **-** | **1,502** | **-** | **1,502** | **12** | **1,514** |
| **-** | **-** | **-** | **-** | **(10)** | **(10)** |
| **-** | **75** | **-** | **75** | **-** | **75** |
| **386** | **-** | **-** | **386** | **-** | **386** |
| **-** | **-** | **1** | **1** | **(2)** | **(1)** |
| **355** | **19,559** | **(42)** | **28,093** | **340** | **28,433** |

(d) Including NIS 353 million not available for distribution as a dividend (31 December 2013 – NIS 471 million, 31 December 2012 – NIS 208 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 2014

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| | (NIS millions) | | |
| **Cash flows from operating activities** | | | |
| Net profit for the year | **1,514** | 2,024 (b) | 959 (b) |
| **Adjustments:** | | | |
| Group share in undistributed losses (profits) of companies included on equity basis (a) | **15** | 340 | 181 |
| Expenses deriving from share-based payment transactions | **-** | 10 | - |
| Depreciation of buildings and equipment (including impairment) | **726** | 768 | 775 |
| Amortization | **58** | 88 | 23 |
| Expenses in respect of credit losses | **472** | 268 | 1,236 |
| Profit on sale of loan portfolios | **(28)** | (99) (c) | - |
| Losses (profits) from assets transferred to group ownership | **(3)** | 1 | 9 |
| Net profit on sale of available-for-sale securities (including impairment) | **(647)** | (747) | (201) |
| Realized and unrealized profit from adjustment to fair value of securities held for trading | **(456)** | (35) | (239) |
| Gain on realization of investments in companies included on equity basis | **-** | (15) | (24) |
| Gain on sale of buildings and equipment | **(83)** | (25) | (2) |
| Interest received (and not yet received) in respect of debentures available for sale | **(67)** | (140) | (100) |
| Unpaid interest in respect of debentures and subordinated notes | **1,000** | 1,428 | 356 |
| Effect of exchange rate differentials on cash and cash equivalents | **(839)** | 653 | 131 |
| Deferred taxes, net | **(171)** | (121) (b) | (646) (b) |
| Increase in excess of provisions for severance pay and pensions over amounts funded | **195** | 89 (b) | 590 (b) |
| Other, net | **-** | (3) (b) | (4) (b) |
| **Net change in current assets:** | | | |
| Deposits with banks for an original period of over 3 months | **(1,215)** | 1,112 | 333 |
| Credit to the public | **(11,029)** | (1,507) (c) | (1,951) (c) |
| Credit to governments | **35** | (118) | 7 |
| Securities borrowed or purchased under agreements to resell | **(640)** | 75 | (210) |
| Assets in respect of derivative instruments | **(3,845)** | (1,595) | 135 |
| Securities held for trading | **(1,633)** | 652 | (734) |
| Other assets | **154** | 279 | (31) |
| **Net change in current liabilities:** | | | |
| Deposits from banks | **191** | 283 | (984) |
| Deposits of the public | **15,184** | (1,986) | 10,459 |
| Deposits of the government | **39** | (38) | (62) |
| Securities lent or sold under agreements to repurchase | **614** | (381) | 566 |
| Liabilities in respect of derivative instruments | **2,086** | 856 | 657 |
| Other liabilities | **163** | 1,161 (b) | 91 |
| **Net cash from operating activities** | **1,790** | 3,277 | 11,320 |

(a) Less dividend received. For details of the effect of the results of the Israel Corporation, see Note 1.X.
(b) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.
(c) Reclassified.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only, see Note 30.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Consolidated Statement of Cash Flows (cont'd)
## for the year ended 31 December 2014

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| | (NIS millions) | | |
| **Cash flows from investment activities** | | | |
| Acquisition of available-for-sale securities | **(33,427)** | (61,350) | (50,487) |
| Proceeds from sale of available-for-sale securities | **22,673** | 33,528 | 25,727 |
| Proceeds from redemption from available-for-sale securities | **26,347** | 19,785 | 18,911 |
| Proceeds of sale of loan portfolios | **344** | 713 (a) | 230 (a) |
| Acquisition of loan portfolios | **-** | - | (101) (a) |
| Acquisition of shares in companies included on equity basis | **(341)** | (67) | (65) |
| Proceeds from realization of investment in companies included on equity basis | **-** | 73 | 64 |
| Repayment of shareholders' loan to company included on equity basis | **-** | - | 4 |
| Acquisition of buildings and equipment | **(764)** | (698) | (770) |
| Proceeds from realization of buildings and equipment | **94** | 39 | 9 |
| Proceeds from realization of assets transferred to group ownership | **3** | 3 | 14 |
| **Net cash from investment activities** | **14,929** | (7,974) | (6,464) |
| **Cash flows from financing activities** | | | |
| Issue of debentures and subordinated notes | **-** | - | 2,420 |
| Redemption of debentures and subordinated notes | **(2,763)** | (3,512) | (5,250) |
| Issue of capital in consolidated companies to minority shareholders | **-** | - | 21 |
| Dividend paid to minority shareholders in consolidated companies | **(10)** | (6) | (8) |
| Additional acquisition of shares in consolidated companies | **(2)** | - | - |
| Loans to employees for purchase of the Bank's shares | **1** | 1 | - |
| **Net cash from financing activities** | **(2,774)** | (3,517) | (2,817) |
| **Increase (decrease) in cash and cash equivalents** | **13,945** | (8,214) | 2,039 |
| **Balance of cash and cash equivalents at beginning of year** | **42,777** | 51,644 | 49,736 |
| **Effect of exchange rate differences on balances of cash and cash equivalents** | **839** | (653) | (131) |
| **Balance of cash and cash equivalents at end of year** | **57,561** | 42,777 | 51,644 |

### Interest and taxes paid and/or received and dividends received

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| | (NIS millions) | | |
| Interest received | **9,922** | 12,474 | 13,823 |
| Interest paid | **(3,455)** | (5,360) | (7,077) |
| Dividends received | **67** | 74 | 170 |
| Taxes paid on income | **(1,604)** | (1,238) | (1,113) |

(a) Reclassified.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only, see Note 30.

# Bank Leumi le-Israel B.M. and its Consolidated Companies
## Consolidated Statement of Cash Flows (cont'd)
## for the year ended 31 December 2014

**Appendix A – Non-cash investment and financing transactions in the reporting period:**

**In 2014:**

1. During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 49 million.

**In 2013:**

1. During the year, assets were transferred from credit to the public to other assets, in the amount of NIS 2 million, in respect of loans that were repaid.

2. During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 24 million.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only, see Note 30.

**Index to Notes**

## Note 1 – Significant Accounting Policies

### A. General

The financial statements have been prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and the directives and guidelines of the Supervisor of Banks relating to the preparation of annual financial statements of a banking corporation.

Publication of the financial statements is on the basis of the consolidated statements only. Condensed financial statements of the Bank on a single-entity basis appear in Note 30.

The financial statements were approved for publication by the Board of Directors of the Bank on 31 March 2014.

### 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 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 paragraph 1 of the Securities Law, 1968.

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 as 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 International Financial Reporting Standards (IFRS) and interpretations of the International Financial Reporting Interpretations Committee (IFRIC), 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 Accounting Standards, Accounting Standards Updates and the Directives of the Banking Supervision Department that were 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.

For information on the functional currency of banking units operating overseas, see Note E below.

**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, except for derivative financial instruments and other financial instruments that are measured at fair value.

- 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 are 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, 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.

**Changes in estimates**

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. Regarding a change in the estimate of the collective allowance, see Note I – Implementation of the Directives of the Supervisor of Banks on "Collective Allowance in respect of Credit to Individual Persons".

**D. First-time Implementation of Accounting Standards, Updates to Accounting Standards, and Directives of the Banking Supervision Department**

As of reporting periods commencing 1 January 2014, the Bank implements the accounting standards and directives set out below:

**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**

As of 1 January, 2014, the Bank applies the instructions set forth in the circular of the Banking Supervision Department regarding adoption of generally accepted accounting principles in U.S. banks on the measurement of interest income (ASC 310-20).

The circular establishes rules, inter alia, for the treatment of commissions from loan origination, commitments to extend credit, changes in the terms of a debt, and early repayment commission.

The main changes relate to the deferment of commission in respect of granting credit and credit allocation commissions, not spreading early repayment commissions and the treatment of changes in debt terms. Following implementation of the directive, certain income was reclassified to interest income.

## Note 1 – Significant Accounting Policies (cont'd)

**Credit origination commissions**
Commissions charged for originating credit, excluding loans for a period up to three months, are not recognized immediately as income in the statement of profit and loss, but are deferred and recognized over the life of the loan as an adjustment of the return. Income from the said commissions will be charged under the effective interest rate method and reported as part of interest income.

**Credit allocation commissions**
Credit allocation commissions are accounted for in accordance with the likelihood of the realization of the obligation to provide credit. If this is remote, the commission is recognized on a straight line basis over the term of the commitment, or the Bank defers recognition of income from such commissions until the date of exercise of the commitment or the date of expiry, whichever the earlier. If the commitment fee is recognized then the commissions are recognized by way of adjusting the yield over the life of the loan as stated above. If the commitment expires unexercised, the commissions are recognized on the date of expiration and reported as part of income from commissions. For this purpose the Bank assumes that the probability of realizing the commitment is not remote.

**Change in the terms of a debt**
In cases of refinancing or restructuring of debts that are not problematic, the Bank considers whether the loan terms were changed significantly, if the present value of cash flows under the new terms of the loan were changed by at least 10% of the present value of the remaining cash flows under the existing conditions, or if there was a change in the currency of the loan etc., which relates to a material change. In such cases all commissions not yet amortized and early repayment commissions collected from the customer due to change in credit terms are recognized in profit or loss, or the above commissions are included as part of the net investment in the new loan and recognized as adjustments to the return as stated above.

**Early repayment commissions**
Early repayment commissions charged for early repayment, performed before 1 January 2014 and not yet amortized, are recognized over a period of three years or the remaining term of the loan, whichever is shorter. Commissions that were charged for early repayment performed after 1 January, 2014, are immediately recognized as part of interest income.

**Effect of initial implementation**
Implementation of the Directive is in a prospective manner.

Below is a disclosure of the effect of implementation of this directive on the net interest income, non-interest income, and the net profit in the year ended 31 December 2014:

| | **For the year ended 31 December 2014** | | |
|---|---|---|---|
| | Pursuant to the Directive on Measurement of Interest Income | Effect of implementation of the Directive on Measurement of Interest Income | Pursuant to previous Reporting Directives |
| | NIS millions | | |
| Interest income, net | **7,363** | (188) | 7,175 |
| Commissions | **4,167** | 210 | 4,377 |
| Net profit (after tax) | **1,563** | 14 | 1,577 |

## Note 1 – Significant Accounting Policies (cont'd)

### E. Foreign currency and linkage

**Transactions in foreign currency**

**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 the reporting 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 resulting from translation to the functional currency are recognized in profit and loss except for the following differences recognized in other comprehensive income resulting 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.

**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.

# Note 1 – Significant Accounting Policies (cont'd)

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".

**Foreign operations**

The assets and liabilities of foreign operations, including goodwill and fair value adjustments generated in an acquisition, have been translated to NIS at the exchange rate prevailing at the date of the transactions.
Exchange rate differentials in respect of the translation are recognized in comprehensive income, and are shown in equity under "Adjustments for translation of financial statements".
On realization of a foreign operation leading to loss of control or substantial influence, the cumulative amount in the translation reserve resulting from the foreign operation is reclassified to profit and loss as part of the profit or loss on the realization.

In addition, when there are changes in the percentage of the Bank's holdings in a subsidiary company that includes foreign operations while retaining control of the subsidiary company, a proportionate part of the accumulated amount of exchange rate differences recognized in other comprehensive income is reattributed to non-controlling interests.
When the Group realizes part of the investment that is a subsidiary company that includes foreign operations while retaining material influence, the proportionate part of the accumulated amount of exchange rate differences is reclassified to profit and loss.

## Note 1 – Significant Accounting Policies (cont'd)

### 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.

### Index-linked assets and liabilities not measured at 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 | | |
|---|---|---|---|---|---|---|
| | **2014** | 2013 | 2012 | **2014** | 2013 | 2012 |
| | NIS | | | % | | |
| **Exchange rate of:** | | | | | | |
| U.S. dollar | **3.889** | 3.471 | 3.733 | **12.0** | (7.0) | (2.3) |
| Euro | **4.725** | 4.782 | 4.921 | **(1.2)** | (2.8) | (0.3) |
| Pound Sterling | **6.064** | 5.742 | 6.037 | **5.6** | (4.9) | 2.5 |
| Swiss franc | **3.929** | 3.897 | 4.077 | **0.8** | (4.4) | 0.4 |
| **Consumer Price Index:** | (Points) | | | | | |
| November – known index | **107.4** | 107.5 | 105.5 | **(0.1)** | 1.9 | 1.4 |
| December – index for the month | **107. 4** | 107.6 | 105.7 | **(0.2)** | 1.8 | 1.6 |

## 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. The Group controls the acquiree when it is exposed, or has rights, to varying returns from its involvement in the acquiree, and it has the ability to influence these returns.

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.

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.

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**

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 interests 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:

- When 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.

- When 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.

- When there are changes in the holding percentage in a subsidiary company, while retaining control, the Bank reapportions the aggregate amounts recognized under other comprehensive income, between the owners and the non-controlling interests.

**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. In addition, for purposes of determining material influence, qualitative criteria are examined which often supersede this quantitative assumption. 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.

The investment in shares of companies included on equity basis is dealt with according to the equity method and recognized initially at cost. 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 a 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.

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.

# Note 1 – Significant Accounting Policies (cont'd)

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.

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. The cost of rights sold for the purpose of calculating the profit or the loss on the sale is determined by a weighted average.

In addition, at the same date a relative part of the amounts recognized in capital reserves by way of other comprehensive income, with reference to that company included on equity basis, is reclassified to the statement of profit and loss or to retained earnings.

The Bank reviews, in each reporting period, the need to record impairment of its investment in companies included on equity basis - see paragraph W.3 below.

Regarding the instruction of the Banking Supervision Department relating to the accounting treatment of the loss of significant influence by the Bank in the Israel Corporation, see the note on events after the balance sheet date and other matters.

## 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 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.

## Note 1 – Significant Accounting Policies (cont'd)

- Credit origination commissions - Commissions charged for originating credit, excluding loans for a period up to three months, are not recognized immediately as income in the statement of profit and loss, but are deferred and recognized over the life of the loan as an adjustment of the return. Income from the said commissions will be charged under the effective interest rate method and reported as part of interest income.

- Early repayment commissions – Income from Commissions charged for early repayment, performed before 1 January 2014 and not yet amortized, are recognized over a period of three years or the remaining term of the loan, whichever is shorter. Commissions that were charged for early repayment performed after 1 January, 2014, are immediately recognized as part of interest income.

- Credit allocation commissions are accounted for in accordance with the likelihood of the realization of the obligation to provide credit. If this is remote, the commission is recognized on a straight line basis over the term of the commitment, or the Bank defers recognition of income from such commissions until the date of exercise of the commitment or the date of expiry, whichever the earlier. If the commitment fee is recognized then the commissions are recognized by way of adjusting the yield over the life of the loan as stated above. If the commitment expires unexercised, the commissions are recognized on the date of expiration and reported as part of income from commissions. For this purpose the Bank assumes that the probability of realizing the commitment is not remote.

- Change in the terms of a debt - In cases of refinancing or restructuring of debts that are not problematic, the Bank considers whether the loan terms were changed significantly, if the present value of cash flows under the new terms of the loan were changed by at least 10% of the present value of the remaining cash flows under the existing conditions, or if there was a change in the currency of the loan etc. In such cases all commissions not yet amortized and early repayment commissions collected from the customer due to change in credit terms are recognized in profit or loss, or the above commissions are included as part of the net investment in the new loan and recognized as adjustments to the return as stated above.

- 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.

### H. Fair value of financial instruments

Effective 1 January 2011, the Bank implements the rules set out in FAS 157 (ASC 820) 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.

## Note 1 – Significant Accounting Policies (cont'd)

Fair value is defined as the price that would be received when selling 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 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.

## Note 1 – Significant Accounting Policies (cont'd)

### Securities

The fair value of securities held for trading and securities available for sale is determined based on market prices quoted in the principal market. In those cases where a quoted market price is not available, the fair value is based on the best available information with maximum use of observable data and taking into account the risks inherent in the financial instrument. Fair value is determined using generally accepted pricing models, based on evaluations obtained from experts in valuing financial instruments or based on an independent system of the Bank. 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.

### Derivative financial instruments

The fair value of derivative financial instruments that have an active market is determined based on market prices quoted in a principal market.
In those cases where a quoted market price is not available, a fair value estimate is made by using models that take into account the risks inherent in the derivative instrument.

### Non-derivative financial instruments

For most financial instruments in this category there is no active market in which they are traded. Accordingly, fair value is estimated using generally accepted pricing models, such as the present value of future cash flows discounted at an interest rate reflecting the level of risk inherent in the financial instrument. For this purpose, pursuant to Banking Supervision Department instructions, future cash flows for impaired debts and other debts have been calculated after deducting the effect of accounting write-offs and allowances for credit losses in respect of the debts.

### Evaluation of Credit Risk and Nonperformance Risk

FAS 157 (ASC 820) determines that credit risk and nonperformance risk is to be reflected in the fair value measurement of a debt, including derivative instruments issued by the Bank and measured for fair value. Nonperformance risk includes the Bank's credit risk but is not limited to this risk alone.

### 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.

## Note 1 – Significant Accounting Policies (cont'd)

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. The Bank did not designate financial instruments under the fair value option.

### I. 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 troubled 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. The allowance to cover expected credit losses in the loan portfolio is estimated in one of the following tracks:

- 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 1 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 principles set out in FAS 5 (ASC 450) – Accounting for Contingencies and 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.

## Note 1 – Significant Accounting Policies (cont'd)

A temporary directive was issued for the years 2011-2012 (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.

In addition, the Bank implemented the provisions of an update of Proper Conduct of Banking Business Directive 329 on "Restrictions on Granting Housing Loans". The Bank formulated a policy designed to ensure that it complies with the new requirements that, as of 31 March 2013, the balance of the collective allowance for credit losses for housing loans will not be less than 0.35% of the balance of the said loans at the reporting date.

Regarding consumer credit to private individuals, the Bank implements the Directive of the Supervisor of Banks from 19 January 2015 on the matter of the "Collective Allowance in respect of Credit to Private Individuals". Pursuant to the Directive, when determining the allowance for credit losses, banking corporations and credit card companies are to take into account, inter alia, past losses, which will be calculated according to the average of past losses in the last five years with adjustments for qualitative factors at a percentage of not less than 0.75% of the balance of unimpaired consumer credit. From the aforesaid was excluded the credit risk deriving from receivables in respect of banking credit cards without interest charge.

Implementation of the Directive was made on a prospective basis.

As a result of implementation, the allowance in respect of consumer credit to private individuals was increased by NIS 208 million, before tax. The increase in the balances of the provision was charged to profit and loss.

The Bank examines the overall appropriateness of the allowance for credit losses based on management's judgment, taking into account the risks inherent in the loan portfolio.

The Bank also calculates a supplementary and 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 and general provision, the allowance is to be made using the higher of the two calculations.

## Note 1 – Significant Accounting Policies (cont'd)

### Classification of troubled debts

The Bank determined procedures for identifying problem credit and classifying debts as impaired. In accordance with these procedures, the Bank classifies the balance of its various troubled 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 troubled debt restructuring, unless prior to and after the restructuring a minimum allowance was made for credit allowance by extent of arrears.

**Reversing 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.

**The rules for reversing an impaired debt will not apply to debts classified as impaired as a result of troubled debt restructuring.**

**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 and only after payments are received that significantly reduce (at least 20%) the recorded balance of debt determined after restructuring.

## Note 1 – Significant Accounting Policies (cont'd)

**Troubled debt restructuring**
A debt which formally underwent a troubled 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 troubled 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 debtor was granted a waiver, even if under the arrangement an increase was made in the contractual interest rate, if one or more of the following situations exist:

- 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 troubled 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 troubled 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 troubled 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.

**Accounting write-off**

**The Bank makes an accounting write-off in the cases set out below:**

- 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.

- A debt in respect of which the Bank is making long-term efforts (defined generally as a period exceeding two years) to collect the debt and for which individual allowances for credit losses have been made.

- In the event of a debt whose collection in collateral-contingent, any part of a debt which exceeds the value of the collateral, which is identified as uncollectible will be written off immediately against the allowance for credit losses.

- Troubled 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.

**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**

The Bank implements the provisions of a circular of 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 debt balances, changes 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.

The Group applies the provisions as of 1 January 2012 on a prospective basis. Pursuant to the circular, some of the new disclosure requirements on troubled debt restructuring are implemented by the Bank as of 1 January 2013. In addition, as of the report for the year 2014, the Bank implements additional disclosure requirements on credit rating. With regard to these new disclosures, the Bank is not required to include comparative data.

First-time implementation of the directive had no effect other than a change in presentation.

## J. Securities

### 1. Securities in which the Bank invests may be 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.
The Bank did not classify debentures in the held to maturity portfolio.

#### 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. Realized and 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 6 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 hedging the hedged risk.

**2.** Dividend income, accumulated interest, linkage and price differences, amortization of premium or discount (in accordance with the effective interest method), as well as losses from impairment in value not of a temporary nature, are recorded to the profit and loss statement.

## Note 1 – Significant Accounting Policies (cont'd)

**3.** 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.

**4.** 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.

**5. Fair Value**

With regard to the determination of fair value, see paragraph H below.

**6. Impairment**

The Bank examines the necessity, in each reporting period, for making a provision for impairment of securities, in the available for sale portfolio, 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 of the cost in full.
- 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.

## K. 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, including embedded derivatives that have been separated.

### Hedge accounting

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.

Hedging a net investment in a foreign operation – see paragraph E.

### 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 covering exposures 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 FAS 155 (ASC 815-15), 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 re-measurement 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.

**L. 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.

As of 1 January 2012, the Bank applies Accounting Standards Update ASU 2011-03 – "Reconsideration of Effective Control for Repurchase Agreements".

## Note 1 – Significant Accounting Policies (cont'd)

In contractions for the transfer of financial assets, the Bank determines that effective control of the assets transferred remains with the transferor 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;
- The agreement is entered into contemporaneously with the transfer.

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 as defined below 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.

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 as mentioned above 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.

## Note 1 – Significant Accounting Policies (cont'd)

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.

### M. Offsetting assets and liabilities

The Bank implements the rules set out in the circular of the Supervisor of Banks dated 12 December 2012, updating the Public Reporting Directives of the Supervisor of Banks regarding offsetting assets and liabilities.

The Bank offsets assets and liabilities arising from the same counterparty and reports their net balance in the balance sheet, if the following cumulative conditions are met:

- In respect of those liabilities, there is a legally enforceable right to offset the liabilities from the assets.
- There is an intention to repay the liabilities and realize the assets on a net basis or simultaneously.
- Both the Bank and the counterparty owe each other determinable amounts.

The Bank offsets assets and liabilities with two different counterparties and reports a net balance in the balance sheet if the above three cumulative conditions are met, and provided that there is an agreement between the three parties that clearly defines the Bank's right of offset in respect of those liabilities.

The Bank offsets deposits whose repayment to the depositor is contingent on the extent of collection of the credit and the credit that was granted from these deposits, with the Bank having no risk of loss from the credit. The margin on this activity is included under "Commissions".

The Bank offsets between derivative instruments made with the same counterparty which is 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.

### N. 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. The cost of purchase of software, that constitutes an integral part of operating the related equipment, is recognized as part of the cost of that equipment.

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 their book value or realizable value.

Profit or loss on the sale of fixed assets is included under "Other income" in the statement of profit and loss.

## Note 1 – Significant Accounting Policies (cont'd)

**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 cost 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 of materials, services and direct labor cost for employees. 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 and amortization**

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, and at least at the end of each financial year, and adjusted if necessary.

In connection with impairment of non-monetary assets, see paragraph 1.W 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.

# Note 1 – Significant Accounting Policies (cont'd)

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 reasonably 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.

Lease payments made in advance to the Israel Lands Administration in respect of operating leases are shown in the balance sheet as prepaid expenses and are charged to profit and loss on a straight line basis over the period of the lease.

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 for 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.

**O. 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.

**P. Assets transferred to Group ownership following the settlement of troubled debts**

Assets that were transferred to Group ownership following the settlement of troubled debts and are included in other assets are stated according to the lower of the asset’s fair value on the date they were transferred or fair value as at balance sheet date. Decreases in value are charged to operating and other expenses.

**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 and/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 of 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, in the event of 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 management assessments and varies according to the age of the employee.

A liability in respect of employee-employer relationships is reported as the higher of (1) the amount of liability calculated on an actuarial basis, taking into account the additional cost that will be incurred in respect of granting the abovementioned benefits, and (2) the amount of liability calculated as a multiple of the monthly salary of the employee and the number of years of his seniority, as required in Opinion 20 of the Institute of certified Public Accountants in Israel.

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.

With regard to the circular on the matter of adoption of accounting principles in the U.S. on employee rights, see 1.Y.

**Instructions and Clarifications on the Strengthening of Internal Control over Financial Reporting relating to Employee Rights**

On 27 March 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.

With regard to the adoption of accounting principles in the U.S. on employee rights, see paragraph 1.Y. below.

**Change in accounting method (retrospective implementation of the Banking Supervision Department's instruction regarding the method of accumulating pension liability)**

Pursuant to the letter of the Supervisor of Banks from 11 February 2015, a change was made in the method of accumulating of liabilities for pension. In accordance with the method applied currently, pension reserves are based on actuarial calculation that reflects past experience and management's evaluation regarding the expected retirement dates of the Bank's employees and the benefits forecast on retirement, attributed on a linear basis over the anticipated period of employment. According to the new method of accumulation, the Bank accumulates pension liabilities of 1st generation employees on a straight-line basis up to the earliest retirement age and an average of retirement ages in practice of 1st generation employees in recent years, for men and women). After this date, additional benefits are attributed for subsequent years based on the formula of the benefit plan of 1st generation employees.
The change was recorded as a restatement of the balance of retained earnings at 31 December 2011 and from that date the effects were recorded in the profit and loss for each period, by restatement of alary expenses, provision for taxes, and net profit. An effect of NIS 322 million net after tax was charged as an adjustment to the opening balance of retained earnings at 1 January 2012.

## Note 1 – Significant Accounting Policies (cont'd)

**Below are details of the amounts that changed as a result of the change:**

| Name of item | For the year ended 31 December 2013 | | | For the year ended 31 December 2012 | | |
|---|---|---|---|---|---|---|
| | Balance before restatement | Change | Balance after restatement | Balance before restatement | Change | Balance after restatement |
| Salary expenses | 5,174 | (41) | 5,133 | 5,289 | 21 | 5,310 |
| Tax expenses | 1,391 | 6 | 1,397 | 811 | (11) | 800 |
| Net profit | 1,947 | (35) | 1,982 | 932 | 10 | 922 |
| Profit per share | 1.32 | 0.03 | 1.35 | 0.63 | - | 0.63 |
| | **At 31 December 2013** | | | At 31 December 2012 | | |
| Other assets | 5,002 | 180 | 5,182 | 4,529 | 185 | 4,714 |
| Other liabilities | 17,333 | 476 | 17,809 | 15,576 | 516 | 16,092 |
| Shareholders' equity | 26,765 | (296) | 26,469 | 25,228 | (331) | 24,897 |
| Ratio of capital adequacy to risk assets | 14.82% | (0.12%) | 14.70% | 14.87% | (0.12%) | 14.75% |

**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 these as share-based payment transactions 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”.

## Note 1 – Significant Accounting Policies (cont'd)

**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 not 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 a net basis 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.

## Note 1 – Significant Accounting Policies (cont'd)

**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.

### T. Earnings per share

The Bank reports basic and diluted earnings per share with regard to its 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. Related party disclosures

IAS 24 – Related Party Disclosures, determines the disclosure requirement an entity has to make of its relationships with a related party and of transactions and unpaid balances with the related party.

In addition, disclosure is to be made of remuneration to key management personnel defined as persons having authority and responsibility for planning the activity of the entity, guiding and controlling it directly or indirectly, including directors.

### V. Transactions with controlling owners

The Bank implements US GAAP for the accounting treatment of transactions between a banking corporation and its controlling owner and a company controlled by the Bank. In those situations where the said principles do not refer to the manner of treatment, the Bank implements the principles set out in Standard No. 23 of the Israel Accounting Standards Board on the matter.
Assets and liabilities regarding which a transaction was carried out with a controlling owner are measured for fair value at the date of the transaction. Due to the fact that this is an equity-type transaction, the Group charges the difference between the fair value and the transaction proceeds to equity.

### W. 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.

## Note 1 – Significant Accounting Policies (cont'd)

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 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 impairment was recognized, and provided that the book value after cancelling the loss from impairment does not exceed the book value after deducting depreciation or amortization, that would have been determined if the loss from impairment had not been recognized. This is except for impairment 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 in addition to indicators for examining the existence of impairment set forth in IAS 36, even if the indicators stated in US GAAP SOP 98-1 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.

## Note 1 – Significant Accounting Policies (cont'd)

**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 – Recognition and Measurement of Financial Instruments and pursuant to Decision 1-4 of the Israel Securities Authority, Guidelines for Examining the Need for Amortizing Fixed Investments.

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".

**4. Non-current assets held for sale**

Non-current assets held for sale are measured at the lower of book value and fair value after deducting selling costs.

### X. Date of publication of the financial statements

As a result of the instructions of the Bank of Israel regarding bringing forward the date of publication of the financial statements, a reporting gap was created between the end of the reporting period of the Israel Corporation and the end of the reporting period of the Bank. In the quarterly financial statements for 2014, the Bank applied IAS28 that allows in such cases when applying the equity method, to use the financial statements of the Israel Corporation prepared at a date prior to that of the Bank with a three-month gap ("the reporting gap"). In addition, adjustments were made for significant transactions concerning the reporting gap.

## Note 1 – Significant Accounting Policies (cont'd)

Pursuant to the letter of the Supervisor of Banks from 4 March 2015, the date of publication of the annual report of the Bank was postponed to 31 March 2015 and the manner of recording the results of the Israel Corporation in the Bank's reports was modified so that there will no longer be a reporting gap.

Below are figures of the pro-forma net profit of the Group showing the effect of canceling the reporting gap:

| | **2014** | | | |
|---|---|---|---|---|
| | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter |
| | NIS millions | | | |
| Net income as reported | 632 | 297 | 684 | (111) |
| Amendment in respect of the reporting gap | (14) | 5 | 20 | (11) |
| Net profit – after canceling the reporting gap | 618 | 302 | 704 | (122) |

(a) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

**Y. New Accounting Standards and Directives of the Supervisor of Banks in the period prior to their implementation**

**1. Adoption of US GAAP regarding employee rights**

On 9 April 2014, the Supervisor of Banks published a circular regarding the adoption of the accounting rules in the United States on the subject of employee rights. The circular updates the recognition, measurement and disclosure requirements regarding employee benefits, including share-based payments, in the Public Reporting Directives in accordance with the generally accepted accounting principles in banks in the United States.

The circular provides that the amendments to the Public Reporting Directives will apply from 1 January 2015, and the Bank, on initial implementation, will correct with retroactive effect the comparative figures for the period commencing 1 January 2013 and onwards, in order to comply with the requirement of the rules as aforesaid.

On 11 January 2015, the Banking Supervision Department published a supplementary circular to the circular published on 9 April 2014 that includes a disclosure format on employee rights and on share-based payments. In addition, the circular updates subjects such as the discount rate, transitional provisions, disclosure requirements on the comprehensive income, in the note on accumulated other comprehensive income and disclosure requirements in the directors' report.

It is stipulated in the circular that the Bank of Israel reached the conclusion that there is no "deep market" of high-quality corporate debentures in Israel. Accordingly, the discount rate for employee benefits will be calculated based on the yield of Israel government bonds plus an average margin of corporate bonds with an international rating of AA and above. For practical reasons, it was decided that the margin calculation will be based on corporate bond margins in the US. A bank that is of the opinion that changes in the margin received in a certain period derive from exceptional movements in the markets so that the margins received from them are both suitable for the discounting above, shall apply to the Banking Supervision Department for a pre-ruling. Examples of these situations could include, inter alia, changes in respect of which the margin received is higher than the margin on corporate bonds rated AA (domestic) in Israel.

## Note 1 – Significant Accounting Policies (cont'd)

The Bank is required to correct retroactively comparative figures for periods beginning on 1 January 2013 and thereafter. As for the accounting treatment of actuarial gains and losses, it was determined:

- The actuarial loss as of 1 January 2013 due to the difference between the discount rate for calculating reserves to cover employee benefits that are linked to the consumer price index determined by the temporary provisions in the Public Reporting Directives (4%) and discount rates at the date determined under the new rules, as explained above, will be included in accumulated other comprehensive income.

- Actuarial gains recorded from 1 January 2013 and thereafter, due to current changes in discount rates during the reporting year, will be recorded in accumulated other comprehensive income and will reduce the net loss recorded as above until this balance is eliminated.

- Actuarial gains arising from current changes in the discount rates during the reporting year after elimination of the recorded balance of loss as aforesaid and actuarial losses, shall be amortized on a straight line basis over the average remaining service period of employees expected to receive benefits under the plan.

- Other actuarial gains and losses (not arising as a result of a change in the discount rate) at 1 January 2013 and subsequent periods, will be included in accumulated other comprehensive income and will be amortized on a straight-line basis over the average service period of employees expected to receive benefits under the plan.

- The effect of initial implementation on other benefits to employees whose changes therein are all recognized on a current basis in profit and loss (such as long-service bonuses), shall be charged to retained earnings.

In addition, the circular updates the disclosure requirements on employee rights and on share-based payments pursuant to generally accepted accounting principles in US banks.

On 12 January 2015 a list of questions and answers about employee benefits was published which includes examples of the treatment of bonuses prevalent in the banking system in accordance with generally accepted accounting principles in the US.

**Main points of the new directives on employee rights**

**Post-retirement benefits – pension, severance pay and other benefits in the framework of defined benefit plans**

A defined benefit plan is a pension plan that defines the amount of pension benefit to be paid, generally as a function of one or more factors such as age, years of service, or remuneration.

- The calculation of liability in respect of pension plans and other post-retirement plans is based on calculations that include actuarial and other assumptions including: discount rate, mortality, forecast long-term return on plan assets, increase in remuneration and employee turnover.

- The Bank reviews its instructions on an annual basis and updates them as necessary.

- Changes in assumptions as a rule, and subject to the provisions set out above, are first recognized on accumulated other comprehensive income and amortized to profit and loss in subsequent periods.

## Note 1 – Significant Accounting Policies (cont'd)

- The accumulated liability over the relevant period is in accordance with the instructions of the Banking Supervision Department.
  See Note 1.R.

- The Bank implements the instructions of the Banking Supervision Department on internal control over the financial reporting procedure on the subject of employee rights, including regarding "an obligation in essence" to grant its employees benefits in respect of increased severance pay and/or early pension.

**Post-retirement benefits in the framework of defined deposit plans**

A defined deposit plan is a plan according to which the Bank makes fixed payments to a separate entity without it having a legal or implicit obligation to make further payments.
The obligation of the Bank to make a deposit in a defined deposit plan is charged to profit and loss in the periods in which the employees provided related services.

**Other long-term benefits to active employees – long service bonuses**

- The liability is accumulated over the period of entitlement to the benefit.

- For purposes of calculating the liability, discount rates and actuarial assumptions are taken into account.

- All the cost components of the benefit for a period, including actuarial gains and losses, are charged immediately to the statement of profit and loss.

- Absences granting entitlement to compensation – the liability in respect of vacation days is measured on an ongoing basis, without using discount rates and actuarial assumptions.

**Share-based payment transactions**

- The Bank generally recognizes an expense in respect of share-based payments it grants to its employees.

- Equity bonuses are measured based on the fair value at the date they are granted.

- Liability bonuses are measured based on the fair value at the date they are granted, and the liability is remeasured until the settlement date.

The principal changes in accounting policies currently applied in the financial statements are:

- Currently, the discount rate for the reserves is 4%, compared with a discount rate based on the yield on government bonds in Israel plus the average margin on corporate bonds with an international rating of AA and above.

- Currently, actuarial gains and losses are charged immediately in the profit and loss statement compared with being charged to accumulated other comprehensive income in respect of a defined deposit plan.

- In accordance with the instructions of the Banking Supervision Department regarding internal control over the financial reporting process on employee benefits, and the liability is reported at the higher of (1) the amount of the liability calculated on an actuarial basis, taking into account the additional cost incurred in respect of the said benefits, and (2 ) the amount of the liability calculated by multiplying the employee's monthly salary by the number of years of employment, as required by Opinion 20 of the Institute of Certified

Public Accountants in Israel. Pursuant to the Supervisor's circular on the subject of adoption of US GAAP on the subject of employee rights, an obligation in respect of payment of severance pay is to be calculated on an actuarial basis that takes into account, inter alia, the additional cost that will be caused to the bank in respect of granting benefits in excess of contractual conditions.

For further information regarding the accounting policies applied by the Bank currently on employee benefits, see paragraph R.1.

**The Manner of the Bank's preparations for implementation of the Directive**

The Bank carried out a mapping of the relevant liabilities, set out a methodology for building the interest curve for discounting and calculated estimates of the effect of the changes from implementing the Directive.

In the Bank's opinion, the expected effect as of 1 January 2015 in respect of implementation of the new rules and that derives mainly from the change in the discount rate is an increase in assets in the amount of approximately NIS 0.9 - 1.1 billion, an increase in liabilities in the amount of approximately NIS 2.4 - 2.8 billion, and a decrease in shareholders' equity in the amount of approximately NIS 1.5 - 1.7 billion. The increase or decrease in the discount rate is likely to have a significant effect on the total liabilities in respect of employee rights, and therefore, on the shareholders' equity. In the first quarter of 2015, the yield derived from the capital markets fell, resulting in a further decrease in the discount rate, which, insofar as it continues until the end of March 2015, will be reflected in the report of 31 March 2015. This decrease, based on the data for the middle of March, is expected to reduce the shareholders' equity by a further amount of between NIS 0.8 - 1.1 billion after the effect of tax.

The calculation of capital requirements under the Basel III directives is to be made in accordance with transitional provisions set forth in Proper Conduct of Banking Business Directive No. 299, that stipulates that the balance of accumulated other profit or loss deriving from adjustments in respect of employee benefits, and the amount charged directly to retained earnings at 1 January 2013 in respect of the effect of initial adoption will not be taken into account immediately, but will be subject to transitional provisions, so that their impact will be spread as follows: 40% from 1 January 2015 and an additional 20% from 1 January each year until implementation in full from 1 January, 2018.

For disclosure of the estimate of the expected impact on the ratio of Tier 1 shareholders' equity at 31 December 2014, see Note 13.A.

As stated, the Bank is in the advanced processes of reviewing the implications of the new rules concerning employee rights. However, because of the complexity of initial implementation of these rules, and the need to complete the determining of methodologies used for the various calculations, this process will be completed together with the initial adoption of the rules in the financial statements for the first quarter of 2015.

For details on additional effects arising from changes in the collective wage agreement, see Note 15.A.

**2. Reporting under US GAAP relating to the distinction between liabilities and equity**

On 6 October 2014, the Supervisor of Banks published a directive on the subject of reporting under US GAAP relating to the distinction between liabilities and equity. For this purpose, it is required to adopt the rules for reporting, measurement and disclosure set forth in the framework of the following matters in the codification:

- Accounting Standards Codification 480 – "Distinguishing Liabilities from Equity".

- Accounting Standards Codification 470-20 – "Debt with Conversion and Other Options".
- Accounting Standards Codification 505-30 – "Treasury Stock".

In addition, in implementing the distinction between liabilities and equity, reference is to be made to the provisions of the Public Reporting Directives concerning embedded instruments.

Along with the publication of the said circular, an FAQ file was published on the subject, in which it was clarified that existing debt instruments with a conditional conversion component to shares (which is included in Tier 1 shareholders' equity under Basel II and in accordance with the transitional provisions meets the definition of a compound capital instrument, or is included as a component of regulatory capital in accordance with the Basel III) should be classified as a liability to be measured at amortized cost, without having to separate an embedded derivative.

The Bank implemented these rules as of 1 January 2015, when on initial application it was required to act in accordance with the transitional provisions enacted on the codification issues listed above.

In the opinion of the Bank, implementation of the Directive did not have a material impact.

**3. Reporting on Operating Segments**

On 3 November 2014 a circular was published concerning the reporting on operating segments that updated the Public Reporting Directives including changing some definitions and guidelines according to which, the Bank is required to classify customers in regulatory segments.

The amendments to the directives were intended to require reporting on operating segments in accordance with the uniform and comparable format prescribed by the Banking Supervision Department. In addition, the circular states that the disclosure of "operating segments in accordance with the management approach" will be provided in accordance with generally accepted accounting principles in US banks, Operating Segments (included in ASC 280) if there is a fundamental difference between the management approach and reporting segments according to the guidelines of the Supervisor.

The new rules will apply to the financial statements for 2015 and thereafter in the following manner:

- In the 2015 financial statements, there will be a disclosure requirement applying to balance sheet data in relation to supervisory operating segments as defined in the new directives. It is possible not to give disclosure to comparative balance sheet data on supervisory operating segments but to include comparative data in accordance with the Public Reporting Directives that were in effect prior to the circular. In addition, no disclosure is required of the financial management sector.
- As of the financial statements for the first quarter of 2016, full disclosure is required under the new rules, except for the disclosure of the financial management sector. Comparative figures will be retroactively adjusted. It will be possible to report comparative figures for one year only in the financial statements in 2016.
- From the financial statements for the first quarter of 2017, the requirements of the circular are required to be implemented in their entirety.
- Implementation of the new directives is not expected to have a material effect except for presentation and disclosure.

## Note 1 – Significant Accounting Policies (cont'd)

**4. Recognition of income from contracts with customers**

On 11 January 2015, a circular was issued on the adoption of updated accounting rules on the subject of income from contracts with customers. The circular updates the Public Reporting Directives in light of ASU 2014-09. The Standard states that income will be recognized in the amount expected to be received in exchange for the transfer of goods or services to the customer.

Banks are required to implement the amendments to the Public Reporting Directives pursuant to the circular as of 1 January 2017. In accordance with the transitional provisions, upon initial adoption, it is possible to choose between the alternative of retrospective implementation while restating comparative figures and the alternative of prospective application while recording the cumulative effect on equity at the time of initial application.

The new Standard does not apply to financial instruments and rights or contractual obligations within the scope of Accounting Standards Codification 310.

The Bank has not yet begun to examine the impact of the Standard on its financial statements and has not yet chosen the alternative for implementation of the transitional provisions.

## Note 2 – Cash and deposits with banks

| | 31 December 2014 | 31 December 2013 |
|---|---|---|
| | (NIS millions) | |
| Cash and deposits with central banks | **46,385** | 35,038 |
| Deposits with commercial banks (a) | **14,230** | 9,313 |
| Total (b) | **60,615** | 44,351 |
| Of which: cash and deposits with central and commercial banks for original periods not exceeding three months | **57,561** | 42,777 |

(a) Net of the allowance for credit losses.
(b) Of which pledged cash in the amount of NIS 1,646 thousand (31 December 2013 – NIS 1,072 thousand).

Note: For liens – See Note 14.

## Note 3 – Securities

| | 31 December 2014 | | | | | 31 December 2013 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Other comprehensive accumulated profit (loss) | | | | | Other comprehensive accumulated profit (loss) | | |
| | Book value | Amortized cost (for shares - cost) | Profits | Losses | Fair value (a) | Book value | Amortized cost (for shares - cost) | Profits | Losses | Fair value (a) |
| | (NIS millions) | | | | | | | | | |
| **1. Securities available for sale: Bonds -** | | | | | | | | | | |
| Government of Israel | **14,290** | **14,033** | **260** | **(3)** | **14,290** | 30,736 | 30,552 | 201 | (17) | 30,736 |
| Foreign governments | **4,715** | **4,708** | **10** | **(3)** | **4,715** | 3,843 | 3,840 | 6 | (3) | 3,843 |
| Financial institutions in Israel | **65** | **60** | **5** | **-** | **65** | 105 | 100 | 6 | (1) | 105 |
| Financial institutions abroad | **5,676** | **5,611** | **80** | **(15)** | **5,676** | 5,280 | 5,213 | 87 | (20) | 5,280 |
| Asset-backed (ABS) or mortgage-backed securities (MBS) | **7,687** | **7,722** | **40** | **(75)** | **7,687** | 7,346 | 7,474 | 34 | (162) | 7,346 |
| Others in Israel | **907** | **881** | **30** | **(4)** | **907** | 721 | 683 | 39 | (1) | 721 |
| Others abroad | **2,602** | **2,594** | **29** | **(21)** | **2,602** | 2,002 | 1,992 | 28 | (18) | 2,002 |
| | **35,942** | **35,609** | **454** | **(121)** | **35,942** | 50,033 | 49,854 | 401 | (222) | 50,033 |
| **Shares and mutual funds (b)** | **3,180** | **2,801** | **390** | **(11)** | **3,180** | 2,828 | 2,744 | 156 | (72) | 2,828 |
| **Total securities available for sale** | **39,122** | **38,410** | **844** (c) | **(132)** (c) | **39,122** | 52,861 | 52,598 | 557 (c) | (294) (c) | 52,861 |

See notes on next page.

# Note 3 – Securities (cont'd)

| | 31 December 2014 | | | | | 31 December 2013 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 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 | **7,915** | **7,888** | **33** | **(6)** | **7,915** | 7,104 | 7,057 | 56 | (9) | 7,104 |
| Foreign governments | **505** | **504** | **1** | **-** | **505** | 1,028 | 1,036 | - | (8) | 1,028 |
| Financial institutions in Israel | **374** | **374** | **1** | **(1)** | **374** | 327 | 322 | 5 | - | 327 |
| Financial institutions abroad | **266** | **262** | **5** | **(1)** | **266** | 116 | 114 | 2 | - | 116 |
| Asset-backed (ABS) or mortgage-backed securities (MBS) | **1,438** | **1,435** | **8** | **(5)** | **1,438** | 279 | 282 | 1 | (4) | 279 |
| Others in Israel | **319** | **318** | **3** | **(2)** | **319** | 409 | 400 | 9 | - | 409 |
| Others abroad | **660** | **658** | **11** | **(9)** | **660** | 520 | 529 | 3 | (12) | 520 |
| | **11,477** | **11,439** | **62** | **(24)** | **11,477** | 9,783 | 9,740 | 76 | (33) | 9,783 |
| **Shares and mutual funds** | **1,514** | **1,400** | **141** | **(27)** | **1,514** | 1,091 | 1,017 | 78 | (4) | 1,091 |
| **Total securities for trading** | **12,991** | **12,839** | **203**(d) | **(51)**(d) | **12,991** | 10,874 | 10,757 | 154(d) | (37)(d) | 10,874 |
| **Total securities** (e)(f) | **52,113** | **51,249** | **1,047** | **(183)** | **52,113** | 63,735 | 63,355 | 711 | (331) | 63,735 |

(a) Fair value data are generally based on stock exchange prices, which do not necessarily reflect the price which will be obtained upon sale of securities in large volumes.
(b) Book value includes NIS 1,596 million with regard to shares and funds which have no readily available fair value, which are shown at cost (31 December 2013 - NIS 1,363 million).
(c) Unrealized profits (losses) are included in equity in the item "other comprehensive income (loss), net after the effect of tax", except for securities hedged in a fair value hedge.
(d) Charged to the profit and loss statement but not yet realized.
(e) During 2013, the Bank realized its holdings in the shares of Migdal Financial and Insurance Holdings Ltd.
(f) Of which: book value of NIS 10 million (31 December 2013 – NIS 27 million) in respect of bonds of companies included on equity basis.
(g) Including impaired bonds in the amount of NIS 19 million (31 December 2013 – NIS 26 million).

**General comments:**
Securities lent amounting to NIS 196 million (31 December 2013 – NIS 571 million) are shown under credit to the public.
Securities pledged to lenders amounted to NIS 2,109 million (31 December 2013 – NIS 1,458 million).

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.
The distinction between Israeli and foreign bonds is made in accordance with the country of residence of the entity issuing the security, as stated in Exhibit G in the Management Review on "Foreign Country Exposure".

## Note 3 – Securities (cont'd)

### Additional details on consolidated basis of mortgage-backed and asset-backed securities available for sale

| | 31 December 2014 | | | | 31 December 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | | Other comprehensive accumulated profit (loss) (a) | | | | Other comprehensive accumulated profit (loss) (a) | | |
| | Amortized cost | Profits | Losses | Fair value | Amortized cost | Profits | Losses | Fair value |
| | (NIS millions) | | | | | | | |
| **3. Bonds available for sale** | | | | | | | | |
| **Pass-through securities:** | | | | | | | | |
| Securities guaranteed by GNMA | **18** | - | - | **18** | 233 | 1 | (2) | 232 |
| Securities issued by FNMA and FHLMC | **1,577** | **1** | **(18)** | **1,560** | 1,662 | - | (81) | 1,581 |
| Total mortgage-backed pass-through securities | **1,595** | **1** | **(18)** | **1,578** | 1,895 | 1 | (83) | 1,813 |
| **Other mortgage-backed securities (including CMO and STRIPPED MBS)** | | | | | | | | |
| Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities | **3,298** | **6** | **(41)** | **3,263** | 3,423 | 6 | (66) | 3,363 |
| Other mortgage-backed securities | **741** | **5** | **(2)** | **744** | 355 | - | - | 355 |
| Total other mortgage-backed securities | **4,039** | **11** | **(43)** | **4,007** | 3,778 | 6 | (66) | 3,718 |
| Total mortgage-backed securities (MBS) | **5,634** | **12** | **(61)** | **5,585** | 5,673 | 7 | (149) | 5,531 |
| **Asset-backed securities (ABS)** | | | | | | | | |
| Credit card receivables | **93** | - | **(2)** | **91** | 86 | - | (1) | 85 |
| Lines of credit for any purpose secured by dwelling | **2** | - | - | **2** | 2 | - | - | 2 |
| Other credit to private persons | **4** | - | - | **4** | 3 | - | - | 3 |
| Credit not to private persons | **1** | - | - | **1** | 1 | - | - | 1 |
| CLO debentures | **1,988** | **28** | **(12)** | **2,004** | 1,709 | 27 | (12) | 1,724 |
| Total asset-backed securities | **2,088** | **28** | **(14)** | **2,102** | 1,801 | 27 | (13) | 1,815 |
| **Total mortgage-backed and asset-backed securities available for sale** | **7,722** | **40** | **(75)** | **7,687** | 7,474 | 34 | (162) | 7,346 |

(a) Amounts charged to capital reserve as part of other comprehensive income, net after the effect of tax.

## Note 3 – Securities (cont'd)

### Additional details on consolidated basis of mortgage-backed and asset-backed securities for trading

| | **31 December 2014** | | | | 31 December 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | Amorized cost | Unrealized profits from adjustments to fair value (a) | Unrealized losses from adjustments to fair value (a) | Fair value | Amorized cost | Unrealized profits from adjustments to fair value (a) | Unrealized losses from adjustments to fair value (a) | Fair value |
| | (NIS millions) | | | | | | | |
| **4. Bonds for trading** | | | | | | | | |
| **Pass-through securities:** | | | | | | | | |
| Securities issued by FNMA and FHLMC | **248** | **-** | **-** | **248** | - | - | - | - |
| Other securities | **-** | **-** | **-** | **-** | 4 | - | - | 4 |
| Total mortgage-backed pass-through securities | **248** | **-** | **-** | **248** | 4 | - | - | 4 |
| **Other mortgage-backed securities (including CMO and STRIPPED MBS)** | **-** | **-** | **-** | **-** | - | - | - | - |
| Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities | **776** | **3** | **(4)** | **775** | 11 | - | - | 11 |
| Other mortgage-backed securities | **116** | **2** | **(1)** | **117** | 76 | - | (3) | 73 |
| Total other mortgage-backed securities | **892** | **5** | **(5)** | **892** | 87 | - | (3) | 84 |
| Total mortgage-backed securities (MBS) | **1,140** | **5** | **(5)** | **1,140** | 91 | - | (3) | 88 |
| **Asset-backed securities (ABS)** | **-** | **-** | **-** | **-** | - | - | - | - |
| Credit card receivables | **19** | **-** | **-** | **19** | - | - | - | - |
| Lines of credit for any purpose secured by dwelling | **1** | **-** | **-** | **1** | - | - | - | - |
| Credit for purchase of vehicles | **78** | **1** | **-** | **79** | 56 | 1 | - | 57 |
| Other credit to private persons | **16** | **-** | **-** | **16** | 16 | - | - | 16 |
| Credit not to private persons | **47** | **-** | **-** | **47** | - | - | - | - |
| Others | **134** | **2** | **-** | **136** | 119 | - | (1) | 118 |
| Total asset-backed securities | **295** | **3** | **-** | **298** | 191 | 1 | (1) | 191 |
| **Total mortgage-backed and asset-backed securities for trading** | **1,435** | **8** | **(5)** | **1,438** | 282 | 1 | (4) | 279 |

(a) These profits (losses) have been charged to profit and loss.

## Note 3 – Securities (cont'd)

**Additional details of fair value and unrealized losses by maturity and rate of impairment of securities available for sale that are in an unrealized loss position**

| | **31 December 2014** | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Less than 12 months | | | | | 12 months and above | | | | |
| | | Unrealized losses | | | | | Unrealized losses | | | |
| | Fair value | 0-20% | 20%-35% | More than 35% | Total | Fair value | 0-20% | 20%-35% | More than 35% | Total |
| | (NIS millions) | | | | | | | | | |
| **Bonds** | | | | | | | | | | |
| Government of Israel | **6,910** | **3** | **-** | **-** | **3** | **31** | **-** | **-** | **-** | **-** |
| Foreign governments | **3,372** | **2** | **-** | **-** | **2** | **115** | **1** | **-** | **-** | **1** |
| Financial institutions in Israel | **5** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Financial institutions abroad | **1,419** | **6** | **-** | **-** | **6** | **317** | **9** | **-** | **-** | **9** |
| Asset-backed securities (ABS) or mortgage-backed securities (MBS) | **1,604** | **9** | **-** | **-** | **9** | **3,541** | **66** | **-** | **-** | **66** |
| Others in Israel | **300** | **4** | **-** | **-** | **4** | **-** | **-** | **-** | **-** | **-** |
| Others abroad | **457** | **3** | **-** | **-** | **3** | **773** | **16** | **-** | **2** | **18** |
| Shares and mutual funds | **1** | **-** | **-** | **-** | **-** | **196** | **11** | **-** | **-** | **11** |
| **Total securities available for sale** | **14,068** | **27** | **-** | **-** | **27** | **4,973** | **103** | **-** | **2** | **105** |

| | 31 December 2013 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Less than 12 months | | | | | 12 months and above | | | | |
| | | Unrealized losses | | | | | Unrealized losses | | | |
| | Fair value | 0-20% | 20%-35% | More than 35% | Total | Fair value | 0-20% | 20%-35% | More than 35% | Total |
| | (NIS millions) | | | | | | | | | |
| **Bonds** | | | | | | | | | | |
| Government of Israel | 408 | 16 | - | - | 16 | 28 | - | - | - | - |
| Foreign governments | 1,032 | 2 | - | - | 2 | 45 | 1 | - | - | 1 |
| Financial institutions in Israel | - | - | - | - | - | 9 | 1 | - | - | 1 |
| Financial institutions abroad | 1,394 | 6 | - | - | 6 | 539 | 10 | 4 | - | 14 |
| Asset-backed securities (ABS) or mortgage-backed securities (MBS) | 4,495 | 130 | - | - | 130 | 779 | 32 | - | - | 32 |
| Others in Israel | 9 | 1 | - | - | 1 | 66 | - | - | - | - |
| Others abroad | 601 | 13 | - | - | 13 | 351 | 5 | - | - | 5 |
| Shares and mutual funds | 966 | 72 | - | 1 | 73 | - | - | - | - | - |
| **Total securities available for sale** | 8,905 | 240 | - | 1 | 241 | 1,817 | 49 | 4 | - | 53 |

**Additional details of mortgage-backed and asset-backed securities that are in an unrealized loss position**

## Note 3 – Securities (cont'd)

| | **31 December 2014** | | | | | |
|---|---|---|---|---|---|---|
| | 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) | | | | | |
| Mortgage-backed securities (MBS) | **57** | **-** | **1,416** | **(18)** | **1,473** | **(18)** |
| Other mortgage-backed securities (including REMIC, CMO and STRIPPED MBS) | **649** | **(4)** | **1,555** | **(39)** | **2,204** | **(43)** |
| Asset-backed securities (ABS) | **898** | **(5)** | **570** | **(9)** | **1,468** | **(14)** |
| Total | **1,604** | **(9)** | **3,541** | **(66)** | **5,145** | **(75)** |

| | 31 December 2013 | | | | | |
|---|---|---|---|---|---|---|
| | 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) | | | | | |
| Mortgage-backed securities (MBS) | 1,362 | (66) | 315 | (17) | 1,677 | (83) |
| Other mortgage-backed securities (including REMIC, CMO and STRIPPED MBS) | 2,435 | (56) | 289 | (10) | 2,724 | (66) |
| Asset-backed securities (ABS) | 698 | (8) | 175 | (5) | 873 | (13) |
| Total | 4,495 | (130) | 779 | (32) | 5,274 | (162) |

## 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 portfolios 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 Allowance for Credit Losses

## A. Debts[a] and off-balance sheet credit instruments
## Allowance for credit losses

### 1. Change in balance of credit loss allowance

| | **31 December 2014** | | | | | |
|---|---|---|---|---|---|---|
| | Allowance for credit losses | | | | | |
| | Credit to the public | | | | | |
| | Commercial | Residential | Other private | Total | Banks and governments | Total |
| | (NIS millions) | | | | | |
| Balance of allowance for credit losses at beginning of year | **3,301** | **498** | **496** | **4,295** | **2** | **4,297** |
| Expenses in respect of credit losses | **90** | **24** | **356** | **470** | **2** | **472** |
| Accounting write-offs | **(574)** | **(10)** | **(560)** | **(1,144)** | **-** | **(1,144)** |
| Collection of debts written off in previous years | **475** | **-** | **364** | **839** | **-** | **839** |
| Net accounting write-offs | **(99)** | **(10)** | **(196)** | **(305)** | **-** | **(305)** |
| Adjustments from translation of financial statements | **25** | **1** | **(4)** | **22** | **-** | **22** |
| Balance of allowance for credit losses at end of year[1] | **3,317** | **513** | **652** | **4,482** | **4** | **4,486** |
| [1]Of which: in respect of off-balance sheet credit instruments | **446** | **1** | **47** | **494** | **-** | **494** |

| | 31 December 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Allowance for credit losses | | | | | |
| | Credit to the public | | | | | |
| | Commercial | Residential | Other private | Total | Banks and governments | Total |
| | (NIS millions) | | | | | |
| Balance of allowance for credit losses at beginning of year | 3,691 | 475 | 395 | 4,561 | 4 | 4,565 |
| Expenses in respect of credit losses | 30 | 53 | 182 | 265 | 3 | 268 |
| Accounting write-offs | (846) (b) | (29) | (477) | (1,352) | (5) | (1,357) |
| Collection of debts written off in previous years | 441 (b) | - | 397 | 838 | - | 838 |
| Net accounting write-offs | (405) | (29) | (80) | (514) | (5) | (519) |
| Adjustments from translation of financial statements | (15) | (1) | (1) | (17) | - | (17) |
| Balance of allowance for credit losses at end of year[1] | 3,301 | 498 | 496 | 4,295 | 2 | 4,297 |
| [1]Of which: in respect of off-balance sheet credit instruments | 373 | - | 39 | 412 | - | 412 |

(a) Credit to the public, credit to governments, deposits in banks (excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Reclassified.

## Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

### A. Debts[(a)] and off-balance sheet credit instruments
### Allowance for credit losses

**1. Change in balance of credit loss allowance (cont'd)**

| | 31 December 2012 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Credit loss allowance | | | | | | |
| | Credit to the public | | | | | | |
| | Commercial | | Residential | Other private | Total | Banks and governments | Total |
| | (NIS millions) | | | | | | |
| Balance of credit loss allowance at beginning of year | 3,441 | | 532 | 462 | 4,435 | 5 | 4,440 |
| Net accounting write-offs recognized at 1.1.2012 | 27 | | 3 | 6 | 36 | - | 36 |
| Expenses in respect of credit losses | 1,156 | | (13) | 93 | 1,236 | - | 1,236 |
| Accounting write-offs | (1,225) | (b) | (47) | (443) | (1,715) | (1) | (1,716) |
| Collection of debts written off in previous years | 296 | (b) | - | 277 | 573 | - | 573 |
| Net accounting write-offs | (929) | | (47) | (166) | (1,142) | (1) | (1,143) |
| Adjustments from translation of financial statements | (4) | | - | - | (4) | - | (4) |
| Balance of allowance for credit losses at end of year[1] | 3,691 | | 475 | 395 | 4,561 | 4 | 4,565 |
| [1]Of which: in respect of off-balance sheet credit instruments | 413 | | - | 34 | 447 | - | 447 |

(a) Credit to the public, credit to governments, deposits in banks (from 2013, excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) Reclassified.

## Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

### A. Debts[(a)] and off-balance sheet credit instruments (cont'd)

#### 2. Additional information on the method of calculating the credit loss allowance in respect of debts[a] and on the debts[a] on which it was calculated

| | 31 December 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Allowance for credit losses | | | | | |
| | Credit to the public | | | | | |
| | Commercial | Residential | Other private | Total | Banks and governments | Total |
| | (NIS millions) | | | | | |
| **Recorded debt balance of debts[a]:** | | | | | | |
| Examined on an individual basis | **110,050** | **52** | **1,553** | **111,655** | **18,300** | **129,955** |
| Examined on a collective basis[2] | **35,613** | **75,392** | **33,808** | **144,813** | **1,364** | **146,177** |
| [2]Of which: the allowance was calculated by extent of arrears | **-** | **74,239** | **-** | **74,239** | **-** | **74,239** |
| Total debts[a] | **145,663** | **75,444** | **35,361** | **256,468** | **19,664** | **276,132** |
| **Allowance for credit losses in respect of debts[a]:** | **-** | **-** | **-** | **-** | **-** | **-** |
| Examined on an individual basis | **2,441** | **16** | **64** | **2,521** | **4** | **2,525** |
| Examined on a collective basis[3] | **430** | **496** | **541** | **1,467** | **-** | **1,467** |
| [3]Of which: the allowance was calculated by extent of arrears | **-** | **495** | **-** | **495** | **-** | **495** |
| Total allowance for credit losses | **2,871** | **512** | **605** | **3,988** | **4** | **3,992** |

| | 31 December 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Allowance for credit losses | | | | | |
| | Credit to the public | | | | | |
| | Commercial | Residential | Other private | Total | Banks and governments | Total |
| | (NIS millions) | | | | | |
| **Recorded debt balance of debts[a]:** | | | | | | |
| Examined on an individual basis | 109,908 | 49 | 1,709 | 111,666 | 12,809 | 124,475 |
| Examined on a collective basis[2] | 32,564 | 69,741 | 30,786 | 133,091 | 2,453 | 135,544 |
| [2]Of which: the allowance was calculated by extent of arrears | - | 68,581 | - | 68,581 | - | 68,581 |
| Total debts[a] | 142,472 | 69,790 | 32,495 | 244,757 | 15,262 | 260,019 |
| **Allowance for credit losses in respect of debts[a]:** | - | - | - | - | - | - |
| Examined on an individual basis | 2,660 | 15 | 87 | 2,762 | 2 | 2,764 |
| Examined on a collective basis[3] | 268 | 483 | 370 | 1,121 | - | 1,121 |
| [3]Of which: the allowance was calculated by extent of arrears | - | 480 | - | 480 | - | 480 |
| Total allowance for credit losses | 2,928 | 498 | 457 | 3,883 | 2 | 3,885 |

(a) Credit to the public, credit to governments, deposits in banks (excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) 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 291 million (2012 – NIS 271 million).

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[(a)]

### 1. Credit quality and arrears

| | 31 December 2014 | | | | | |
|---|---|---|---|---|---|---|
| | | Problem debts (b) | | | Unimpaired debts - additional information | |
| | Non-problem debts | Not impaired | Impaired (c) | Total | In arrears of 90 days or more (d) | In arrears of 30 to 89 days (e) |
| | (NIS millions) | | | | | |
| Activity of borrowers in Israel<br>Public - commercial | | | | | | |
| Construction & real estate - construction | **15,327** | **290** | **579** | **16,196** | **9** | **31** |
| Construction & real estate - real estate activities | **20,573** | **518** | **1,331** | **22,422** | **5** | **12** |
| Financial services | **9,978** | **33** | **20** | **10,031** | **-** | **12** |
| Commercial - other | **65,293** | **3,074** | **1,499** | **69,866** | **36** | **81** |
| **Total commercial** | **111,171** | **3,915** | **3,429** | **118,515** | **50** | **136** |
| Private individuals - housing loans(f) | **73,465** | **775** | **-** | **74,240** | **768** | **499** |
| Private individuals - other | **34,037** | **335** | **100** | **34,472** | **89** | **171** |
| **Total public - activity in Israel** | **218,673** | **5,025** | **3,529** | **227,227** | **907** | **806** |
| **Israeli banks** | **1,581** | **-** | **-** | **1,581** | **-** | **-** |
| **Government of Israel** | **294** | **-** | **-** | **294** | **-** | **-** |
| **Total activity in Israel** | **220,548** | **5,025** | **3,529** | **229,102** | **907** | **806** |
| Activity of borrowers abroad<br>Public - commercial | | | | | | |
| Construction & real estate | **8,014** | **57** | **500** | **8,571** | **4** | **23** |
| Other commercial | **17,621** | **259** | **697** | **18,577** | **3** | **36** |
| **Total commercial** | **25,635** | **316** | **1,197** | **27,148** | **7** | **59** |
| Private individuals | **2,008** | **20** | **65** | **2,093** | **27** | **3** |
| **Total public - activity abroad** | **27,643** | **336** | **1,262** | **29,241** | **34** | **62** |
| **Foreign banks** | **17,555** | **-** | **-** | **17,555** | **-** | **-** |
| **Foreign governments** | **234** | **-** | **-** | **234** | **-** | **-** |
| **Total activity abroad** | **45,432** | **336** | **1,262** | **47,030** | **34** | **62** |
| **Total public** | **246,316** | **5,361** | **4,791** | **256,468** | **941** | **868** |
| **Total banks** | **19,136** | **-** | **-** | **19,136** | **-** | **-** |
| **Total governments** | **528** | **-** | **-** | **528** | **-** | **-** |
| **Total** | **265,980** | **5,361** | **4,791** | **276,132** | **941** | **868** |

See notes on page 348.

## Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

### B. Debts[a] (cont'd)

#### 1. Credit quality and arrears (cont'd)

| | 31 December 2013 | | | | | |
|---|---|---|---|---|---|---|
| | | Problem debts(b) | | | Unimpaired debts - additional information | |
| | Non-problem debts | Not impaired | Impaired (c) | Total | In arrears of 90 days or more (d) (g) | In arrears of 30 to 89 days (e) (g) |
| | (NIS millions) | | | | | |
| Activity of borrowers in Israel | | | | | | |
| Public - commercial | | | | | | |
| Construction & real estate - construction | 13,684 | 558 | 478 | 14,720 | 6 | 16 |
| Construction & real estate - real estate activities | 21,786 | 196 | 1,392 | 23,374 | 5 | 22 |
| Financial services (g) | 10,472 | 6 | 200 | 10,678 | 1 | 9 |
| Commercial - other (g) | 61,866 | 2,677 | 1,914 | 66,457 | 31 | 83 |
| **Total commercial** | 107,808 | 3,437 | 3,984 | 115,229 | 43 | 130 |
| Private individuals - housing loans(f) | 67,789 | 803 | - | 68,592 | 786 | 602 |
| Private individuals - other | 31,046 | 306 | 106 | 31,458 | 90 | 185 |
| **Total public - activity in Israel** | 206,643 | 4,546 | 4,090 | 215,279 | 919 | 917 |
| **Israeli banks** | 1,688 | - | - | 1,688 | - | - |
| **Government of Israel** | 338 | - | - | 338 | - | - |
| **Total activity in Israel** | 208,669 | 4,546 | 4,090 | 217,305 | 919 | 917 |
| Activity of borrowers abroad | | | | | | |
| Public - commercial | | | | | | |
| Construction & real estate | 6,783 | 166 | 718 | 7,667 | 34 | 122 |
| Other commercial | 18,389 | 317 | 870 | 19,576 | 159 | 37 |
| **Total commercial** | 25,172 | 483 | 1,588 | 27,243 | 193 | 159 |
| Private individuals | 2,126 | 19 | 90 | 2,235 | - | 22 |
| **Total public - activity abroad** | 27,298 | 502 | 1,678 | 29,478 | 193 | 181 |
| **Foreign banks** | 13,016 | - | - | 13,016 | - | - |
| **Foreign governments** | 220 | - | - | 220 | - | - |
| **Total activity abroad** | 40,534 | 502 | 1,678 | 42,714 | 193 | 181 |
| **Total public** | 233,941 | 5,048 | 5,768 | 244,757 | 1,112 | 1,098 |
| **Total banks** | 14,704 | - | - | 14,704 | - | - |
| **Total governments** | 558 | - | - | 558 | - | - |
| **Total** | 249,203 | 5,048 | 5,768 | 260,019 | 1,112 | 1,098 |

See notes on page 348.

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[a] (cont'd)

### 1. Credit quality and arrears (cont'd)

**Notes:**

(a) Credit to the public, credit to governments, deposits in banks (in 2013, excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) 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 for which there is no provision that are in arrears of 90 days or more.

(c) 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.

(d) Classified as problem debts that are not impaired, accruing interest income.

(e) Accruing interest income. Debts in arrears of 30 to 89 days in the amount of NIS 533 million (31 December 2013 – NIS 773 million) were classified as problem debts that are not impaired.

(f) Including housing loans in the amount of NIS 175 million (31 December 2013 – NIS 198 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.

(g) Reclassified.

### Credit quality – status of debts in arrears[a]

The status of debts in arrears is monitored routinely, and serves as one of the key indicators of credit quality. The status of debts in arrears is determined based on actual days of arrears. Debts are treated as nonperforming (not accruing interest income) after 90 days of arrears, as is any debt that has undergone troubled debt restructuring and has resumed accruing interest when it is one day of arrears relative to the new terms of the debt. With regard to debts evaluated on a collective basis, the status of arrears affects the classification of the debt (the classification is more severe for more extensive arrears) and after 150 days of arrears, the Bank performs a charge-off of the debt. With regard to housing loans, with the exception of loans without quarterly or monthly payments, the Bank establishes an allowance according to the method of the extent of arrears.

(a) Credit to the public, credit to governments, deposits in banks (in 2013, excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[(a)] (cont'd)

### 2. Additional information on impaired debts
### A. Impaired debts and individual allowance

| | 31 December 2014 | | | | |
|---|---|---|---|---|---|
| | Balance (b) of impaired debts in respect of which there is an individual allowance (c) | Balance of individual allowance (c) | Balance (b) of impaired debts in respect of which there is no individual allowance (c) | Total balance (b) of impaired debts | Contractual principal balance of impaired debts |
| | (NIS millions) | | | | |
| Activity of borrowers in Israel | | | | | |
| Public - commercial | | | | | |
| Construction & real estate - construction | **93** | **36** | **486** | **579** | **1,283** |
| Construction & real estate - real estate activities | **733** | **322** | **598** | **1,331** | **2,449** |
| Financial services | **7** | **7** | **13** | **20** | **534** |
| Commercial - other | **888** | **347** | **611** | **1,499** | **4,951** |
| **Total commercial** | **1,721** | **712** | **1,708** | **3,429** | **9,217** |
| Private individuals - housing loans | - | - | - | - | - |
| Private individuals - other | **79** | **44** | **21** | **100** | **1,841** |
| **Total public - activity in Israel** | **1,800** | **756** | **1,729** | **3,529** | **11,058** |
| **Israeli banks** | - | - | - | - | - |
| **Government of Israel** | - | - | - | - | - |
| **Total activity in Israel** | **1,800** | **756** | **1,729** | **3,529** | **11,058** |
| Activity of borrowers abroad | | | | | |
| Public - commercial | | | | | |
| Construction & real estate | **327** | **205** | **173** | **500** | **679** |
| Other commercial | **536** | **294** | **161** | **697** | **942** |
| **Total commercial** | **863** | **499** | **334** | **1,197** | **1,621** |
| Private individuals | **36** | **24** | **29** | **65** | **90** |
| **Total public - activity abroad** | **899** | **523** | **363** | **1,262** | **1,711** |
| **Foreign banks** | - | - | - | - | **1** |
| **Foreign governments** | - | - | - | - | - |
| **Total activity abroad** | **899** | **523** | **363** | **1,262** | **1,712** |
| **Total public** | **2,699** | **1,279** | **2,092** | **4,791** | **12,769** |
| **Total banks** | - | - | - | - | **1** |
| **Total governments** | - | - | - | - | - |
| **Total** | **2,699** | **1,279** | **2,092** | **4,791** | **12,770** |
| **Of which:** | | | | | |
| **Measured by present value of cash flows** | **1,573** | **858** | **1,281** | **2,854** | |
| **Debts under troubled debt restructuring** | **1,434** | **567** | **1,268** | **2,702** | |

See notes on next page.

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[(a)] (cont'd)

### 2. Additional information on impaired debts (cont'd)
### A. Impaired debts and individual allowance (cont'd)

| | 31 December 2013 | | | | |
|---|---|---|---|---|---|
| | Balance (b) of impaired debts in respect of which there is an individual allowance (c) | Balance of individual allowance (c) | Balance (b) of impaired debts in respect of which there is no individual allowance (c) | Total balance (b) of impaired debts | Contractual principal balance of impaired debts |
| | (NIS millions) | | | | |
| Activity of borrowers in Israel | | | | | |
| Public - commercial | | | | | |
| Construction & real estate - construction | 108 | 23 | 370 | 478 | 1,651 |
| Construction & real estate - real estate activities | 979 | 176 | 413 | 1,392 | 2,520 |
| Financial services (d) | 157 | 143 | 43 | 200 | 1,160 |
| Commercial - other (d) | 1,006 | 356 | 908 | 1,914 | 4,999 |
| **Total commercial** | 2,250 | 698 | 1,734 | 3,984 | 10,330 |
| Private individuals - housing loans | - | - | - | - | - |
| Private individuals - other | 67 | 44 | 39 | 106 | 1,793 |
| **Total public - activity in Israel** | 2,317 | 742 | 1,773 | 4,090 | 12,123 |
| **Israeli banks** | - | - | - | - | - |
| **Government of Israel** | - | - | - | - | - |
| **Total activity in Israel** | 2,317 | 742 | 1,773 | 4,090 | 12,123 |
| Activity of borrowers abroad | | | | | |
| Public - commercial | | | | | |
| Construction & real estate | 503 | 302 | 215 | 718 | 900 |
| Other commercial | 695 | 384 | 175 | 870 | 1,058 |
| **Total commercial** | 1,198 | 686 | 390 | 1,588 | 1,958 |
| Private individuals | 62 | 49 | 28 | 90 | 105 |
| **Total public - activity abroad** | 1,260 | 735 | 418 | 1,678 | 2,063 |
| **Foreign banks** | - | - | - | - | - |
| **Foreign governments** | - | - | - | - | - |
| **Total activity abroad** | 1,260 | 735 | 418 | 1,678 | 2,063 |
| **Total public** | 3,577 | 1,477 | 2,191 | 5,768 | 14,186 |
| **Total banks** | - | - | - | - | - |
| **Total governments** | - | - | - | - | - |
| **Total** | 3,577 | 1,477 | 2,191 | 5,768 | 14,186 |
| **Of which:** | | | | | |
| **Measured by present value of cash flows** | 2,203 | 1,147 | 1,115 | 3,318 | |
| **Debts under troubled debt restructuring** | 1,218 | 348 | 1,251 | 2,469 | |

(a) Credit to the public, credit to governments, deposits in banks (excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Balance of recorded debt.
(c) Individual allowance for credit losses.
(d) Reclassified.

## B. Debts[(a)] (cont'd)

### 2. Additional information on impaired debts (cont'd)
### B. Average balance and interest income

| | 31 December 2014 | | |
|---|---|---|---|
| | Average balance (b) of impaired debts | Interest income recorded (c) | Of which: recorded on cash basis |
| | (NIS millions) | | |
| Activity of borrowers in Israel | | | |
| Public - commercial | | | |
| Construction & real estate - construction | **501** | **10** | **10** |
| Construction & real estate - real estate activities | **1,404** | **13** | **13** |
| Financial services | **150** | **2** | **2** |
| Commercial - other | **1,612** | **39** | **38** |
| **Total commercial** | **3,667** | **64** | **63** |
| Private individuals - housing loans | **-** | **-** | **-** |
| Private individuals - other | **105** | **20** | **20** |
| **Total public - activity in Israel** | **3,772** | **84** | **83** |
| **Israeli banks** | **-** | **-** | **-** |
| **Government of Israel** | **-** | **-** | **-** |
| **Total activity in Israel** | **3,772** | **84** | **83** |
| Activity of borrowers abroad | | | |
| Public - commercial | | | |
| Construction & real estate | **674** | **8** | **8** |
| Other commercial | **804** | **14** | **14** |
| **Total commercial** | **1,478** | **22** | **22** |
| Private individuals | **71** | **1** | **1** |
| **Total public - activity abroad** | **1,549** | **23** | **23** |
| **Foreign banks** | **-** | **-** | **-** |
| **Foreign governments** | **-** | **-** | **-** |
| **Total activity abroad** | **1,549** | **23** | **23** |
| **Total public** | **5,321** | **107** | **106** |
| **Total banks** | **-** | **-** | **-** |
| **Total governments** | **-** | **-** | **-** |
| **Total** | **5,321** | **107** | **106** |

See notes on next page.

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[(a)] (cont'd)

### 2. Additional information on impaired debts (cont'd)
### B. Average balance and interest income (cont'd)

| | 31 December 2013 | | |
|---|---|---|---|
| | Average balance (b) of impaired debts | Interest income recorded (c) | Of which: recorded on cash basis |
| | (NIS millions) | | |
| Activity of borrowers in Israel | | | |
| Public - commercial | | | |
| Construction & real estate - construction | 549 | 12 | 12 |
| Construction & real estate - real estate activities | 1,585 | 19 | 19 |
| Financial services | 477 | - | - |
| Commercial - other | 2,064 | 19 | 17 |
| **Total commercial** | 4,675 | 50 | 48 |
| Private individuals - housing loans | - | - | - |
| Private individuals - other | 68 | 5 | 5 |
| **Total public - activity in Israel** | 4,743 | 55 | 53 |
| **Israeli banks** | - | - | - |
| **Government of Israel** | - | - | - |
| **Total activity in Israel** | 4,743 | 55 | 53 |
| Activity of borrowers abroad | | | |
| Public - commercial | | | |
| Construction & real estate | 787 | 8 | 4 |
| Other commercial | 894 | 16 | 15 |
| **Total commercial** | 1,681 | 24 | 19 |
| Private individuals | 92 | 1 | 1 |
| **Total public - activity abroad** | 1,773 | 25 | 20 |
| **Foreign banks** | 2 | - | - |
| **Foreign governments** | - | - | - |
| **Total activity abroad** | 1,775 | 25 | 20 |
| **Total public** | 6,516 | 80 | 73 |
| **Total banks** | 2 | - | - |
| **Total governments** | - | - | - |
| **Total** | 6,518 | 80 | 73 |

(a) Credit to the public, credit to governments, deposits in banks (excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Average debt balance recorded of impaired debts in the reporting period.
(c) Interest income recorded in the reporting period in respect of the average balance of impaired debts, for the period in which the debts were classified as impaired.
(d) If the impaired debts had accrued interest under their original terms, interest income would have been recorded in the amount of NIS 401 million (31 December 2013 - NIS 510 million).
(e) Reclassified.

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[(a)] (cont'd)

### 2. Additional information on impaired debts (cont'd)
### C. Impaired debts under restructuring

| | 31 December 2014 | | | | |
|---|---|---|---|---|---|
| | Not accruing interest income | Accruing (b) in arrears of 90 days or more | Accruing (b) in arrears of 30 to 89 days | Accruing (b) not in arrears | Total (c) |
| | (NIS millions) | | | | |
| Activity of borrowers in Israel | | | | | |
| Public - commercial | | | | | |
| Construction & real estate - construction | **411** | - | - | **18** | **429** |
| Construction & real estate - real estate activities | **826** | - | - | - | **826** |
| Financial services | **17** | - | - | - | **17** |
| Commercial - other | **564** | - | - | **30** | **594** |
| **Total commercial** | **1,818** | - | - | **48** | **1,866** |
| **Private individuals - housing loans** | - | - | - | - | - |
| **Private individuals - other** | **61** | - | - | - | **61** |
| **Total public - activity in Israel** | **1,879** | - | - | **48** | **1,927** |
| **Israeli banks** | - | - | - | - | - |
| **Government of Israel** | - | - | - | - | - |
| **Total activity in Israel** | **1,879** | - | - | **48** | **1,927** |
| Activity of borrowers abroad | | | | | |
| Public - commercial | | | | | |
| Construction & real estate | **200** | - | - | **141** | **341** |
| Other commercial | **213** | - | - | **185** | **398** |
| **Total commercial** | **413** | - | - | **326** | **739** |
| **Private individuals** | **25** | - | - | **11** | **36** |
| **Total public - activity abroad** | **438** | - | - | **337** | **775** |
| **Foreign banks** | - | - | - | - | - |
| **Foreign governments** | - | - | - | - | - |
| **Total activity abroad** | **438** | - | - | **337** | **775** |
| **Total public** | **2,317** | - | - | **385** | **2,702** |
| **Total banks** | - | - | - | - | - |
| **Total governments** | - | - | - | - | - |
| **Total** | **2,317** | - | - | **385** | **2,702** |

See notes on next page.

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[(a)] (cont'd)

### 2. Additional information on impaired debts (cont'd)
### C. Impaired debts under restructuring (cont'd)

| | 31 December 2013 | | | | |
|---|---|---|---|---|---|
| | Not accruing interest income | Accruing (b) in arrears of 90 days or more | Accruing (b) in arrears of 30 to 89 days | Accruing (b) not in arrears | Total (c) |
| | (NIS millions) | | | | |
| Activity of borrowers in Israel | | | | | |
| Public - commercial | | | | | |
| Construction & real estate - construction | 301 | - | - | - | 301 |
| Construction & real estate - real estate activities | 607 | - | - | - | 607 |
| Financial services | 48 | - | - | - | 48 |
| Commercial - other | 457 | - | - | 36 | 493 |
| **Total commercial** | 1,413 | - | - | 36 | 1,449 |
| **Private individuals - housing loans** | - | - | - | - | - |
| **Private individuals - other** | 49 | - | - | 1 | 50 |
| **Total public - activity in Israel** | 1,462 | - | - | 37 | 1,499 |
| **Israeli banks** | - | - | - | - | - |
| **Government of Israel** | - | - | - | - | - |
| **Total activity in Israel** | 1,462 | - | - | 37 | 1,499 |
| Activity of borrowers abroad | | | | | |
| Public - commercial | | | | | |
| Construction & real estate | 222 | - | - | 304 | 526 |
| Other commercial | 201 | - | - | 203 | 404 |
| **Total commercial** | 423 | - | - | 507 | 930 |
| **Private individuals** | 30 | - | - | 10 | 40 |
| **Total public - activity abroad** | 453 | - | - | 517 | 970 |
| **Foreign banks** | - | - | - | - | - |
| **Foreign governments** | - | - | - | - | - |
| **Total activity abroad** | 453 | - | - | 517 | 970 |
| **Total public** | 1,915 | - | - | 554 | 2,469 |
| **Total banks** | - | - | - | - | - |
| **Total governments** | - | - | - | - | - |
| **Total** | 1,915 | - | - | 554 | 2,469 |

(a) Credit to the public, credit to governments, deposits in banks (excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Accruing interest income.
(c) Included in impaired debts.

Commitments to grant additional credit to borrowers for whom there was a troubled debt restructuring that included changes in the credit terms amounted at 31 December 2014 to NIS 98 million (31 December 2013 – NIS 123 million).

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[(a)] (cont'd)

### 2. Additional information on impaired debts (cont'd)
### C. Impaired debts under restructuring (cont'd)

#### 1. Restructurings carried out

| | 31 December 2014 | | |
|---|---|---|---|
| | Number of contracts | Recorded debt balance before restructuring | Recorded debt balance after restructuring |
| | (NIS millions) | | |
| Activity of borrowers in Israel | | | |
| Public - commercial | | | |
| Construction & real estate - construction | 27 | 241 | 241 |
| Construction & real estate - real estate activities | 11 | 385 | 379 |
| Financial services | - | - | - |
| Commercial - other | 96 | 150 | 144 |
| **Total commercial** | 134 | 776 | 764 |
| Private individuals - housing loans | - | - | - |
| Private individuals - other | 855 | 10 | 10 |
| **Total public - activity in Israel** | 989 | 786 | 774 |
| **Israeli banks** | - | - | - |
| **Government of Israel** | - | - | - |
| **Total activity in Israel** | 989 | 786 | 774 |
| Activity of borrowers abroad | | | |
| Public - commercial | | | |
| Construction & real estate | 12 | 142 | 142 |
| Other commercial | 49 | 211 | 205 |
| **Total commercial** | 61 | 353 | 347 |
| Private individuals | 12 | 2 | 2 |
| **Total public - activity abroad** | 73 | 355 | 349 |
| **Foreign banks** | - | - | - |
| **Foreign governments** | - | - | - |
| **Total activity abroad** | 73 | 355 | 349 |
| **Total public** | 1,062 | 1,141 | 1,123 |
| **Total banks** | - | - | - |
| **Total governments** | - | - | - |
| **Total** | 1,062 | 1,141 | 1,123 |

## Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

### B. Debts[(a)] (cont'd)

#### 2. Additional information on impaired debts (cont'd)
#### C. Impaired debts under restructuring (cont'd)

#### 1. Restructurings carried out (cont'd)

| | 31 December 2013 | | |
|---|---|---|---|
| | Number of contracts | Recorded debt balance before restructuring | Recorded debt balance after restructuring |
| | (NIS millions) | | |
| Activity of borrowers in Israel | | | |
| Public - commercial | | | |
| Construction & real estate - construction | 18 (a) | 186 (a) | 176 (a) |
| Construction & real estate - real estate activities | 15 | 165 | 138 |
| Financial services | - | - | - |
| Commercial - other | 75 | 5 | 5 |
| **Total commercial** | 108 (a) | 356 (a) | 319 (a) |
| Private individuals - housing loans | - | - | - |
| Private individuals - other | 753 | 7 | 7 |
| **Total public - activity in Israel** | 861 | 363 | 326 |
| **Israeli banks** | - | - | - |
| **Government of Israel** | - | - | - |
| **Total activity in Israel** | 861 | 363 | 326 |
| Activity of borrowers abroad | | | |
| Public - commercial | | | |
| Construction & real estate | 12 | 166 | 166 |
| Other commercial | 63 | 322 | 321 |
| **Total commercial** | 75 | 488 | 487 |
| Private individuals | 52 | 7 | 7 |
| **Total public - activity abroad** | 127 | 495 | 494 |
| **Foreign banks** | - | - | - |
| **Foreign governments** | - | - | - |
| **Total activity abroad** | 127 | 495 | 494 |
| **Total public** | 988 | 858 | 820 |
| **Total banks** | - | - | - |
| **Total governments** | - | - | - |
| **Total** | 988 | 858 | 820 |

(a) Reclassified.

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[(a)] (cont'd)

### 2. Additional information on impaired debts (cont'd)

### C. Impaired debts under restructuring (cont'd)

### 2. Failed restructurings[b]

| | 31 December 2014 | |
|---|---|---|
| | Number of contracts | Recorded debt balance (c) |
| | (NIS millions) | |
| Activity of borrowers in Israel | | |
| Public - commercial | | |
| Construction & real estate - construction | **30** | **19** |
| Construction & real estate - real estate activities | **12** | **106** |
| Financial services | **1** | **-** |
| Commercial - other | **109** | **43** |
| **Total commercial** | **152** | **168** |
| Private individuals - housing loans | **-** | **-** |
| Private individuals - other | **437** | **4** |
| **Total public - activity in Israel** | **589** | **172** |
| **Israeli banks** | **-** | **-** |
| **Government of Israel** | **-** | **-** |
| **Total activity in Israel** | **589** | **172** |
| Activity of borrowers abroad | | |
| Public - commercial | | |
| Construction & real estate | **3** | **16** |
| Other commercial | **25** | **69** |
| **Total commercial** | **28** | **85** |
| Private individuals | **8** | **1** |
| **Total public - activity abroad** | **36** | **86** |
| **Foreign banks** | **-** | **-** |
| **Foreign governments** | **-** | **-** |
| **Total activity abroad** | **36** | **86** |
| **Total public** | **625** | **258** |
| **Total banks** | **-** | **-** |
| **Total governments** | **-** | **-** |
| **Total** | **625** | **258** |

See notes on next page.

# Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

## B. Debts[(a)] (cont'd)

### 2. Additional information on impaired debts (cont'd)
### C. Impaired debts under restructuring (cont'd)
### 2. Failed restructurings[b] (cont'd)

| | 31 December 2013 | |
|---|---|---|
| | Number of contracts | Recorded debt balance (c) |
| | (NIS millions) | |
| Activity of borrowers in Israel | | |
| Public - commercial | | |
| Construction & real estate - construction | 46 | 14 |
| Construction & real estate - real estate activities | 17 | 21 |
| Financial services | 2 | - |
| Commercial - other | 91 | 55 |
| **Total commercial** | 156 | 90 |
| Private individuals - housing loans | - | - |
| Private individuals - other | 523 | 11 |
| **Total public - activity in Israel** | 679 | 101 |
| **Israeli banks** | - | - |
| **Government of Israel** | - | - |
| **Total activity in Israel** | 679 | 101 |
| Activity of borrowers abroad | | |
| Public - commercial | | |
| Construction & real estate | 4 | 8 |
| Other commercial | 27 | 90 |
| **Total commercial** | 31 | 98 |
| Private individuals | 16 | 3 |
| **Total public - activity abroad** | 47 | 101 |
| **Foreign banks** | - | - |
| **Foreign governments** | - | - |
| **Total activity abroad** | 47 | 101 |
| **Total public** | 726 | 202 |
| **Total banks** | - | - |
| **Total governments** | - | - |
| **Total** | 726 | 202 |

(a) Credit to the public, credit to governments, deposits in banks (excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) Debts that during the reporting year went into arrears of 30 days or more and underwent a troubled debt restructuring during the 12 months preceding the date they became debts in arrears.

(c) Recorded debt balance at the end of the period when the failure occurred.

## Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

### B. Debts[a] (cont'd)

#### 3. Additional information on housing loans
#### Year-end balances by LTV[b], type of repayment and type of interest

| | | **31 December 2014** | | | |
|---|---|---|---|---|---|
| | | Total[1] | [1]Of which: bullet and balloon | [1]Of which: variable interest | Total off-balance sheet credit risk |
| | | (NIS millions) | | | |
| First charge: financing ratio | Up to 60% | **45,206** | **3,386** | **33,061** | **834** |
| | Above 60% | **28,222** | **1,172** | **21,506** | **281** |
| Second charge or without charge | | **745** | **35** | **582** | **1,324** |
| Total | | **74,173** | **4,593** | **55,149** | **2,439** |
| | | 31 December 2013 | | | |
| | | Total[1] | [1]Of which: bullet and balloon | [1]Of which: variable interest | Total off-balance sheet credit risk |
| | | (NIS millions) | | | |
| First charge: financing ratio | Up to 60% | 37,175 | 3,038 | 28,542 | 762 |
| | Above 60% | 30,578 | 1,587 | 24,177 | 372 |
| Second charge or without charge | | 740 | 43 | 600 | 1,061 |
| Total | | 68,493 | 4,668 | 53,319 | 2,195 |

(a) Credit to the public, credit to governments, deposits in banks (excluding deposits in the Bank of Israel) and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) 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.
The LTV ratio is another indication of the Bank as to the assessment of customer risk when the facility was granted. On a quarterly basis, the minimum collective allowance of 0.35% is examined as required in Bank of Israel directives against the ratio of 0.75% required on credit with an LTV higher than 60%. It should be noted that the collective allowance is higher than the allowance required according to the LTV.

## Note 4 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

### C. Credit to the public and off-balance sheet credit risk by size of credit of borrower

| | | 31 December 2014 | | |
|---|---|---|---|---|
| Credit limit | | Number of borrowers (c) | Credit (a) | Off-balance sheet credit risk (b) |
| (NIS thousands) | | | (NIS millions) | |
| From | To | | | |
| **0** | **10** | **641,662** | **448** | **1,641** |
| **10** | **20** | **346,222** | **1,797** | **3,474** |
| **20** | **40** | **443,813** | **4,671** | **8,389** |
| **40** | **80** | **340,268** | **9,411** | **9,840** |
| **80** | **150** | **183,441** | **13,160** | **6,368** |
| **150** | **300** | **100,803** | **16,610** | **3,616** |
| **300** | **600** | **68,176** | **25,807** | **2,449** |
| **600** | **1,200** | **47,228** | **35,311** | **3,293** |
| **1,200** | **2,000** | **11,921** | **15,633** | **2,175** |
| **2,000** | **4,000** | **5,593** | **12,615** | **2,321** |
| **4,000** | **8,000** | **2,465** | **10,683** | **2,726** |
| **8,000** | **20,000** | **1,813** | **17,776** | **5,199** |
| **20,000** | **40,000** | **829** | **17,459** | **6,178** |
| **40,000** | **200,000** | **735** | **38,009** | **20,273** |
| **200,000** | **400,000** | **112** | **18,622** | **12,900** |
| **400,000** | **800,000** | **41** | **11,740** | **11,582** |
| **800,000** | **1,200,000** | **10** | **4,656** | **5,290** |
| **1,200,000** | **1,600,000** | **2** | **268** | **2,360** |
| **1,600,000** | **2,000,000** | **2** | **2,942** | **400** |
| **2,000,000** | **2,400,000** | **3** | **4,068** | **2,019** |
| **2,400,000** | **2,800,000** | **-** | **-** | **-** |
| **2,800,000** | **2,855,203** | **1** | **2,157** | **698** |
| **Total** | | **2,195,140** | **263,843** | **113,191** |

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 7,375 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".

### C. Credit to the public and off-balance sheet credit risk by size of credit of borrower (cont'd)

| Credit limit | | 31 December 2013<br>Number of borrowers (c) | | Credit (a) | Off-balance sheet credit risk (b) |
|---|---|---|---|---|---|
| (NIS thousands) | | | | (NIS millions) | |
| From | To | | | | |
| 0 | 10 | 613,537 | (d) | 688 | 1,492 |
| 10 | 20 | 342,442 | | 1,842 | 3,395 |
| 20 | 40 | 421,737 | | 4,608 | 7,805 |
| 40 | 80 | 326,383 | | 9,089 | 9,344 |
| 80 | 150 | 168,932 | | 11,787 | 6,118 |
| 150 | 300 | 91,050 | | 14,931 | 3,328 |
| 300 | 600 | 62,610 | | 23,828 | 2,320 |
| 600 | 1,200 | 41,427 | | 31,064 | 3,022 |
| 1,200 | 2,000 | 10,883 | | 14,199 | 2,158 |
| 2,000 | 4,000 | 5,433 | | 12,021 | 2,495 |
| 4,000 | 8,000 | 2,427 | | 10,523 | 2,727 |
| 8,000 | 20,000 | 1,813 | | 17,551 | 5,473 |
| 20,000 | 40,000 | 821 | | 15,812 | 6,458 |
| 40,000 | 200,000 | 688 | | 35,878 | 18,538 |
| 200,000 | 400,000 | 107 | | 14,980 | 13,871 |
| 400,000 | 800,000 | 42 | | 10,814 | 11,916 |
| 800,000 | 1,200,000 | 9 | | 6,564 | 2,188 |
| 1,200,000 | 1,600,000 | 5 | | 4,382 | 2,539 |
| 1,600,000 | 2,000,000 | 2 | | 519 | 2,795 |
| 2,000,000 | 2,400,000 | 3 | | 2,607 | 3,777 |
| 2,400,000 | 2,800,000 | 1 | | 2,376 | 41 |
| 2,800,000 | 3,200,000 | - | | - | - |
| 3,200,000 | 3,523,640 | 1 | | 2,941 | 583 |
| Total | | 2,090,353 | | 249,004 | 112,383 |

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 4,247 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".
(d) Reclassified.

### D. Information on loans sold

Proceeds of NIS 344 million were received for commercial loans sold in 2014 (NIS 718 million in 2013).

For further information regarding transactions for the sale of loans, see Note 21.A.5 below.

## Note 5 – Credit to Governments

| | 31 December 2014 | 31 December 2013 |
|---|---|---|
| | (NIS millions) | |
| Credit to the government | **294** | 338 |
| Credit to foreign governments | **234** | 220 |
| Total credit to governments | **528** | 558 |

## Note 6 - Investments in and Details of Investee Companies

### A. Composition

| | 31 December 2014 | 31 December 2013 |
|---|---|---|
| | Companies included on equity basis | |
| | NIS millions | |
| **Total investments in shares on equity basis (including other assets and goodwill)** | **2,216** | 1,689 |
| Of which: post-acquisition profits | **1,031** | 1,000 |
| **Post-acquisition items accrued in equity:** | | |
| Adjustments in respect of companies included on equity basis | **15** | (141) |
| **Details regarding goodwill and other intangible assets:** | | |
| Amortization period | **0-20 years** | 0-20 years |
| Original amount, net | **228** (a) | 228 |
| Unamortized balance | **146** | 157 |

(a) As of the date of approval of the financial statements, the subsidiary had not yet completed attributing the cost of acquisition to the acquired assets and liabilities..

### Details of book value and market value of quoted investments:

| | 31 December 2014 | | 31 December 2013 | |
|---|---|---|---|---|
| | Book value | Market value | Book value | Market value |
| | (NIS millions) | | | |
| The Israel Corporation Ltd. | **1,318** | **2,566** | 1,137 | 2,526 |

### B. Group's equity in profits (losses) of companies included on equity basis:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | (NIS millions) | | |
| Group's equity in profits of companies included on equity basis | **88** | (313) | (31) |
| Provision for deferred taxes | **(46)** | 20 | (36) |
| Group's equity in after-tax profits of companies included on equity basis | **42** | (293) | (67) |

# Note 6 - Investments in and Details of Investee Companies (cont'd)

## 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.
Pursuant to the letter of the Supervisor of Banks from 4 March 2015, the Bank is to act as soon as possible to discontinue its significant influence on the Israel Corporation, including by way of a permanent waiver on the Bank's representation in the Board of Directors of the Israel Corporation and on its right to appoint directors to it.

For further information, see Note 31.

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.

For further information, see Note 1.X.

### 2. Details of impairment of securities

In light of the change in regulations in the international private banking field worldwide, and in Switzerland in particular, which increase the cost of service, and in light of the effect anticipated from these changes also on Leumi Private Bank (formerly Bank Leumi Switzerland), the Bank depreciated the balance of goodwill by NIS 45 million (in 2013 - NIS 76 million).

# Note 6 - Investments in and Details of Investee Companies (cont'd)

## D. Details concerning principal investee companies

### 1. Consolidated subsidiaries[a]

| Name of company | Details of the company | Percentage of equity granting a right to profits 31 December 2014 | 2013 | Percentage of voting rights 31 December 2014 | 2013 | Investment in shares - net asset value 31 December 2014 | 2013 |
|---|---|---|---|---|---|---|---|
| | | **(%)** | (%) | **(%)** | (%) | (NIS millions) | |
| **In Israel** | | | | | | | |
| Arab-Israel Bank Ltd. | General banking services | **99.7** | 99.7 | **99.7** | 99.7 | **650** | 550 |
| Leumi Agricultural Development Ltd. | | **100.0** | 100.0 | **100.0** | 100.0 | **57** | 58 |
| Leumi Industrial Development Ltd. | | **99.6** | 99.6 | **99.8** | 99.8 | **104** | 105 |
| Leumi Partners Ltd. (c) | Business and financial services | **100.0** | 100.0 | **100.0** | 100.0 | **1,131** | 676 |
| Leumi Tech Ltd. (d) | Equipment leasing and granting loans | **99.5** | 99.5 | **99.8** | 99.8 | **994** | 986 |
| Leumi Finance Company Ltd. | Raising funds through bond issues | **100.0** | 100.0 | **100.0** | 100.0 | **168** | 157 |
| Leumi Card Ltd. | Provision of credit card services | **80.0** | 80.0 | **80.0** | 80.0 | **1,242** | 1,122 |
| Leumi Securities and Investments Ltd. | | **100.0** | 100.0 | **100.0** | 100.0 | **23** | 21 |
| Leumi Capital Market Services Ltd. | Operating services to provident and mutual funds | **100.0** | 100.0 | **100.0** | 100.0 | **42** | 38 |
| Leumi Financial Holdings Ltd. | Financial holdings | **100.0** | 100.0 | **100.0** | 100.0 | **545** | 503 |
| **Abroad** | | | | | | | |
| Bank Leumi le-Israel Corporation | Holding company - registered in the U.S. | **100.0** | 100.0 | **100.0** | 100.0 | **371** | 504 |
| Bank Leumi USA (e) | General banking services - registered in the U.S. | **99.9** | 99.9 | **99.9** | 99.9 | **2,106** | 1,897 |
| Bank Leumi (UK) plc | General banking services - registered in the U.K. | **100.0** | 99.8 | **100.0** | 99.8 | **800** | 725 |
| Leumi Private Bank (j) | General banking services - registered in Switzerland | **94.8** | 94.8 | **98.6** | 98.6 | **399** | 956 |
| Leumi Re Ltd. | Insurance | **100.0** | 100.0 | **100.0** | 100.0 | **96** | 81 |
| Bank Leumi (Luxembourg) SA | General banking services - registered in Luxembourg | **100.0** | 100.0 | **100.0** | 100.0 | **145** | 164 |
| Bank Leumi Romania S.A. | General banking services - registered in Romania | **99.9** | 99.9 | **99.9** | 99.9 | **190** | 247 |
| **Companies held by Bank Leumi USA** | | | | | | | |
| Leumi Financial Corporation (f) | | **99.9** | 99.9 | **99.9** | 99.9 | **5,428** | 4,827 |
| Leumi USA Investment Corporation (f) | | **99.9** | 99.9 | **99.9** | 99.9 | **3,892** | 3,426 |

See notes on page 366.

| 31 December | | 31 December | | 31 December | | 31 December | | 31 December | | 31 December | | 31 December | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| Balance of goodwill and intangible assets | | Other equity investments (7) | | Contribution to net profit attributed to shareholders of the banking corporation | | Loss on impairment | | Dividend recorded | | Other items in accumulated shareholders' equity (2) | | Guarantees for the company in favour of parties outside the Group | |
| **-** | - | **103** | 104 | **100** | 106 | **-** | - | **-** | 80 | **-** | - | **-** | - |
| **-** | - | **-** | - | **-** | - | **-** | - | **1** | 1 | **-** | - | **-** | - |
| **-** | - | **-** | - | **1** | 1 | **-** | - | **1** | 1 | **-** | - | **-** | - |
| **-** | - | **1,126** | 1,195 | **286** | 213 | **-** | - | **-** | - | **169** | 37 | **523** | 578 |
| **-** | - | **-** | - | **9** | 22 | **-** | - | **-** | - | **(1)** | 1 | **5** | 2 |
| **-** | - | **-** | - | **11** | 13 | **-** | - | **-** | 13 | **-** | - | **-** | - |
| **-** | - | **-** | - | **160** | 160 | **-** | - | **-** | - | **-** | - | **-** | - |
| **-** | - | **-** | - | **2** | 2 | **-** | - | **-** | - | **-** | - | **-** | - |
| **-** | - | **-** | - | **4** | 4 | **-** | - | **-** | - | **-** | - | **-** | - |
| **-** | - | **-** | - | **2** | 5 | **-** | - | **-** | - | **-** | - | **-** | - |
| **-** | - | **-** | - | **1** | 1 | **-** | - | **-** | - | **61** | (38) | **-** | - |
| **-** | - | **-** | - | **(225)** | 64 | **-** | - | **-** | - | **239** | (183) | **58** | 52 |
| **-** | - | **507** | 480 | **73** | (66) | **-** | - | **-** | - | **-** | - | **-** | - |
| **25** | 61 | **188** | 186 | **(554)** | (57) | **-** | - | **-** | - | **(4)** | (41) | **-** | - |
| **-** | - | **-** | - | **15** | 5 | **-** | - | **-** | 18 | **-** | - | **-** | - |
| **-** | - | **34** | 40 | **(20)** | 10 | **-** | - | **-** | - | **-** | 2 | **30** | 25 |
| **-** | - | **-** | - | **(57)** | (7) | **-** | - | **-** | - | **-** | - | **-** | 10 |
| **-** | - | **-** | - | **601** | (349) | **-** | - | **-** | - | **-** | - | **-** | - |
| **-** | - | **-** | - | **456** | (233) | **-** | - | **(10)** | 61 | **-** | - | **-** | - |

## 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

| | | 31 December | | 31 December | |
|---|---|---|---|---|---|
| | | **2014** | 2013 | **2014** | 2013 |
| Name of company | Details of the company | Percentage of equity granting a right to profits | | Percentage of voting rights | |
| | | **(%)** | (%) | **(%)** | (%) |
| The Israel Corporation Ltd. | Holding company | **18.1** | 18.1 | **18.1** | 18.1 |

(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 123 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) 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) was generated on the consolidated capital, which are offset from Bank Leumi U.S.A.
(g) Other equity investments include capital notes and shareholders' loans.
(h) The balance of goodwill less accumulated losses for impairment of goodwill has been included in the column for investment in shares at net asset value.
(i) Includes translation adjustment reserves and other funds accumulated in retained earnings.
(j) On 5 February 2015, the Bank acquired shares from the minority. After the acquisition, the percentage holding is 94.8%

## Note 6 - Investments in and Details of Investee Companies (cont'd)

| Balance of goodwill and intangible assets | | Investments in shares at book value | | Investments in shares at market value | | Contribution to net profit attributed to shareholders of the banking | | Dividend recorded | | Other items in accumulated shareholders' equity (12) | | 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 | |
| **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 | **2014** | 2013 |
| **26** | 31 | **1,318** | 1,137 | **2,566** | 2,526 | **(8)** | (340) | **-** | - | **114** | (42) | **17** | 30 |

## 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 2012 | 274 | 83 | 357 |
| Additions | - | - | - |
| As at 31 December 2013 | 274 | 83 | 357 |
| Additions | 1 | - | 1 |
| **As at 31 December 2014** | **275** | **83** | **358** |
| **Amortization and losses from impairment** | | | |
| As at 31 December 2012 | 156 | 12 | 168 |
| Amortization for the year | - | 14 | 14 |
| Amortization and losses from impairment | 76 | - | 76 |
| As at 31 December 2013 | 232 | 26 | 258 |
| Amortization for the year | - | 12 | 12 |
| Loss from impairment | - | 45 | 45 |
| **As at 31 December 2014** | **232** | **83** | **315** |
| **Amortized balance at 31 December 2014** | **43** | **-** | **43** |
| **Book value** | | | |
| As at 31 December 2012 | 118 | 71 | 189 |
| As at 31 December 2013 | 42 | 57 | 99 |
| **As at 31 December 2014** | **43** | **-** | **43** |

# Note 7 – Buildings and Equipment

## A. Composition

| | Buildings and real estate (a) | Equipment, furniture and vehicles (b) | Software (b) | Total |
|---|---|---|---|---|
| | NIS millions | | | |
| **Cost** | | | | |
| As at 31 December 2012 | 3,395 | 3,211 | 4,632 | 11,238 |
| Additions | 70 | 167 | 511 | 748 |
| Disposals | (41) | (15) | (129) | (185) |
| Adjustments from translation differences | (2) | (5) | - | (7) |
| As at 31 December 2013 | 3,422 | 3,358 | 5,014 | 11,794 |
| Additions | **127** | **146** | **540** | **813** |
| Disposals | **(38)** | **(68)** | **(20)** | **(126)** |
| Adjustments from translation differences | **6** | **9** | **-** | **15** |
| **As at 31 December 2014** | **3,517** | **3,445** | **5,534** | **12,496** |
| **Accumulated depreciation** | | | | |
| As at 31 December 2012 | 1,836 | 2,531 | 3,166 | 7,533 |
| Provision in the reporting year | 82 | 174 | 517 | 773 |
| Recognized losses from impairment | (5) | - | - | (5) |
| Disposals | (32) | (12) | (101) | (145) |
| As at 31 December 2013 | 1,881 | 2,693 | 3,582 | 8,156 |
| Provision in the reporting year | **85** | **160** | **482** | **727** |
| Recognized losses from impairment | **(1)** | **-** | **-** | **(1)** |
| Disposals | **(30)** | **(65)** | **(20)** | **(115)** |
| **As at 31 December 2014** | **1,935** | **2,788** | **4,044** | **8,767** |
| **Amortized balance as at 31 December 2014** | **1,582** | **657** | **1,490** | **3,729** |
| Amortized balance as at 31 December 2013 | 1,541 | 665 | 1,432 | 3,638 |
| Amortized balance as at 31 December 2012 | 1,559 | 680 | 1,466 | 3,705 |

(a) Including leasehold installations and improvements.
(b) Reclassified.

## B. Average rate of depreciation:

| | **31 December 2014** | 31 December 2013 |
|---|---|---|
| Buildings and real estate - | **3.48%** | 3.34% |
| Equipment, furniture and vehicles - | **15.17%** | 15.86% |
| Software | **16.77%** | 19.52% |

## Note 7 – Buildings and Equipment (cont'd)

**C.** The Group has rental or leasing rights on real estate and equipment for a period of 1 to 60 years from the balance sheet date in an amount (net of depreciation) of NIS 132 million (31 December 2013 – NIS 134 million).

**D.** Investment property - buildings and real estate not used by the Group, mainly rental buildings, amount to NIS 26 million in the balance sheet (31 December 2013 – NIS 26 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 177 million (31 December 2013 – NIS 216 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 74 million (31 December 2013 – NIS 66 million) are shown net of a provision for anticipated losses. The fair value of the assets earmarked for sale at 31 December 2014 was NIS 154 million (31 December 2013 - NIS 141 million).

**G.** The balance of software includes costs capitalized during the year relating to the development of computer software in the amount of NIS 349 million (31 December 2013 – NIS 365 million).

## Note 8 – Other Assets

| | **31 December 2014** | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| Deferred tax asset, net - see Note 26.I. | **3,194** | 3,135 (a) |
| Excess of funds allocated for severance pay over provision – see Note 15.C | **1,118** | 771 |
| Assets transferred to ownership of the Group as a result of settlement of problem loans | **6** | 11 |
| Value of insurance policies in foreign branch | **432** | 378 |
| Excess of advance tax payments over current provisions | **93** | 66 |
| Expenses to be amortized on issuance of debentures, bonds and subordinated notes | **31** | 43 |
| Accrued income | **145** | 161 |
| Prepaid expenses | **181** | 189 |
| Other receivables and prepayments | **301** | 428 |
| **Total other assets** | **5,501** | 5,182 |

(a) Restated pursuant to a change in the method of accounting for accumulating employee rights, see Note 1.R.

# Note 9 - Deposits of the public

## A. Types of deposits by location raised and type of depositor

| | 31 December 2014 | 31 December 2013(1) |
|---|---|---|
| | NIS millions | |
| **In Israel** | | |
| On demand | | |
| Non-interest bearing | **54,937** | 43,800 |
| Interest bearing | **55,823** | 49,417 (a) |
| Total on demand | **110,760** | 93,217 |
| Fixed term | **161,900** | 163,575 (a) |
| Total deposits in Israel[1] | **272,660** | 256,792 |
| **Outside Israel** | | |
| On demand | | |
| Non-interest bearing | **13,945** | 12,887 |
| Interest bearing | **2,919** | 2,587 |
| Total on demand | **16,864** | 15,474 |
| Fixed term | **13,873** | 13,737 |
| Total deposits outside Israel | **30,737** | 29,211 |
| **Total deposits of the public** | **303,397** | 286,003 |
| [1]Of which: | | |
| Deposits of private persons | **121,943** | 125,774 |
| Deposits of institutional entities | **30,978** | 29,554 |
| Deposits of corporations and others | **119,739** | 101,464 |

(a) Reclassified.

## B. Deposits of the public by size on consolidated basis

| | 31 December 2014 | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| Up to 1 | **86,042** | 84,392 |
| From 1 to 10 | **78,995** | 80,261 |
| From 10 to 100 | **52,543** | 47,525 |
| From 100 to 500 | **30,537** | 26,907 |
| Above 500 | **55,280** | 46,918 |
| Total | **303,397** | 286,003 |

# Note 10 - Deposits from banks

| | 31 December 2014 | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| **In Israel** | | |
| **Commercial banks:** | | |
| Demand deposits | **3,099** | 2,591(a) |
| Time deposits | **793** | 1,040 |
| Acceptances | **526** | 506 |
| **Central banks:** | | |
| Demand deposits | **-** | 32 (a) |
| Time deposits | **-** | - |
| **Outside Israel** | | |
| **Commercial banks:** | | |
| Demand deposits | **47** | 67 (a) |
| Time deposits | **2** | 10 (a) |
| Acceptances | **89** | 64 |
| Total deposits from banks | **4,556** | 4,310 |

(a) Reclassified.

## Note 11 – Debentures, Bonds and Subordinated Notes

| | Duration (a) | Internal rate of return (a) | 31 December 2014 | 31 December 2013 |
|---|---|---|---|---|
| | Years | % | NIS millions | |
| **Debentures and notes** (b)**:** | | | | |
| In Israeli currency linked to the CPI | **1.1** | 5.0 | **652** | 980 |
| **Subordinated notes** (b) (e) (f): | | | | |
| Unlinked Israeli currency | **4.4** (c) | 3.1 | **4,547** | 4,554 |
| In Israeli currency linked to the CPI (d) | **2.8** (c) | 4.1 | **18,469** | 19,897 |
| In Swiss Francs | **4.3** (c) | 4.1 | **10** | 10 |
| Total debentures, notes and subordinated notes | | | **23,678** | 25,441 |

(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 it is 1.48 years, in those linked to the CPI it is 2.54 years and in subordinated notes in Swiss Francs is 3.33 years.

(d) Of which: subordinated notes (unquoted) deemed Tier 2 capital in the amount of NIS 519 million (31 December 2013 – NIS 520 million) that in certain circumstances may be converted into shares.

(e) Of which: listed for trading on the Tel Aviv Stock Exchange an amount of NIS 14,832 million linked to the CPI and an amount of NIS 4,499 million unlinked (31 December 2013 – NIS 15,656 million linked and NIS 4,500 million unlinked).

(f) Tier 2 equity pursuant to the Basel III transitional provisions.

## Note 12 - Other Liabilities

| | 31 December 2014 | 31 December 2013 |
|---|---|---|
| | (NIS millions) | |
| Deferred tax liability, net – see Note 26.I. | **220** | 140 |
| Excess of current provisions for taxes over advance payments | **24** | 310 |
| Excess of provisions for severance pay and pensions over amounts allocated - see Note 15.C. | **6,546** | 6,000 (a) |
| Provisions for unutilized vacations and long service bonuses | **945** | 931 |
| Deferred income | **685** | 597 |
| Allowance for credit losses in respect of off-balance sheet items | **494** | 412 |
| Accrued expenses in respect of salaries and related expenses | **316** | 632 |
| Payables in respect of credit cards | **6,363** | 6,156 |
| Accrued expenses | **385** | 390 |
| Market value of securities sold short | **758** | 858 |
| Other payables and credit balances | **1,979** | 1,383 |
| Total other liabilities | **18,715** | 17,809 |

(a) Restated.

# Note 13 – Capital

## A. Share capital

| | **31 December 2014** | | 31 December 2013 | |
|---|---|---|---|---|
| | 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** | 3,215,000,000 | 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.

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 in June and July 2101, 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 note, to 152,952,469 ordinary shares of the Bank, as of the date of the report.

## B. Share-based Remuneration Plan

On 11 February 2014, the General Meeting of the Bank, approved the remuneration policy for office holders in the Bank for the years 2013-2016, after obtaining the approval of the Board of Directors pursuant to the approval and recommendation of the Remuneration Committee. The Remuneration Policy is based on Amendment 20 of the Companies Law regarding terms of office and employment of office holders in the Bank and on that stipulated in the new Proper Conduct of Banking Business Directive 301A concerning remuneration policy in a banking corporation.

As part of the approval of the performance-contingent annual basis for office holders in the Bank for 2013 and pursuant to the above remuneration policy, the Remuneration Committee and the Board of Directors of the Bank in March 2014 approved the allocation for no payment of 657,869 Performance Share Units ("PSU units"), to the Chairman of the Board of Directors, the President and Chief Executive Officer, and other office holders in the Bank, in an equity track with the Trustee under Section 102 of the Income Tax Ordinance. Accordingly, the Bank issued on 13 April 2014 the above PSU units in the name of the Trustee, ESOP Management and Trust Services Ltd. ("the Trustee"). As set forth in the Private Offering Report published by the Bank on 31 March 2014 ("Private Offering Report"), and under the terms stated therein, the aggregate fair value of all the said PSU units amounts to about NIS 8.97 million.

Pursuant to the provisions of the remuneration policy, the rate of the overall cumulative amount of the PSU units to be allocated to all the senior officers (the Chairman of the Board of Directors, the President and Chief Executive Officer, and members of Bank Management) in respect of all the years covered by the bonus plan (2013 to 2016) will not exceed 0.38% of the issues and paid-up share capital of the Bank (see Note 15.G).

The vesting of the PSU units will be in three equal tranches and is contingent on the business results of the Bank in each of the three calendar years 2014, 2015 and 2016, pursuant and subject to that stated and the terms set forth in the Bank's remuneration policy, and set forth in the Private Offering Report, whereby subject to the fulfillment of all the terms in relation to the vesting date, each PSU unit will be converted automatically to 1 ordinary share of NIS 1 par value each of the Bank, on reaching each vesting date.

## Note 13 – Capital (cont'd)

In March 2014, the Remuneration Committee and the Board of Directors of the Bank approved the allocation for no payment of 81,414 Restricted Share Units (RSU), for two office holders in the Bank, in an equity track with the Trustee under Section 102 of the Income Tax Ordinance, pursuant to the provisions of the Remuneration Policy regarding the granting of signing rights to a new office holder, and as set forth in the Private Offering Report. Accordingly, the Bank issued on 13 April 2014 the above RSU units in the name of the Trustee. As set forth in the Private Offering Report and under the terms stated therein, the aggregate fair value of all the said RSU units amounted to about NIS 1.1 million.

The vesting of the RSU units will be in three equal tranches and is contingent on the continued employment of each of the office holders with the Bank or with the banking group, at the vesting date of each of the tranches, pursuant and subject to that stated and the terms set forth in the Private Offering Report, whereby in the event of fulfillment of the said term, each RSU unit will be converted automatically to 1 ordinary share of NIS 1 par value each of the Bank, on reaching each vesting date.

If the terms set for the vesting of PSU units and RSU units into shares are not met at any of the vesting dates, the units which were to have been vested at that date will expire and become void, and all their associated rights will expire and become void.

The PSU units and RSU units allocated as above are not marketable, and pursuant to the approval of the Tel-Aviv Stock Exchange Ltd. ("the Stock Exchange"), the shares deriving from the vesting of the above units will be listed for trading on the Stock Exchange in the name of the nominee company of Bank Leumi Le-Israel B.M.

### C. Changes in the Bank's equity

On 13 April 2014, the Bank issued 657,869 Performance Share Units (PSU), in the name of the trustee, ESOP Management and Trust Services Ltd. (**"the Trustee"**), to the Chairman of the Board of Directors, the President and Chief Executive Officer, and other office holders in the Bank. If all the terms are met for exercising the said PSU units at each of the vesting dates, as stated in detail in the Report of the Private Offering published by the Bank on 31 March 2014 ("Private Offering Report"), the said PSU units will vest into 657,869 ordinary shares of NIS 1 par value each of the Bank, which will constitute about 0.045% of the issued and paid-up capital of the Bank. The first vesting date for the PSU units is expected to occur after the date of publication of the financial statements.

On 13 April 2014, the Bank issued 81,414 Restricted Share Units (RSU), in the name of the trustee, for two office holders in the Bank. If all the terms are met for exercising the said RSU units at each of the vesting dates, as stated in detail in the Report of the Private Offering, the said RSU units will vest into 81,414 ordinary shares of NIS 1 par value each of the Bank, which will constitute about 0.005% of the issued and paid-up capital of the Bank. At the date of publication of these statements no date had arrived for vesting into shares of the Bank for any of the RSU units.

If the terms set for the vesting of PSU units and RSU units into shares are not met at any of the vesting dates, the units which were to have been vested at that date will expire and become void, and all their associated rights will expire and become void.

The PSU units and RSU units allocated as above are not marketable, and pursuant to the approval of the Tel-Aviv Stock Exchange Ltd. ("the Stock Exchange"), the shares deriving from the vesting of the above units will be listed for trading on the Stock Exchange in the name of the nominee company of Bank Leumi Le-Israel B.M.

## Note 13 – Capital (cont'd)

### D. Dividend

The Bank did not distribute dividends in respect of the years 2012-2014.

**Restrictions on the distribution of dividends**

In addition to restrictions under the Companies Law, a circular was issued on 15 January 2013 amending Proper Conduct of Banking Business Directive No. 331 concerning dividend distribution by banking corporations. In light of requirements added in recent years to the Public Reporting Directives making it mandatory to record certain profits and losses of the Bank in other comprehensive income and not in profit and loss, the tests for distributing a dividend were updated. Pursuant to the update, "distributable profits" include elements of other comprehensive income, and the Bank shall not carry out a dividend distribution (unless it received prior approval from the Supervisor), inter alia:

- When the cumulative balance of retained earnings, net of negative differences included in cumulative other comprehensive income is not positive, or if the amount of the proposed distribution would cause such a balance of retained earnings;
- When one or more of the last three calendar years ended in a loss or in a comprehensive loss;
- When the cumulative result of the three quarters ended at the end of the interim period for which the last financial statement has been published indicates a loss or a comprehensive loss.

It was further established that the Bank shall not perform distributions from capital reserves or from positive differences included in the statement of cumulative other comprehensive income.
The amendment came into effect as of 1 January 2013.

Furthermore, in the letter of the Supervisor of Banks on the subject of capital policy for interim periods, it was determined that a banking corporation shall not distribute a dividend if it does not have a core capital ratio of at least 7.5%, or if such distribution would cause a failure to comply with the aforesaid ratio. In the letter of the Banking Supervision Department, concerning minimum core capital ratios under Basel 3, the banks were required, inter alia, to refrain from distributing a dividend if as a result it may not meet the capital targets required in it (for further details, see Note 13.A.F. below).

Notwithstanding the above, in certain cases the Bank can distribute dividends even if the aforesaid circumstances apply, if it obtains prior written approval of the Supervisor of Banks for such distribution, up to the amount thus approved.

## Note 13a – Capital and Capital Adequacy in accordance with the directives of the Supervisor of Banks

| | 31 December 2014 | 1 January 2014 | 31 December 2013 |
|---|---|---|---|
| | Basel III (a) | | Basel II (b) (f) |
| | NIS millions | | |
| **A. Consolidated data** | | | |
| **Capital for purposes of calculating capital ratio** | | | |
| Tier 1 capital, after deductions | **28,130** | 26,082 | 25,967 (g) |
| Tier 2 capital, after deductions | **14,684** | 14,337 | 15,007 |
| Total capital | **42,814** | 40,419 | 40,974 |
| **Weighted balance of risk assets** | | | |
| Credit risk | **274,341** | 255,932 | 247,728 (g) |
| Market risk | **10,839** | 10,613 | 10,510 |
| Operational risk (c) | **20,317** | 20,426 | 20,426 |
| Total weighted balances of risk assets | **305,497** | 286,971 | 278,664 |
| **Ratio of capital to risk components** | | | |
| Ratio of Tier 1 capital to risk components | **9.21%** | 9.09% (g) | 9.32% (g) |
| Ratio of total capital to risk components | **14.01%** | 14.08% (g) | 14.70% (g) |
| Ratio of minimum Tier 1 capital required by the Supervisor of Banks | **9.00%** (e) | 9.00% (e) | - |
| Ratio of total minimum capital required by the Supervisor of Banks | **12.50%** (e) | 12.50% (e) | 9.00% |
| **B. Principal subsidiary companies** | | | |
| **Arab Israel Bank** | | | |
| Ratio of Tier 1 capital to risk components | **12.27%** | 11.58% | 11.85% |
| Ratio of total capital to risk components | **13.36%** | 12.97% | 12.50% |
| Ratio of minimum Tier 1 capital required by the Supervisor of Banks | **9.00%** (e) | 9.00% (e) | 0.00% |
| Ratio of total minimum capital required by the Supervisor of Banks | **12.50%** (e) | 12.50% (e) | 9.00% |
| **Leumi Card Ltd.** | | | |
| Ratio of Tier 1 capital to risk components | **16.36%** | 16.40% | 16.00% |
| Ratio of total capital to risk components | **17.36%** | 17.30% | 16.00% |
| Ratio of minimum Tier 1 capital required by the Supervisor of Banks | **9.00%** (e) | 9.00% (e) | 0.00% |
| Ratio of total minimum capital required by the Supervisor of Banks | **12.50%** (e) | 12.50% (e) | 9.00% |
| **Bank Leumi USA (d)** | | | |
| Ratio of Tier 1 capital to risk components | **11.39%** | 11.70% | 11.70% |
| Ratio of total capital to risk components | **14.23%** | 14.54% | 14.54% |
| Ratio of total minimum capital required by the local authorities | **10.00%** | 10.00% | 10.00% |

(a) Calculated pursuant to Proper Conduct of Banking Business Directives Nos. 201-211, 299 on "Capital Measurement and Adequacy" applicable from 1 January 2014.

(b) Calculated pursuant to Proper Conduct of Banking Business Directives Nos. 201-211 on "Capital Measurement and Adequacy" applicable until 31 December 2013.

(c) First Pillar capital allocation in respect of operational risk is in accordance with the Standardized Approach.

(d) The United States office will commence reporting according to the Basel III rules only from 1 January 2015. The capital adequacy ratio reported for this period is according to the Basel I rules.

(e) Capital ratios required according to directives of the Supervisor of Banks commencing 1 January 2015. As of 1 January 2015, there will be added to these ratios a capital requirement of 1% of the balance of housing loans at the reporting date.

(f) Tier 1 shareholders' equity in Basel II data should be referred to as Tier 1 capital.

## Note 13a – Capital and Capital Adequacy in accordance with the directives of the Supervisor of Banks

| | 31 December 2014 | 1 January 2014 | 31 December 2013 |
|---|---|---|---|
| | Basel III (a) | | Basel II (b) (f) (c) |
| | NIS millions | | |
| **C. Capital components for purposes of calculating the capital ratio** | | | |
| **1. Tier 1 shareholders' equity** | | | |
| Equity attributed to shareholders of the Bank | **28,093** | **26,129** (d) | 25,948 |
| Differences between equity attributed to shareholders of the Bank and Tier 1 shareholders equity - minority interests | **303** | **299** | 340 |
| Tier 1 shareholders' equity before regulatory adjustments and deductions | **28,396** | **26,428** | 26,288 |
| **Regulatory adjustments and deductions:** | | | |
| Goodwill and intangible assets | **(189)** | **(234)** | (256) |
| Deferred tax assets | **(75)** | **(108)** (d) | - |
| Equity investments in financial corporations that are not consolidated in reports to the public | **-** | **-** | - |
| Regulatory adjustments and deductions - Tier 1 shareholders' equity | **(2)** | **(4)** | (65) |
| Total regulatory adjustments and deductions - Tier 1 shareholders' equity | **(266)** | **(346)** | (321) |
| Total Tier 1 shareholders' equity, after regulatory adjustments and deductions | **28,130** | **26,082** | 25,967 |
| **2. Tier 2 capital** | | | |
| Tier 2 capital: instruments before deductions | **11,640** | **11,639** | 14,544 |
| Tier 2 capital: provisions before deductions | **3,044** | **2,698** | 528 |
| Total Tier 2 capital before deductions | **14,684** | **14,337** | 15,072 |
| Deductions: | | | |
| Total deductions - Tier 2 capital | **-** | **-** | (65) |
| Total Tier 2 capital | **14,684** | **14,337** | 15,007 |

(a) Calculated pursuant to Proper Conduct of Banking Business Directives Nos. 201-211, 299 on "Capital Measurement and Adequacy" applicable from 1 January 2014.

(b) Calculated pursuant to Proper Conduct of Banking Business Directives Nos. 201-211 on "Capital Measurement and Adequacy" applicable until 31 December 2013.

(c) Tier 1 shareholders' equity in Basel II data should be referred to as Tier 1 capital.

(d) Restated pursuant to a change in the method of accounting for accumulating employee rights, see Note 1.R.

## Note 13a - Capital and Capital Adequacy in accordance with the directives of the Supervisor of Banks (cont'd)

| | 31 December 2014 | 1 January 2014 (b) |
|---|---|---|
| | (Basel III) | |
| | (Audited) | (Unaudited) |
| | (%) | |
| **D. Ratio of capital to risk components** | | |
| Ratio of Tier 1 shareholders' equity to risk components before application of the effect of the transition in Directive 299 | **8.09%** (a) | 8.88% |
| Effect of the transitional directive | **1.12%** | 0.21% |
| Ratio of Tier 1 shareholders' equity to risk components after application of the effect of the transition in Directive 299 | **9.21%** | 9.09% |

(a) Including the expected effect of initial adoption of generally accepted accounting rules in the US on employee rights, according to data forecast for 1 January 2015.

(b) Restated pursuant to a change in the method of accounting for accumulating employee rights, see Note 1.R.

### E. Restrictions on housing loans

The Bank implements Proper Conduct of Banking Business Directive 329 on "Restrictions on Granting Housing Loans", which redefines the term "rate of repayment from income" and includes, inter alia, new requirements regarding capital adequacy:

- A risk weighting restriction on loans exceeding NIS 5 million: a loan exceeding NIS 5 million, that meets the conditions of Section 72 for receipt of a reduced risk weighting, will be weighted at 100% commencing on 1 October 2014.
  If the amount of the loan decreases below NIS 5 million, it is possible to again reduce the risk weighting in accordance with Section 72 of Proper Conduct of Banking Business Directive No. 203.

- Updating an increased risk weighting for leveraged loans at a variable interest rate: commencing on 1 January 2015, banking corporations are permitted to reduce the risk weighting from 100% to 75%, for leveraged loans at a variable interest rate granted between the dates 26 October 2010 and 31 December 2012. The effect is a reduction in risk assets in the amount of some NIS 714 million, an increase in Tier 1 shareholders' equity capital ratio of about 0.02%, and an increase in the overall capital Ratio of about 0.04%

### F. Adoption of Basel III directives on 1 January 2014

On 29 August 2013, a Banking Supervision Department circular was published on "Basel Disclosure Requirements relating to the Composition of Capital". The above circular set out updated disclosure requirements that banks will have to include as part of adopting the Basel III directives. The disclosure requirements came into effect as of 1 January 2014 and thereafter.

The effect of adoption of the Basel III directives on 1 January 2014 is shown in the above table, as of the position of the Bank on 31 December 2013. In calculating the effect of adoption of the Basel III directives on 1 January 2014, the transitional provisions detailed above were taken into consideration.

### G. Capital Adequacy

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.

## Note 13a - Capital and Capital Adequacy in accordance with the directives of the Supervisor of Banks (cont'd)

On 30 May 2013, the Supervisor of Banks issued final directives for the adoption of Basel III recommendations in Israel, including an amendment of Proper Conduct of Banking Business Regulation 201 regarding "Measurement and Capital Adequacy, Introduction, Scope of Application and Calculation of Requirements". Pursuant to this directive, all banking corporations will be required to comply with a minimum Tier 1 capital ratio of 9% with effect from1 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 Tier 1 capital ratio of 10%, with effect from 1 January 2017. This additional directive is applicable to Leumi.

Compliance with these targets will be achieved gradually. The Bank intends to maintain a planning margin above these targets.

In addition, all banking corporations in Israel will be required to maintain an overall capital ratio of 12.5% by 1 January 2015. A large banking corporation will be required to maintain an overall capital ratio of 13.5% by 1 January 2017 This additional provision applies to Leumi.

Following an analysis of the ICAAP risk map, the Board of Directors of the Bank decided to determine the overall capital adequacy target that the Group wishes to meet in the event of a stress scenario.

The Bank is prepared to meet the requirements described above that comply with the requirements of the Supervisor of Banks as set forth in the directives.

### H. Liquidity cover ratio

On 28 September 2014, the Supervisor of Banks published a circular in which was added Proper Conduct of Banking Business Management Directive No. 221 on the liquidity coverage ratio that adopts the recommendations of the Basel Committee on the subject of the liquidity cover ratio in the banking system in Israel.
The liquidity cover ratio examines a horizon of 30 days in a stress scenario and is intended to ensure that a banking corporation has an inventory of high-quality liquid assets that provide a response to the liquidity requirements of the corporation in this time horizon.
The stress scenario set forth in the directive includes a shock combining a shock specific to the corporation with a systemic shock, and in this context standard withdrawal rates were defined for outgoing cash flows and deposit rates of incoming cash flows in accordance with the categories of the various balances.

The liquidity cover ratio will come into effect on 1 April 2015.

Pursuant to the transitional provisions, commencing on 1 April 2015, the minimum requirement will be set at 60% and will increase to 80% on 1 January 2016, and to 100% on 1 January 2017 and thereafter. However, in a period of financial pressure, a banking corporation can go below these minimum requirements.

In addition, on 28 September 2014, a circular was published by the Banking Supervision Department on the subject of a Temporary Provision – Implementation of a Disclosure Requirement under the Third Pillar of Basel – Disclosure in respect of the Liquidity Cover Ratio. In the framework of the circular, the Public Reporting Directives were amended to incorporate the disclosure requirements that the banks will be required to include as part of adopting the liquidity cover ratio.

## Note 14 – Liens and Restrictive Conditions

As at 31 December 2014 and 31 December 2013, 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 1,024 million (31 December 2013 - NIS 358 million). Total liabilities in respect of which assets were pledged amount to NIS 289 million (31 December 2013 - NIS 295 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 2014 was about NIS 98 million (31 December 2013 - NIS 84 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 the 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. At the date of the financial statements, the Bank's share of the Stock Exchange Clearing Fund was NIS 65 million (31 December 2013 – NIS 80 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 another member provided was 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 284 million (about 15.6% 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 2014 was NIS 1,701 million (31 December 2013 – NIS 983 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 2014 in the *Masav* system is 17.29% and in the check clearing system – 22.60% (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 check 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 in 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 2014, the Group had made deposits in favor of foreign banks totaling NIS 913 million (31 December 2013 – NIS 480 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 and their customers. As at 31 December 2014, the Group had deposited an amount of US$ 214 million in the above banks (31 December 2013 – US$ 170 million).

The Bank has signed a debenture, in accordance with which 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 21 May 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 2010-2014.

| | **31 December 2014** | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| **Sources of securities received which the Bank may sell or pledge, at fair value, before the effect of set-offs** | | |
| Securities received in securities borrowing transactions against cash | **2,000** | 1,360 |
| **Uses of securities received as collateral and securities of the Bank, at fair value, before the effect of set-offs** | | |
| Securities loaned in securities lending transactions against cash | **1,238** | 624 |

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 2014 was US$ 37 million (31 December 2013 - US$ 44 million).

## Note 15 – Employee Rights

### A. Signing of collective labor agreement

On 21 January 2015, the Bank announced that the Bank's management and the Bank's employee organization reached agreements on a special collective agreement (hereinafter: the "Collective Agreement"), which were approved by the Board of Directors and by the Employees Council. The agreements regarding the collective agreement were reached after the first collective bargaining agreement in 2010 ended in December 2014. The collective agreement is for a period of four years, i.e. until 31 December 2018.

The main changes included in the collective agreement, in relation to the previous collective agreement:

The annual salary update mechanism for all employees, at an average rate of 5%, was modified and will be as follows:

In 2015 – 4.0%
In 2016 – 4.0%
In 2017 - 3.5%
In 2018 - 3.5%

The Bank will pay employees covered by the collective agreement a one-time grant of one salary ("one-time bonus").

The Bank will carry out early implementation of an update of the minimum wage amount specified in the decision by the Government, so that the update of the minimum wage to NIS 5,000 will be carried out in a single stage (rather than gradually as decided by the Government), for all employees earning minimum wage.

Additional provisions were stipulated relating to the reduction of long-service amounts (bonuses and vacations) by about 40% in bonuses and about 50% in vacations. The rate of employer provisions to provident funds for employees eligible for "contributory pension" benefits was updated, such that the provision will be at the rate of 7.5% instead of a provision at the rate of 5%; encouraging employees not taking advantage of sick leave days, changing of contract workers to employees of the Bank; and updating the maximum period for receiving seniority increments, so as to be up to 38 years' seniority, instead of 37 years' seniority in the agreement ended.

Signing the agreement is expected to lead to a reduction in actuarial liabilities recorded in the books of the Bank in respect of employee rights, mainly due to the effect of reducing the wage adjustment mechanisms. The effect after a one-time bonus is expected to amount to about NIS 600 million to NIS 700 million, which will lead to an increase in capital in 2015.

The main effect is in respect of a reduction in the salary update mechanism in calculating pension liabilities to be charged to other comprehensive income and spread in subsequent periods in the statement of profit and loss. Pursuant to the instructions of the Banking Supervision Department, the implications of the wage agreement will be reflected in the financial statements of the Bank for the first quarter of 2015.

It should be clarified that the collective agreement applies only to Bank staff employed under the collective agreement and therefore is not relevant to employees under the Bank's remuneration plan.

## Note 15 – Employee Rights (cont'd)

### 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 received permanent employment status before the date of signing the aforementioned agreement, and who 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, subject to the provisions of the law. The entitlement 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 (current utilization rate of pension rights is about 76%, while the remainder choose severance pay and provident funds), and past experience regarding disability, etc.
The accumulation of liability is on a straight-line basis up to the earliest retirement age (an average of retirement ages in practice of 1st generation employees in recent years, for men and women). After this date, additional benefits are attributed for subsequent years based on the formula of the benefit plan of 1st generation employees.

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 calculation is made under a comprehensive pension plan, which includes old age, disability and survivor pensions and also takes into account employees who have not yet completed the period required for receipt of pension benefits (15 years of service).

The balance sheet includes provisions based on the higher of the liabilities for severance pay plus provident benefits, and the pension liability. The Bank's pension liability for employees who have left and have opted for pension benefits, as well as that stated in (3) below, is covered by the pension provision, which is calculated based on the present value of the liability calculated by an actuary, as noted above.

**2. Benefits to "Leumi Alumni"**

"Leumi Alumni" are entitled to receive, in addition to their individual choice of a pension and/or severance payments, additional benefits which consist mainly of a holiday gift, 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 2014 for expected costs in respect of the above entitlements in the period following the employment period, according to actuarial calculation, amounts to some NIS 139 million (31 December 2013 - NIS 128 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 CEO is NIS 183,000 (linked to the increase in the last known index in January 2013). The President and CEO, who had a first generation employment agreement, transferred to the employment conditions of a second generation agreement as of 2013, as follows: the rights of the President and CEO to a non-contributory pension from the Bank pursuant to her rights as stated below will only be in respect of the frozen salary level (the salary of the President and CEO at the date of transfer from first generation to second generation plus linkage to the CPI), whereas her rights regarding salary increments above the frozen salary level will be pursuant to second generation conditions (provident fund and severance fund contributions without non-contributory pension rights from the Bank).

Pursuant to her terms of office and employment in the Bank, and in accordance with the update approved by the General Meeting of the Bank on 11 February 2014 (after approval of the Remuneration Committee and the Board of Directors) 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 completing three years in the position of President and CEO, the President and CEO will be entitled to severance pay of 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 provident fund contributions. In the event of dismissal after three years in the position of President and CEO or in the event of retirement, the President and CEO will be entitled to choose between (a) severance pay in the amount equivalent to 200% of her last monthly salary, multiplied by the number of years of her employment in the Bank, with the addition of provident fund contributions; and (b) an immediate

## Note 15 – Employee Rights (cont'd)

retirement pension from the Bank pursuant to conditions of first generation that transferred to second generation. The rate of retirement pension to the President and CEO is as set out in sub-paragraph c. below concerning members of management. The definition of "dismissal" regarding the President and CEO includes resignation following deterioration in working conditions, including resignation as a consequence of changes that took place in the Bank and that do not allow the President and CEO to continue functioning as President and CEO, in the opinion of the President and CEO with approval of the Remuneration Committee or the Board of Directors. In the event of resignation before completing three years in her position as President and CEO, 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 provident fund contributions, whereas if the resignation is after completing three years of working in the Bank, the President and CEO will be entitled to compensation in the amount of 250% of her last monthly salary multiplied by the number of years of her employment at the Bank, with the addition of provident fund contributions.

The Bank and the President and CEO are each entitled to terminate the working relationship by giving advance notice of six months.

The Remuneration Committee, the Board of Directors, and the General Meeting confirmed (on 11 February 2014) that the President and CEO is entitled to an annual performance-contingent bonus and a fixed annual bonus, pursuant to and subject to the provisions of the remuneration policy for office holders in the Bank as set forth in Section G. below, for each of the years 2013, 2014, 2015, and 2016.

**b.** Members of the Management of the Bank who have a first generation employment agreement, were transferred to second generation employment conditions as of 2013, as follows: their rights to a non-contributory pension from the Bank pursuant to the rights stated below will only be in respect of the frozen salary level (the salary at the date of transfer from first generation to second generation plus linkage to the CPI), whereas rights regarding salary increments above the frozen salary level will be pursuant to second generation conditions (provident fund and severance fund contributions without non-contributory pension rights from the Bank).

Employees with personal employment agreements with the Bank (that are not members of Management), who have a first generation employment agreement with the Bank, were transferred to second generation employment conditions as of 2014, as follows: their rights to a non-contributory pension from the Bank pursuant to their first generation rights will only be in respect of the frozen salary level (the salary at the date of transfer from first generation to second generation plus linkage to the CPI), whereas rights regarding salary increments above the frozen salary level will be pursuant to second generation conditions (provident fund and severance fund contributions without non-contributory pension rights from the Bank).

**c.** In accordance with first generation terms of employment, members of Management of the Bank (subject to that stated in sub-paragraph b. above) and a group of senior executives of the Bank (executive vice presidents, senior assistants to the CEO, and assistants to the CEO), are entitled, in the event of dismissal, to an immediate pension, 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

## Note 15 – Employee Rights (cont'd)

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 provide, inter alia, 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. 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.

According to the personal contracts with members of the management of the Bank, who are not 1$^{st}$ generation or 2$^{nd}$ 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 pay, plus the monies in the provident fund after deduction of the amounts accrued in the severance pay fund.

The Bank approved personal employment contracts for a group of senior managers from among the 2$^{nd}$ 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 first generation 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 above, 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, to receive 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 may incur in the event of the employees mentioned in the above paragraph being immediately dismissed, amounts to NIS 349 million (including salary tax payable on the pension) (2013 – NIS 372 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 88 million (including salary tax) (2013 – NIS 93 million). The above amounts also include members of Management.

Part of the said provision was attributed specifically to members of Management, the balance of which at 31 December 2014 was NIS 11 million (31 December 2013 – 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 the Board of Directors, who is employed in a full-time position as Executive Chairman.

The Bank and the Chairman have the option of discontinuing the engagement between them by giving 6 months notice in advance. It is clarified that the Bank will be authorized to demand that the advance notice period will be actual employment, in whole or in part. In the advance 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 provident fund. The Chairman gave an undertaking for 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 advance notice period, in whole or part, the Chairman will be entitled only to payment in respect of the advance notice period.

The Remuneration Committee, the Board of Directors, and the General Meeting also confirmed (on 11 February 2014) that the Chairman of the Board of Directors is entitled to an annual performance-contingent bonus, pursuant to and subject to the provisions of the remuneration policy for office holders in the Bank as set forth in Section G. below, for each of the years 2013, 2014, 2015, and 2016.

## Note 15 – Employee Rights (cont'd)

### 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 2014** | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| Provision for severance pay | **2,870** | 2,919 |
| Amounts funded for severance pay (a) | **(3,895)** | (3,628) |
| Provision for pensions | **6,654** | 6,120 (c) |
| Amounts funded for pensions | **(201)** | (182) |
| Excess of provisions over amounts funded, net | **5,428** | 5,229 |
| Excess of provisions over amounts funded, net, included in "Other Liabilities" | **6,546** | 6,000 (c) |
| Excess of amounts funded included in "Other Assets" | **1,118** | 771 |
| Excess of provisions over amounts funded, net (b) | **5,428** | 5,229 |

(a) The Bank and the consolidated companies may not withdraw amounts funded other than for the purpose of making severance payments.

(b) 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.

(c) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

Total liabilities for pensions to active employees who commenced work in the Bank before 1 January 1999 totaled NIS 7,443 million at 31 December 2014. To cover this liability, severance monies in the amount of NIS 2,325 million are deposited in Central Severance Pay Funds managed by a management company controlled by the Bank, as well as provident and severance monies deposited in a provident and severance fund in the amount of NIS 3,520 million which is managed by a management company owned by the members of the fund, 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 other 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 709 million (31 December 2013 – NIS 691 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 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 236 million under "Other Liabilities" for unutilized vacation pay (31 December 2013 - NIS 240 million). The provision is calculated on the basis of the latest salary plus related payments.

**F. Provident and severance pay funds of the employees of the Bank**

The Bank deposits provident and severance monies for "1st generation" employees in the Bank Leumi Employees Provident and Severance Funds, which is managed by a management company held by the members of the funds.

Until the end of 2012, the management company managed two provident and severance funds for Bank Leumi employees and Leumi Mortgage Bank employees. As of January 2013, the two funds were merged into one fund for all 1st generation employees.

The Bank provides the company with the services it requires to manage the fund, as permitted by law.

Commencing in 2008, the 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 Officers**

On 11 February 2014, the General Meeting of the Bank, after obtaining the approval and recommendation of the Remuneration Committee and the approval of the Board of Directors, approved a remuneration policy regarding conditions of service and employment of Bank office holders (including senior office holders), pursuant to Amendment 20 of the Companies Law, 1999, pursuant to the directives of the Supervisor of Banks concerning remuneration policy of a banking corporation ("remuneration policy"), which includes a program for bonuses to office holders of the Bank (the

## Note 15 – Employee Rights (cont'd)

"bonus program"). The remuneration policy and bonus program are valid for each of the years 2013, 2014, 2015, and 2016.

The bonus program provides, inter alia, the manner of determining the annual variable bonus for senior officers and the manner of determining the annual bonus for office holders who are not senior officers, the eligibility of the President and CEO to a fixed annual bonus, the eligibility of senior staff members in audit and control functions to a fixed annual bonus, and the possibility for the competent organs in the Bank to approve a signing-up bonus to a new office holder in the Bank; in accordance with the provisions of the remuneration policy as set out in a condensed form below:

**1. The variable annual bonus to senior officers:**

**1.1.** The variable annual bonus to senior officers is based, inter alia, on the rate of return on equity of the Bank, the Bank's annual performance relative to the objectives set by the Board of Directors and in relation to other banking groups, the performance of relevant units of the bank for measuring the performance of each senior officer, and on the development of the business results of the Bank over time.

**1.2.** The cumulative threshold conditions for variable annual bonus for senior officers are: (a) the employees of the Bank are entitled to a bonus for the relevant year; (b) the Bank achieved a minimum of 7.5% return on equity in the relevant year; and (c) the Bank met the capital adequacy ratios required under the directives of the Banking Supervision Department in the relevant year.

**1.3.** The variable annual bonus to senior officers is based on measurable criteria and qualitative criteria, as follows:

**1.3.1.** Part of the variable annual bonus based on measurable criteria shall be as specified below:

**1.3.1.1.** First, a basic annual variable bonus amount is to be determined for each of the senior officers in terms of fixed monthly remuneration amounts (employer's cost of one monthly amount), based on the rate of return on equity of the Bank for the bonus year and according to the role of each senior officer and his area of responsibility in the Bank and the Group (the "basic annual bonus"):

The basic annual bonus of the Chairman of the Board of Directors, the President and CEO, and senior officers not in audit and control functions (in a number of amounts of fixed monthly remuneration): 6 amounts for a rate of return on equity of 7.5%; 7 amounts for a rate of return on equity of 8%; 7.5 amounts for a rate of return on equity of 8.5%; 8 amounts for a rate of return on equity of 9%, 8.5 amounts for a rate of return on equity of 9.5%; 9 amounts for a rate of return on equity of 10%, 9.5 amounts for a rate of return on equity of 10.5%, and 10 amounts for a rate of return on equity of 11% and above.

The basic annual bonus for senior officers who belong to auditing and control functions in a number of amounts of fixed monthly remuneration): 4 amounts for a rate of return on equity of 7.5%; 4⅔ amounts for a rate of return on equity of 8%; 5 amounts for a rate of return on equity of 8.5%; 5⅓ amounts for a rate of return on equity of 9%, 5⅔ amounts for a rate of return on equity of 9.5%; 6 amounts for a rate of return on equity of 10%, 6⅓ amounts for a rate of return on equity of 10.5%, and 6⅔ amounts for a rate of return on equity of 11% and above.

If the rate of return will be within a range of values listed above, the amount of the basic annual bonus will be determined for the relevant senior officer linearly between the two closest values.

**1.3.1.2.** After that, the basic annual bonus amount will be adjusted according to a measurable score of each senior officer between 80 to 120, with the measurable score for each senior officer determined according to the following: (1) Twenty percent (20%) of the measurable score for each senior officer will be determined according to the comparison of return on equity in the bonus year versus the return on equity (weighted by shareholders' equity ) in the four other major banks in Israel (Bank Hapoalim, Israel Discount Bank, Mizrahi – Tefahot Bank and the First International Bank) in that year; and (2) eighty percent (80%) of the measurable score for each senior officer will be determined according to a performance measurement sheet of the senior officer and the departments for which he is responsible, in the bonus year, less the return on equity of the Bank as a whole in the bonus year (this part of the measurable score of Chairman of the Board of Directors and the President and CEO, will be determined by a performance measurement sheet of the Bank as a whole).

**1.3.2.** Part of the variable annual bonus based on qualitative criteria shall be as specified as set forth below:

The Board of Directors, after receiving the recommendation of the President and CEO (other than with respect to the Chairman of the Board of Directors, the President and CEO, and the Chief Internal Auditor, for whom the recommendation will be given by the Audit Committee) and the approval of the Remuneration Committee will have the authority to approve an additional bonus amount as part of the variable annual bonus based on qualitative criteria in respect of the relevant year, for any of the senior officers in the Bank.

Part of this grant will be given to the senior officer subject to fulfillment of various qualitative criteria specified in the remuneration policy, in accordance with the areas of responsibility of the senior officer.

Subject to paragraph 1.4 below, the qualitative part of the bonus shall not constitute more than 20 % of the annual variable bonus of that officer senior in the relevant year.

**1.4.** Adjusting the basic annual bonus amount as stated in paragraph 1.3.1.2 above, plus the variable annual bonus based on qualitative criteria as stated in paragraph 1.3.2 above, may increase jointly the basic annual bonus by one and a half amounts of a fixed monthly remuneration.

## Note 15 – Employee Rights (cont'd)

**1.5.** The variable annual bonus amount for each of the above senior officers shall not in any event exceed 100% of the fixed annual remuneration of the senior officer (i.e. shall not exceed 12 monthly amounts of fixed annual remuneration), with the ratio of variable remuneration to fixed remuneration for senior officers who are members of audit and control functions, will incline more in favor of the fixed remuneration, in comparison with this ratio for other senior officers.

**1.6.** The checking of the variable annual bonus calculation for each senior officer will be made by an external expert, and then the calculated amount will be brought for approval of the Remuneration Committee and the Board of Directors.

**1.7.** The Board of Directors of the Bank, after receiving the approval of the Remuneration Committee, may decide, at its discretion, on a reduction in the variable annual bonus amount (in whole or in part) for senior officers in the Bank (all or some). For this purpose there will be taken into account, inter alia, Bank data in the bonus year and / or the years prior to the bonus year, relating to material profits of the Bank that the Board of Directors considers that they did not arise from normal activity, as well as material losses in those years.

**1.8.** If the variable annual bonus to the senior officer exceeded one sixth constant of his fixed annual remuneration, fifty percent (50%) of the variable annual bonus for that senior officer shall be paid in cash next following the reporting of the financial results of the banking system for the relevant year, and the remaining fifty percent (50%) will be awarded through blocked performance-contingent share units (PSU) to be allotted following the reporting of the financial results of the banking system for the relevant year, provided that the total amount and the accumulated PSU units to be allotted to all senior officers in the Bank for each year of the bonus program will not exceed 0.38% of the issued and paid up share capital of the Bank. If the amount of PSU units exceeded the said rate, the entitlement of all those eligible would be reduced by the same proportion to the said rate ceiling.

**1.9.** The PSU units will vest into ordinary shares of NIS 1 par value each of the Bank in three equal tranches (subject to that stated below) following the reporting of the financial results of the banking system of each of the three years after the bonus year, with the first amount of the three being blocked for a period of one additional year. The vesting of the PSU share units will be contingent upon the fulfillment of two cumulative conditions: (a) rate of return on equity for the calendar year preceding the date of vesting of the relevant tranche of PSU units was not lower than 5%; and (b) The Bank complied with all the capital adequacy ratios required by the Supervisor of Banks according to the financial statements in the calendar year preceding the vesting date of the relevant tranche.

Allocating the PSU units and their conversion into shares of the Bank, shall be made in the capital gains track under Section 102 of the Income Tax Ordinance, as specified in the bonus program.

**1.10.** Retirement of a senior officer and joining of a new senior officer:

**1.10.1.** A senior officer retiring from the Bank after reaching the age of retirement or retiring from the Bank not on his own initiative during a calendar year shall be entitled to a proportional variable annual bonus for the actual term of

## Note 15 – Employee Rights (cont'd)

office during the calendar year in which his resignation occurred, insofar as he is entitled to a variable annual bonus for that year.

**1.10.2.** A senior officer retiring from the Bank voluntarily (not having reached retirement age) or was dismissed due to the occurrence of an event that allowed dismissal without compensation, during the calendar year, shall not be entitled to a variable annual bonus for the year of retirement.

**1.10.3.** A Bank employee who was promoted and appointed to the role of a senior officer in the Bank during a calendar year shall be entitled to a proportional variable annual bonus for the actual term of office during the calendar year in which the senior officer was appointed as aforesaid, insofar as he is entitled to a variable annual bonus for that year.

**1.10.4.** A person appointed to the role of a senior officer in the Bank during a calendar year, who was not previously an employee of the Bank, is entitled to a proportional variable annual bonus for the actual term of office in the year of appointment, insofar as he is entitled to a variable annual bonus for that year.

**1.11.** Special bonus: in accordance with the provisions of paragraph 13(a)(2) of Proper Conduct of Banking Business Directive 301A, in exceptional and outstanding cases, the Remuneration Committee and the Board of Directors will be entitled, and when required by the Companies Act after receiving the approval of the General Meeting, as applicable, to approve the amount of an additional variable bonus in respect of a given year for some of its officers, subject to the following conditions: (1) The additional variable bonus will be given due to an exceptional event not recurring every year, such as a one – time project, a material structural change and / or an extraordinary transaction in scope and essence, provided that the exceptional business event was defined in advance by the Board of Directors at the beginning of the year relevant to the specific office holder; (2) The total maximum variable remuneration for an office holder in the same year shall not exceed 200% of the fixed annual remuneration of that senior officer; (3) Detailed reasons will be given for the relevant decision, when a decision is made.

**2.** Fixed annual payment to the President and CEO: the President and CEO will be entitled to a fixed annual bonus of one amount of fixed monthly remuneration. The fixed annual bonus of the President and CEO is part of the calculation of the "fixed monthly remuneration" used for calculating the variable annual bonus of the President and CEO.

**3.** Fixed payment to senior officers who are members of the audit and control functions: senior officers in the audit and control functions will be entitled to a fixed annual bonus of one amount of fixed monthly remuneration. Without detracting from this bonus being part of the fixed remuneration component of the senior officers in the audit and control functions, this bonus will not be part of the calculation of the "fixed monthly remuneration" used for calculating the variable annual bonus of the senior officers.

**4.** Signing-up bonus for a new office holder: a new office holder of the Bank may be entitled to a limited signing-up bonus for the first year of work, up to 12 amounts of fixed monthly remuneration. The Remuneration Committee followed by the Board of Directors will consider, for the purpose of making the decision on granting the said signing-up bonus and its amount, the recommendation of the President and CEO, and will consider for this purpose, inter alia, the circumstances of his appointment, the nature of the job to which he is appointed, the scope and areas of his responsibility, and so forth.

**5.** Notwithstanding the aforesaid and in accordance with the Companies Law, an office holder will return to the Bank amounts of bonuses paid to him, if paid to him, on the basis of data found to be erroneous and restated in the financial statements of the Bank.

**6.** Bonuses, insofar as the office holders will be eligible for bonuses under this program, will not be taken into account for social contributions, severance, and retirement pension and will not be considered as a fringe benefit of any kind for any of the office holders.

Appropriate provisions have been made in the financial statements.

**H. Allocation of Performance Share Units (PSU) to Officeholders in the Bank**

**1.** In accordance with the remuneration policy described in Section G above, and as part of the approval of the performance-contingent annual bonus for officeholders in the Bank for 2013 and pursuant to the above remuneration policy, the Remuneration Committee and the Board of Directors of the Bank in March 2014 approved the allocation for no payment of 657,869 Performance Share Units ("PSU units"), to the Chairman of the Board of Directors, the President and CEO, and other office holders in the Bank, in an equity track with the Trustee under Section 102 of the Income Tax Ordinance. Accordingly, the Bank issued on 13 April 2014 the above PSU units in the name of the Trustee, ESOP Management and Trust Services Ltd. ("the Trustee"). As set forth in the Private Offering Report published by the Bank on 31 March 2014 ("Private Offering Report"), and under the terms stated therein, the aggregate fair value of all the said PSU units amounts to about NIS 8.97 million.

**2.** The vesting of the PSU units will be in three equal tranches and is contingent on the business results of the Bank in each of the three calendar years 2014, 2015 and 2016, pursuant and subject to that stated and the terms set forth in the Bank's remuneration policy, and set forth in the Private Offering Report, whereby subject to the fulfillment of all the terms in relation to the vesting date, each PSU unit will be converted automatically to 1 ordinary share of NIS 1 par value each of the Bank, on reaching each vesting date.

**3.** In March 2014, the Remuneration Committee and the Board of Directors of the Bank approved the allocation for no payment of 81,414 Restricted Share Units (RSU), for two office holders in the Bank, in an equity track with the Trustee under Section 102 of the Income Tax Ordinance, pursuant to the provisions of the Remuneration Policy regarding the granting of signing rights to a new office holder, and as set forth in the Private Offering Report. Accordingly, the Bank issued on 13 April 2014 the above RSU units in the name of the Trustee. As set forth in the Private Offering Report and under the terms stated therein, the aggregate fair value of all the said RSU units amounted to about NIS 1.1 million.

**4.** The vesting of the RSU units will be in three equal tranches and is contingent on the continued employment of each of the office holders with the Bank or with the banking group, at the vesting date of each of the tranches, pursuant and subject to that stated and the terms set forth in the Private Offering Report, whereby in the event of fulfillment of the said term, each RSU unit will be converted automatically to 1 ordinary share of NIS 1 par value each of the Bank, on reaching each vesting date.

## Note 15 – Employee Rights (cont'd)

**5.** If the terms set for the vesting of PSU units and RSU units into shares are not met at any of the vesting dates, the units which were to have been vested at that date will expire and become void, and all their associated rights will expire and become void.

**6.** The PSU units and RSU units allocated as above are not marketable, and pursuant to the approval of the Tel-Aviv Stock Exchange Ltd. ("the Stock Exchange"), the shares deriving from the vesting of the above units will be listed for trading on the Stock Exchange in the name of the nominee company of Bank Leumi Le-Israel B.M.

**7.** For further details in connection with the issue of PSU units and the issue of RSU units, and in connection with the remuneration policy of the Bank, see the Private Offer Report and the Remuneration Policy attached thereto as Appendix A to the said Private Offer Report, and the Immediate Reports of the Bank at 13 April 2014.

**I. Remuneration policy for officeholders and key employees**

On 31 March 2015, the Board of Directors of the Bank, after approval of the Remuneration Committee, approved an update in the terms of employment of key employees (as defined in Directive 301A of the Supervisor of Banks, and in the Remuneration Policy of the Bank by virtue of the said Directive 301A) and of office holders in the Bank, including the President and Chief Executive Officer, as follows:

1. Cancellation in full of the entitlement of office holders and key employees, including the President and Chief Executive Officer, to jubilee (long-service) bonuses and jubilee vacations (benefits to which office holders in the Bank are entitled according to the provisions of the employment agreements between them and the Bank), with effect from 31 December 2014, as follows:
   The accumulated rights for each office holder and key employee in respect of jubilee (long-service) bonuses and jubilee vacations, during the period of their employment in the Bank until the date of cancellation of the entitlement, namely until 31 December 2014, will be reduced, without any compensation and/or consideration, by about 45% (in a similar manner to the reduction carried out in the collective agreement for all employees of the Bank).
   The balance of the said accumulated rights for the office holder or key employee, as applicable, will be cancelled against payment of one-time compensation, in an amount equal to the balance of the accounting provision remaining in the books of the Bank at 31 December 2014, after the reduction, in respect of that office holder or key employee, as applicable. Subject to the aforesaid, the entitlement of office holders and key employees to jubilee (long-service) bonuses and jubilee vacations will be cancelled in full and the employment agreement of office holders and key employees will be amended accordingly. Accordingly, after cancelation of the said entitlements, the Bank will discontinue recording a current expense in respect of accumulating rights to jubilee bonuses and vacations for office holders and key employees.

   The decision to cancel jubilee (long-service) bonuses and jubilee vacations for office holders and key employees in the Bank, as stated above, was made in consideration of the provisions of Proper Conduct of Banking Business Directive No. 301A on Remuneration Policy in a Banking Corporation. This does not allow granting a variable bonus independent of performance and that is only conditional on employment (for office holders in the Bank). Pursuant to the transitional provisions of the said directive, it was possible to amend employment agreements with office holders and key employees in this matter as required in Directive 301A until the end of 2016. However, because of the arrangement with the other employees of the Bank in the framework of the collective agreement signed recently in the Bank, in which the employees to which the collective agreement applies waived their entitlement to jubilee (long-service) bonuses and jubilee vacations, it was decided to cancel, already at this stage, the entitlement of office holders in the Bank to jubilee (long-service) bonuses and jubilee vacations. In this connection it should be noted that the payment of reduced compensation to office holders and key employees againt cancellation of their entitlement to jubilee (long-service) bonuses and jubilee vacations, as explained above, does not create an accounting expense for the bank, since a salary expense was recorded over the years for office holders and key employees in the Bank for jubilee (long-service) bonuses and jubilee vacations, and, as described above, the compensation mechanism will grant office holders and key employees a payment that represents about half the accounting reserve recorded in the books of the Bank. Furthermore, in light of the cancellation of the entitlement to jubilee (long-service) bonuses and jubilee vacations for office holders and key employees, the Bank will discontinue recording a current expense in respect of the accumulation of the said rights. Pursuant to the cancelation of the entitlement to jubilee bonuses and jubilee vacations, the cancelation of an expense amounting to NIS 16 million will be recorded in the Bank's books in 2015, and an annual current expense of NIS 3 million, in respect of office-holders and key employees, will be saved.

2. The increase in salary of certain office holders in the Bank that are not directors is in effect as of 1 January 2015. Included in this, it was approved that the salary of the President and Chief Executive Officer of the Bank will be increased at the rate of 4% of the total cost of the terms of employment of the President and Chief Executive Officer in the Bank. The salary of the President and Chief Executive Officer of the Bank, after the said update, will be NIS 195,400. The said update of the terms of employment was made in accordance with the Bank’s Remuneration Policy and after the Remuneration Committee and the Board of Directors reviewed the normal cost of employment of holders of equivalent positions in comparable companies, and after they have examined the contribution of the said office holders and of the President and Chief Executive Officer to the activity of the Bank.

3. Similar to normal practice in the Bank for all the employees, by virtue of the collective agreements, the increase in the rate of the Bank’s contributions to provident funds (the employer’s contribution) for key employees and office holders of the Bank, including the long-serving office holders in the Bank who previously waived their entitlement to be included in 1$^{st}$ generation terms and transferred to 2$^{nd}$ generation terms, including for the President and Chief Executive Officer of the Bank, will be so that the rate of contributions by the Bank to provident funds (the employer’s contribution) is 7.5% of the employee’s salary for contributions (instead of 5%). The said increase in the rate of contributions to provident funds is only in respect of the part of the salary of the office holders that is not paid under 1$^{st}$ generation terms (if relevant). In other words, the increment will be added to the external fund without rights to a non-contributory pension from the Bank, and only the part of salary not included in 1$^{st}$ generation terms. The Remuneration Committee and the Board of Directors of the Bank approved that the abovementioned update to the terms of employment constitutes an insignificant update in relation to the existing terms of office and employment of office holders in the Bank, including the President and Chief Executive Officer, as stated in Section 272(D) of the Companies Law, and that updating the said terms of employment is in the interest of the Bank, taking into consideration the contribution of the office holders and the importance of their remuneration in a manner giving them motivation to continue in their position over time. The Remuneration Committee and the Board of Directors were also of the opinion that the updates determined in the updated terms of engagement with office holders in the Bank, as set forth above, would encourage these office holders to continue investing their best efforts in the interest of the Bank, taking into account the challenges facing Bank Management in the short and the long term, and considering the work load placed upon them as part of coping on an ongoing basis with these challenges.

## Note 15 – Employee Rights (cont'd)

On 8 April 2014, the Board of Directors, after receiving the approval and recommendation of the Remuneration Committee of the Board of Directors, approved a remuneration policy applying to "key employees" in the Bank who are not office-holders, pursuant to the provisions of and as required by Proper Conduct of Banking Business Management Regulation No. 301A of the Supervisor of Banks.

The aforesaid remuneration policy for "key employees" provides the framework for the remuneration of key employees, and includes, *inter alia*, consideration of the salary component, the related conditions, the terms of retirement and the annual bonus component. This policy was devised paying attention to the principles of the remuneration policy for office-holders in the Bank, *mutatis mutandis*.

**J. Remuneration policy for all employees**

In December 2014, the Board of Directors, after receiving the approval of the Remuneration Committee, approved the remuneration policy for all the employees of the bank not covered by the remuneration policy for key employees.

The remuneration policy for all the employees of the Bank is based on the provisions of Proper Conduct of Banking Business Management Directive No. 301A of the Supervisor of Banks

The remuneration policy for all the employees of the Bank is intended to serve as a tool for promoting the meeting of the Bank's business targets, including facilitating the recruitment of quality employees to work in the Bank, to retain them in the long-term and motivate them to improve performance and achieve the business objectives and targets of the Bank, while preventing the taking of risks deviating from the risk appetite of the bank.

The remuneration policy refers to the current remuneration for employees, including salaries and salary-related benefits and bonuses, conditions of retirement and other payments to which the employees are entitled.

**K. 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.

## Note 15 – Employee Rights (cont'd)

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 are blocked for a period of four years from the determining date (as defined in the outline prospectus), and are 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.

### L. Streamlining – Structural change

In 2013 and in 2012, expenses were recorded of about NIS 75 million and NIS 323 million (respectively) 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 spread over the years 2012-2014.

### M. Effect of the change in the rate of tax

For information regarding the effect of the change in tax rates on the liabilities for employee rights, see Note 26 below.

## Note 16 - Assets and Liabilities by Linkage Basis

| | 31 December 2014 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Israeli currency | | Foreign currency (a) | | | | |
| | Unlinked | Linked to the CPI | In US dollars | In Euros | In other currencies | Non-monetary items (b) | Total |
| | NIS millions | | | | | | |
| **Assets** | | | | | | | |
| Cash and deposits with banks | 41,900 | 263 | 11,764 | 1,325 | 5,277 | 86 | 60,615 |
| Securities | 19,138 | 2,294 | 20,764 | 3,090 | 2,133 | 4,694 | 52,113 |
| Securities borrowed or purchased under agreements to resell | 2,000 | - | - | - | - | - | 2,000 |
| Credit to the public, net (c) | 159,533 | 51,221 | 29,813 | 5,599 | 6,092 | 222 | 252,480 |
| Credit to governments | 53 | 240 | 176 | 59 | - | - | 528 |
| Investments in companies included on equity basis | - | - | - | - | - | 2,216 | 2,216 |
| Buildings and equipment | - | - | - | - | - | 3,729 | 3,729 |
| Assets in respect of derivative instruments | 7,602 | 181 | 7,174 | 104 | 281 | 1,567 | 16,909 |
| Other assets and intangible property | 4,248 | 4 | 886 | 7 | 45 | 354 | 5,544 |
| Total assets | 234,474 | 54,203 | 70,577 | 10,184 | 13,828 | 12,868 | 396,134 |
| **Liabilities** | | | | | | | |
| Deposits of the public | 166,479 | 27,399 | 83,050 | 16,107 | 10,019 | 343 | 303,397 |
| Deposits from banks | 1,807 | 91 | 2,136 | 423 | 99 | - | 4,556 |
| Deposits from governments | 22 | 2 | 435 | 8 | - | - | 467 |
| Securities loaned or sold under agreements to repurchase | 1,238 | - | - | - | - | - | 1,238 |
| Debentures, bonds and subordinated notes | 4,547 | 19,121 | - | - | 10 | - | 23,678 |
| Liabilities in respect of derivative instruments | 7,102 | 129 | 6,426 | 313 | 154 | 1,526 | 15,650 |
| Other liabilities | 8,792 | 7,276 | 1,704 | 29 | 168 | 746 | 18,715 |
| Total liabilities | 189,987 | 54,018 | 93,751 | 16,880 | 10,450 | 2,615 | 367,701 |
| Difference (d) | 44,487 | 185 | (23,174) | (6,696) | 3,378 | 10,253 | 28,433 |
| **Effect of hedging derivative instruments:** | | | | | | | |
| Derivative instruments (except options) | - | - | - | - | - | - | - |
| Options in the money, net (in terms of underlying asset) | - | - | - | - | - | - | - |
| Options out of the money, net (in terms of underlying asset) | - | - | - | - | - | - | - |
| **Effect of non-hedging derivative instruments:** | - | - | - | - | - | - | - |
| Derivative instruments (except options) | (20,272) | (2,177) | 22,279 | 5,592 | (4,072) | (1,350) | - |
| Options in the money, net (in terms of underlying asset) | 777 | - | (1,694) | 936 | (19) | - | - |
| Options out of the money, net (in terms of underlying asset) | 517 | - | (360) | (132) | (25) | - | - |
| Total | 25,509 | (1,992) | (2,949) | (300) | (738) | 8,903 | 28,433 |
| **Effect of non-hedging derivative instruments:** | | | | | | | |
| value) | 1,580 | - | (2,555) | 978 | (3) | - | - |
| Options out of the money, net (discounted par value) | 266 | - | (6) | (233) | (27) | - | - |

See notes on next page.

## Note 16 - Assets and Liabilities by Linkage Basis (cont'd)

| | 31 December 2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Israeli currency | | Foreign currency (a) | | | | |
| | Unlinked | Linked to the CPI | In US dollars | In Euros | In other currencies | Non-monetary items (b) | Total |
| | NIS millions | | | | | | |
| **Assets** | | | | | | | |
| Cash and deposits with banks | 29,847 | 272 | 6,667 | 2,475 | 4,964 | 126 | 44,351 |
| Securities | 34,323 | 3,410 | 16,506 | 3,745 | 1,832 | 3,919 | 63,735 |
| Securities borrowed or purchased under agreements to resell | 1,350 | - | - | 10 | - | - | 1,360 |
| Credit to the public, net (c) | 146,545 | 53,544 | 27,213 | 6,020 | 7,190 | 362 | 240,874 |
| Credit to governments | 65 | 273 | 176 | 44 | - | - | 558 |
| Investments in companies included on equity basis | - | - | - | - | - | 1,689 | 1,689 |
| Buildings and equipment | - | - | - | - | - | 3,638 | 3,638 |
| Assets in respect of derivative instruments | 8,678 | 309 | 2,076 | 347 | 202 | 1,442 | 13,054 |
| Other assets and intangible property | 3,684 | 184(e) | 922 | 7 | 126 | 358 | 5,281 |
| Total assets | 224,492 | 57,992 | 53,560 | 12,648 | 14,314 | 11,534 | 374,540 |
| **Liabilities** | | | | | | | |
| Deposits of the public | 154,825 | 28,779 | 74,139 | 16,883 | 10,756 | 621 | 286,003 |
| Deposits from banks | 1,717 | 117 | 1,840 | 523 | 113 | - | 4,310 |
| Deposits from governments | 24 | 3 | 360 | 10 | - | - | 397 |
| Securities loaned or sold under agreements to repurchase | 624 | - | - | - | - | - | 624 |
| Debentures, bonds and subordinated notes | 4,554 | 20,877 | - | - | 10 | - | 25,441 |
| Liabilities in respect of derivative instruments | 8,362 | 514 | 2,054 | 835 | 269 | 1,453 | 13,487 |
| Other liabilities | 9,561 | 6,316 (e) | 1,028 | 25 | 269 | 610 | 17,809 |
| Total liabilities | 179,667 | 56,606 | 79,421 | 18,276 | 11,417 | 2,684 | 348,071 |
| Difference (d) | 44,825 | 1,386 | (25,861) | (5,628) | 2,897 | 8,850 | 26,469 |
| **Effect of hedging derivative instruments:** | | | | | | | |
| Derivative instruments (except options) | 694 | - | - | - | (694) | - | - |
| Options in the money, net (in terms of underlying asset) | - | - | - | - | - | - | - |
| Options out of the money, net (in terms of underlying asset) | - | - | - | - | - | - | - |
| **Effect of non-hedging derivative instruments:** | - | - | - | - | - | - | - |
| Derivative instruments (except options) | (25,740) | (2,441) | 25,700 | 5,460 | (2,629) | (350) | - |
| Options in the money, net (in terms of underlying asset) | 1,125 | - | (1,127) | (43) | 36 | 9 | - |
| Options out of the money, net (in terms of underlying asset) | 876 | - | (1,284) | 462 | (59) | 5 | - |
| Total | 21,780 | (1,055) | (2,572) | 251 | (449) | 8,514 | 26,469 |
| **Effect of non-hedging derivative instruments:** | | | | | | | |
| Options in the money, net (discounted par value) | 1,226 | - | (1,279) | 25 | 16 | 12 | - |
| Options out of the money, net (discounted par value) | 4,252 | - | (3,947) | 65 | (428) | 58 | - |

(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 3,988 million (31 December 2013 – NIS 3,883 million)..

(d) Shareholders' equity includes non-controlling interests.

(e) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

# Note 17 - Assets and Liabilities by Currency and Repayment Date (1) (cont'd)

| | 31 December 2014 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Estimated future contractual cash flows | | | | | | | | | | | Book balance (d) | | |
| | Upon demand and up to one month (f) | One month to three months (f) | Three months to one year (f) | 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 (e) in % |
| | (NIS millions) | | | | | | | | | | | | | |
| **Israeli currency (including linked to foreign currency):** | | | | | | | | | | | | | | |
| Assets | 84,031 | 20,459 | 52,947 | 27,968 | 23,519 | 16,943 | 13,880 | 40,734 | 34,593 | 10,773 | 325,847 | 2,796 | 293,948 | 2.63 |
| Liabilities | 148,540 | 15,754 | 35,427 | 12,585 | 13,923 | 4,242 | 3,934 | 14,215 | 3,528 | 2,950 | 255,098 | 1,630 | 248,888 | 1.24 |
| Difference | (64,509) | 4,705 | 17,520 | 15,383 | 9,596 | 12,701 | 9,946 | 26,519 | 31,065 | 7,823 | 70,749 | 1,166 | 45,060 | |
| Of which: credit to the public | 35,520 | 18,668 | 37,801 | 24,607 | 21,162 | 15,786 | 12,645 | 36,468 | 33,161 | 10,672 | 246,490 | 778 | 210,732 | 3.35 |
| Of which: deposits of the public | 135,542 | 12,532 | 30,828 | 6,635 | 4,750 | 2,612 | 1,473 | 4,385 | 664 | 2 | 199,423 | - | 194,120 | 1.75 |
| Derivative instruments (except options) | (6,283) | (3,718) | (8,863) | (132) | 210 | (14) | 1,807 | (1,956) | (40) | (85) | (19,074) | - | (18,856) | - |
| Options (in terms of underlying asset) | 294.00 | 316.00 | 30.00 | 19.00 | - | 183.00 | 895.00 | 687.00 | - | - | 2,424.00 | - | 1,877.00 | - |
| Difference after effect of derivative instruments | (70,498.00) | 1,303.00 | 8,687.00 | 15,270 | 9,806 | 12,870 | 12,648 | 25,250 | 31,025 | 7,738 | 54,099.00 | 1,166.00 | 28,081.00 | |
| **Foreign currency (c)** | | | | | | | | | | | | | | |
| Assets | 32,104 | 8,441 | 17,284 | 9,472 | 6,217 | 5,239 | 4,758 | 9,503 | 5,566 | 3,522 | 102,106 | 563 | 89,318 | 2.41 |
| Liabilities | 75,958 | 17,857 | 18,748 | 3,826 | 1,873 | 731 | 1,763 | 2,284 | 430 | 3 | 123,473 | 15 | 116,198 | 1.92 |
| Difference | (43,854) | (9,416) | (1,464) | 5,646 | 4,344 | 4,508 | 2,995 | 7,219 | 5,136 | 3,519 | (21,367) | 548 | (26,880) | |
| Of which: credit to the public | 11,469 | 5,876 | 10,134 | 4,886 | 3,315 | 2,013 | 2,492 | 2,406 | 960 | 240 | 43,791 | 382 | 41,526.00 | 3.34 |
| Of which: deposits of the public | 70,145 | 16,429 | 15,837 | 3,120 | 1,115 | 487 | 1,298 | 1,848 | 1 | 1 | 110,281 | - | 108,934 | 1.50 |
| Of which difference in $ | (46,374) | 2,283 | (2,501) | 4,826 | 3,487 | 3,409 | 1,946 | 5,670 | 5,549 | 3,095 | (18,610) | 589 | (24,386) | |
| Of which: difference in respect of foreign operations | (5,697) | (180) | 171 | 2,262 | 2,596 | 2,388 | 1,383 | (123) | 441 | 200 | 3,441 | (3) | 2,383 | |
| Derivative instruments (except options) | 6,283 | 3,718 | 8,863 | 132 | (210) | 14 | (1,807) | 1,956 | 40 | 85 | 19,074 | - | 18,856 | |
| Options (in terms of underlying asset) | (294) | (316) | (30) | (19) | - | (183) | (895) | (687) | - | - | (2,424) | - | (1,877) | |
| Difference after effect of derivative instruments | (37,865) | (6,014) | 7,369 | 5,759 | 4,134 | 4,339 | 293 | 8,488 | 5,176 | 3,604 | (4,717) | 548 | (9,901) | |
| **Total** | | | | | | | | | | | | | | |
| Assets[1] | 116,135 | 28,900 | 70,231 | 37,440 | 29,736 | 22,182 | 18,638 | 50,237 | 40,159 | 14,295 | 427,953 | 3,359 | 383,266 | 2.59 |
| Liabilities[2] | 224,498 | 33,611 | 54,175 | 16,411 | 15,796 | 4,973 | 5,697 | 16,499 | 3,958 | 2,953 | 378,571 | 1,645 | 365,086 | 1.46 |
| Difference (g) | (108,363) | (4,711) | 16,056 | 21,029 | 13,940 | 17,209 | 12,941 | 33,738 | 36,201 | 11,342 | 49,382 | 1,714 | 18,180 | |
| [1]Of which: credit to the public | 46,989 | 24,544 | 47,935 | 29,493 | 24,477 | 17,799 | 15,137 | 38,874 | 34,121 | 10,912 | 290,281 | 1,160 | 252,258 | 3.35 |
| [2]Of which: deposits of the public | 205,687 | 28,961 | 46,665 | 9,755 | 5,865 | 3,099 | 2,771 | 6,233 | 665 | 3 | 309,704 | - | 303,054 | 1.66 |

See notes on page 405.

# Note 17 - Assets and Liabilities by Currency and Repayment Date (1) (cont'd)

| | 31 December 2013 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Estimated future contractual cash flows | | | | | | | | | | | Book balance (d) | | |
| | Upon demand and up to one month (f) | One month to three months (f) | Three months to one year (f) | 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 (e) in % |
| | (NIS millions) | | | | | | | | | | | | | |
| **Israeli currency (including linked to foreign currency):** | | | | | | | | | | | | | | |
| Assets | 68,678 | 20,545 | 62,469 | 28,485 | 21,445 | 17,424 | 13,446 | 40,876 | 34,336 | 11,361 | 319,065 | 2,995 | 282,860 | 3.67 |
| Liabilities | 137,343 | 14,960 | 30,151 | 16,892 | 9,740 | 11,267 | 3,225 | 15,214 | 3,198 | 2,406 | 244,396 | 2,271 | 239,179 | 2.37 |
| Difference | (68,665) | 5,585 | 32,318 | 11,593 | 11,705 | 6,157 | 10,221 | 25,662 | 31,138 | 8,955 | 74,669 | 724 | 43,681 | |
| Of which: credit to the public | 35,385 | 17,893 | 35,228 | 25,719 | 18,493 | 15,429 | 11,376 | 35,453 | 32,518 | 11,198 | 238,692 | 771 | 201,721 | 3.99 |
| Of which: deposits of the public | 130,380 | 11,459 | 23,671 | 7,715 | 4,283 | 2,948 | 2,263 | 4,771 | 737 | 7 | 188,234 | - | 185,601 | 2.35 |
| Derivative instruments (except options) | (10,197) | (12,755) | (2,147) | (488) | 172 | (117) | 18 | 171 | (27) | (78) | (25,448) | - | (25,515) | - |
| Options (in terms of underlying asset) | 779 | (372) | 20 | 15 | - | - | 162 | 1,399 | - | - | 2,003 | - | 1,902 | - |
| Difference after effect of derivative instruments | (78,083) | (7,542) | 30,191 | 11,120 | 11,877 | 6,040 | 10,401 | 27,232 | 31,111 | 8,877 | 51,224 | 724 | 20,068 | |
| **Foreign currency (c)** | | | | | | | | | | | | | | |
| Assets | 26,057 | 7,231 | 12,840 | 10,020 | 6,854 | 6,227 | 5,911 | 8,525 | 2,189 | 487 | 86,341 | 473 | 80,146 | 3.85 |
| Liabilities | 71,680 | 13,524 | 15,106 | 2,747 | 1,071 | 998 | 2,076 | 1,321 | 374 | 4 | 108,901 | 517 | 106,208 | 3.06 |
| Difference | (45,623) | (6,293) | (2,266) | 7,273 | 5,783 | 5,229 | 3,835 | 7,204 | 1,815 | 483 | (22,560) | (44) | (26,062) | |
| Of which: credit to the public | 11,652 | 6,314 | 9,066 | 3,781 | 3,024 | 1,758 | 1,574 | 2,358 | 1,013 | 268 | 40,808 | 463 | 38,791.00 | 3.94 |
| Of which: deposits of the public | 67,324 | 12,577 | 14,297 | 2,460 | 804 | 382 | 1,722 | 428 | - | 1 | 99,995 | - | 99,781 | 0.60 |
| Of which difference in $ | (40,772) | (895) | (2,615) | 5,980 | 4,204 | 3,739 | 1,958 | 5,521 | 1,368 | 368 | (21,144) | (111) | (24,174) | |
| Of which: difference in respect of foreign operations | (3,076) | (1,145) | (1,084) | (2,654) | (1,184) | (5,195) | (64) | (3,644) | 258 | 73 | (17,715) | (172) | (16,075) | |
| Derivative instruments (except options) | 10,197 | 12,755 | 2,147 | 488 | (172) | 117 | (18) | (171) | 27 | 78 | 25,448 | - | 25,515 | |
| Options (in terms of underlying asset) | (779) | 372 | (20) | (15) | - | - | (162) | (1,399) | - | - | (2,003) | - | (1,902) | |
| Difference after effect of derivative instruments | (36,205) | 6,834 | (139) | 7,746 | 5,611 | 5,346 | 3,655 | 5,634 | 1,842 | 561 | 885 | (44) | (2,449) | |
| **Total** | | | | | | | | | | | | | | |
| Assets[1] | 94,735 | 27,776 | 75,309 | 38,505 | 28,299 | 23,651 | 19,357 | 49,401 | 36,525 | 11,848 | 405,406 | 3,468 | 363,006 | 3.70 |
| Liabilities[2] | 209,023 | 28,484 | 45,257 | 19,639 | 10,811 | 12,265 | 5,301 | 16,535 | 3,572 | 2,410 | 353,297 | 2,788 | 345,387 | 2.58 |
| Difference (g) | (114,288) | (708) | 30,052 | 18,866 | 17,488 | 11,386 | 14,056 | 32,866 | 32,953 | 9,438 | 52,109 | 680 | 17,619 | |
| [1]Of which: credit to the public | 47,037 | 24,207 | 44,294 | 29,500 | 21,517 | 17,187 | 12,950 | 37,811 | 33,531 | 11,466 | 279,500 | 1,234 | 240,512 | 3.99 |
| [2]Of which: deposits of the public | 197,704 | 24,036 | 37,968 | 10,175 | 5,087 | 3,330 | 3,985 | 5,199 | 737 | 8 | 288,229 | - | 285,382 | 1.92 |

See notes on page 405.

# Note 17 - Assets and Liabilities by Currency and Repayment Date [1] (cont'd)

**Notes:**

(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 allowance for credit losses.

(b) Assets without a fixed maturity include assets in the amount of NIS 431 million that are overdue (31 December 2013 – NIS 514 million).

(c) Not including Israeli currency 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 that are not settled net.

(e) The contractual rate of return is the interest rate discounting future anticipated contractual cash flows reported in this Note in respect of a monetary item to the balance sheet figure.

(f) Credit with revolving account conditions is classified in accordance with the period of the credit facility in the amount of NIS 13.1 billion (31 December 2013 - NIS 13.0 billion). Over-limit credit in the amount of NIS 0.7 billion (31 December 2013 - NIS 0.7 billion) is classified as without repayment date.

(g) The above difference does not necessarily reflect the exposure to interest and/or linkage basis.

(h) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

Note: Total memorandum liabilities against which short-term credit was granted in the Bank amount to NIS 4.5 billion as of 31 December 2014 (31 December 2013 - NIS 5.1 billion).

## Note 18 - Contingent Liabilities and Special Commitments

| | 31 December 2014 | | 31 December 2013 | |
|---|---|---|---|---|
| | Contract balances (a) | Balance of allowance for credit losses | Contract balances (a) | 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 period** **Transactions in which the balance reflects a credit risk:** | | | | |
| Documentary credits | **1,627** | **3** | 1,867 | 4 |
| Credit guarantees | **6,071** | **102** | 5,490 | 84 |
| Guarantees to apartment purchasers | **17,547** | **24** | 15,529 | 22 |
| Other guarantees and liabilities (b) | **17,079** | **216** | 15,033 | 172 |
| Unutilized credit card facilities | **26,506** | **28** | 24,669 | 22 |
| Other unutilized revolving credit facilities and credit facilities in accounts on demand | **14,125** | **25** | 14,158 | 24 |
| Irrevocable commitments to provide credit which has been approved and not yet granted[1] | **22,727** | **73** | 20,801 | 66 |
| Commitments to issue guarantees | **15,097** | **23** | 11,845 | 18 |
| Unutilized facilities for activity in derivative instruments | **5,533** | **-** | 6,406 | - |
| Approval in principle for a guaranteed rate of interest | **4,565** | **-** | 3,692 | - |

[1] 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 233 million (31 December 2013 – NIS 208 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.

(a) The balances of the contracts or their stated amounts at the year-end, before the effect of the allowance for credit losses.
(b) Including the Bank's liabilities in respect of its share in the risk fund of the Maof Clearing House in the amount NIS 284 million (31 December 2013 – NIS 145 million).

### **B. Off-balance sheet commitments for transactions based on extent of collections** (a)

### **Balance of credit from deposits based on extent of collections** (b)

| | 31 December 2014 | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| Israeli currency unlinked | **820** | 1,070 |
| Israeli currency linked to the CPI | **3,087** | 3,785 |
| Foreign currency | **155** | 267 |
| Total | **4,062** | 5,122 |

See notes on next page.

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

### B. Off-balance sheet commitments for transactions based on extent of collections (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 2014 | Total 2013 |
|---|---|---|---|---|---|---|---|---|
| | NIS millions | | | | | | | |
| **CPI linked sector (c)** | | | | | | | | |
| Cash flows of futures contracts | **26** | **34** | **32** | **49** | **16** | **1** | **158** | 244 |
| Expected future cash flows after management estimate of early repayments | **26** | **34** | **32** | **49** | **15** | **-** | **156** | 242 |
| Discounted expected future cash flows after management estimate of early repayments (d) | **25** | **33** | **29** | **41** | **11** | **-** | **139** | 215 |
| **Unlinked shekel sector** | | | | | | | | |
| Cash flows of futures contracts | **8** | **3** | **3** | **3** | **-** | **-** | **17** | 17 |
| Expected future cash flows after management estimate of early repayments | **8** | **3** | **3** | **3** | **-** | **-** | **17** | 17 |
| Discounted expected future cash flows after management estimate of early repayments (d) | **8** | **3** | **2** | **3** | **-** | **-** | **16** | 15 |

(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 204 million (previous year - NIS 267 million) are not included in this table.

(c) Including foreign currency sector.

(d) Discounting was at the rate of 2.45% (2013 – at the rate of 2.97%).

### Information on loans granted during the year by mortgage banks:

| | 2014 | 2013 |
|---|---|---|
| | NIS millions | |
| **Information on loans granted during the year by mortgage banks:** | | |
| Loans from deposits on collection basis | **32** | 38 |
| Standing loans | **15** | 28 |

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

### C. Other contingent liabilities and special commitments:

| | 2014 | 2013 |
|---|---|---|
| | NIS millions | |
| **(1) Long-term rental contracts - rental of buildings, equipment and motor vehicles and maintenance in respect of commitments payable in following years** | | |
| First year | **227** | 225 |
| Second year | **186** | 195 |
| Third year | **169** | 174 |
| Fourth year | **151** | 162 |
| Fifth year | **118** | 130 |
| After five years | **717** | 815 |
| Total long-term rental contracts | **1,568** | 1,701 |
| **(2) Commitments to purchase securities** | **724** | 568 |
| **(3) Commitments to invest in and acquire buildings and equipment** | **31** | 56 |

### D. Legal claims

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, 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 113 million.

**1.** The following are details of claims, including the petitions for approval of class actions, filed against the Bank in material amounts. In the opinion of the Management of the Bank, based on legal opinions regarding the chances of success of these claims, appropriate provisions have been recorded in the financial statements, where required, to cover damages resulting from the said claims:

**A.** On 12 September 2006, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, against Bank Hapoalim B.M. and against 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 debitory current 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 Banks submitted an appeal against the ruling in the Supreme Court. In the context of the hearing of the appeal, the Attorney General submitted, on 21 November 2011, his position 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 position is that in the view of the Attorney General the decision justifies the approval of a class action. On 28 July 2013, the Supreme Court decided to accept the appeal and the decision of the District Court to approve a class action was canceled. The Supreme Court also decided that in view of the fact that the decision may have significant implications on the approval of the class action, there is no alternative than to return the proceedings to the District Court for a further hearing on the petition for approval. As part of the appeal proceedings against the decision, the Anti-Trust Tribunal on 15 June 2014 gave effect to an agreed order for agreement between the banks appealing to the Anti-Trust Commissioner, under which, inter alia, subject to the deposit of an amount of NIS 70 million (the Bank's share – NIS 21.425 million) with a trustee, the decision would be void. This amount was deposited with a trustee ("the Trustee"). On 11 December 2014, a petition was filed with the Court to approve a settlement agreement under which the respondent banks would pay the members of the group an amount of NIS 35 million, out of the monies deposited with the Trustee. Pursuant to the decision of the Court, the agreement was sent to the parties set forth in the decision and notices published in the press on the settlement agreement. After publication, the plaintiffs filed under the proceedings described in Section B below a petition to cancel the decision or alternatively to postpone it until after a decision in reference between the proceedings here and the proceedings described in Section B below, and subsequently the Court ordered the postponement of its decision until another decision is made.

**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, against Bank Hapoalim B.M. and against 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 Section A above. The plaintiffs submitted a petition, on 29 October 2013, for renewal of proceedings in the claim. On 21 January 2015, the court decided to transfer the proceedings in the claim to the Tel-Aviv-Yaffo Court that is dealing with the proceedings described in Section 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 11 March 2014, a verdict was handed down rejecting most of the appeal, and accepting the Bank's claims in full regarding rejection outright due to a final judgment. However, the Court returned the case to the Magistrates Court to examine whether to allow filing an amended claim on the grounds that there was no final judgment.

**D**. On 30 June 2008, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, against Israel Discount Bank and against 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 at NIS 3.5 billion, with the heading of the petition indicating the amount of the claim to be 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 Section B below). On 16 November 2014, a petition was filed for approval of a compromise agreement in this case, in an additional claim and two additional proceedings against Bank Mizrahi-Tefahot Ltd. and the First International Bank of Israel Ltd. Pursuant to the compromise agreement, the Bank and the above four other banks will pay their customers a total amount of NIS 35,000,000 out of the funds deposited with the Trustee according to the agreement in the appeal proceedings against the decision of the Commissioner that the Restrictive Practices Court gave the validity of an agreed order (see Section 1.A above).

**E**. 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. On 16 November 2014, a petition was filed for approval of a compromise agreement in this case and additional cases as detailed in Section 1.D above, , namely in accordance with the settlement submitted for approval of the court, the settlement amount will be paid out of the monies deposited with the trustee as described in Section 1.A above.

**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. On 21 July 2013, a verdict was handed down accepting the claim on a partial basis only. The parties have filed an appeal to the Supreme Court.

**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. On 20 October 2013, the parties filed a petition with the court for approval of a compromise arrangement in the case. The arrangement has not yet been approved by the Court.

**H.** 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 the 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. At the request of the Court, the Supervisor of Banks submitted responses to the Court to the questions raised by the parties concerning the claim.

**I.** 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 payment 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.

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

**J.** On 28 August 2013, a petition was filed with the Tel Aviv District Court to approve a class action against Bank Hapoalim, Bank Leumi, Bank Mizrahi-Tefahot, Israel Discount Bank, First International Bank, and the CEO's of these banks. The Supervisor of Banks, the Governor of the Bank of Israel, and the Antitrust Commissioner were joined as formal respondents. The subject of the petition is the allegedly unlawful charging of commissions regarding activities of conversion and delivery of foreign currency, without fair disclosure. According to the petitioners, the banks are concealing from the customers that, when selling / buying foreign currency, they are also charged in excess of exchange commission, as defined by them, a "price increase" or "price reduction" commission – i.e. exchange rate differences. The plaintiffs claim that the disclosure made by the banks at the time of the transaction refers only to exchange commission and not to exchange rate differences, and since the bank is a Forex "intermediary" and not a "market maker", it should charge customers the price it was charged for the foreign currency, perhaps with a miniscule addition, and in any case it should disclose this to the customer. As claimed by the petitioners, the direct damage caused to customers is at least NIS 10.5 billion over the last seven years, subject to documents and information they will receive as part of the claim. T the request of the petitioners, the Court approved dismissing the CEO's of the banks from the petition for approval, leaving only the banks. On 3 February 2014, the petitioners filed a petition to amend the petition for approval of a class action so that the amount claimed would be NIS 11.15 billion. The Bank has filed its response to the petition. On 20 January 2015, the Court decided on the joining of the proceedings in the petition with a petition for approval of a class action filed in a similar matter, against the credit card companies.

**K.** On 27 November, 2013, a petition for approval of a class action was filed in the Central District Court against the Bank, claiming that the Bank calculates incorrectly the theoretical value of options traded on the Tel Aviv Stock Exchange. According to the petitioners, the Bank uses the Black & Scholes mathematical model, which is the model relevant for determining the value of the option, but inserts an erroneous element. The erroneous element, according to the petitioners, is the expiry date of the option. They argue that the Bank adds an extra value date to this element, which affects the theoretical value of the option, and affects the judgment of customers regarding the feasibility of the transaction and its price. They further contend that other financial institutions do not make this mistake. According to the petitioners, they cannot accurately assess the damages, but estimate it to be tens of millions of shekels.

**L.** On 2 December 2013, a petition for approval of a class action was filed in the Central District Court, against the Bank, on the subject of early repayment commission of non-housing loans. According to the petitioner, the manner of calculating early repayment commission, in cases of loans regarding which there apply the calculation principles set forth in the Proper Conduct of Banking Business Directives and for cases of loans regarding which there apply the rules set forth by the Bank, was made unlawfully. The petitioner claims that she is unable to assess the total amount of the claim at this stage.

**M.** On 9 March 2014, a petition was filed in the Tel Aviv District Court to approve a class action against the Bank without specifying the amount claimed. According to the plaintiff, the Bank collects money from customers unlawfully in two cases. The first is when the Bank allows customers to exceed the credit limit and debits customer accounts with a fee in the amount of NIS 53 in respect of delivering a warning letter of the deviation from the credit limit. Second, "non-approved" deviations from the credit limit are merged into the excess debit balance in the account resulting in the charging of the maximum rate of interest. The Bank has filed its response to the petition.

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

**N.** On 17 March 2014, the provisional liquidator of a company in liquidation (the "Company" and "the Special Manager") filed a petition in the Central District Court to issue instructions against the Bank, in which it requested that the Court declare that the Bank will bear the payment to the Company of the liquidation fund of an aggregate amount of NIS 1,200 million, of which an amount of NIS 635 million to cover all the company's debts to its creditors and an amount of NIS 565 million for repayment of the full value of the assets of the Company in the principal amount standing as at 25 March 2001 in the amount of NIS 165 million, plus interest from that date at the rate it was obliged to pay the Bank. According to the special manager, the Bank is to bear individual responsibility for the liabilities of the company, since allegedly the Bank is to be deemed an "office holder" in the company due to its alleged control over the company; since the Bank is to be deemed as a "director de-facto" or a "shadow director " in the company; because of its responsibility in jointly committing and / or jointly misleading in allegedly fraudulent actions detailed in the petition; and because of the Lenders' Liability doctrine. It should be noted that as part of the motion, the liquidator retained the right to file additional proceedings against the Bank and / or other officers of the company and / or individuals on behalf of the Bank and lawyers advising the Bank. The Bank has filed its response to the petition.

**O.** On 18 March 2014, a petition was filed in the Central District Court for approval of a class action against the Bank for an asserted amount of about NIS 155 million. According to the plaintiff, as part of the deducting of tax at source carried out by the Bank in securities transactions executed through it, the Bank's computer systems calculate long capital gains and / or short capital losses unlawfully. The incorrect data are presented to customers in the Leumi Trade system and the simulator existing in the system. The "group" for purpose of the proceedings is: 1. anyone who executed securities trading through Leumi Trade, and for whom, within the deduction of tax at source a long capital gain and / or a short capital loss was calculated. 2. anyone who was presented by the Bank and / or by the Leumi Trade system with incorrect representations about capital gains and / or capital losses reflected in securities owned by him. According to the plaintiff, the aggregate damage caused to members of the first group is about NIS 79 million, and the aggregate damage caused to the members of the second group is about NIS 76.5 million. The Bank has filed its response to the petition.

**P.** On 6 January 2015, a petition was filed with the Central District Court, for approval of a class action for an amount claimed of NIS 400 million, based on estimates and valuations of the expert of the petitioner. According to the petitioner, the Bank is violating the provisions of the Interest Rate Law (Determination of the Maximum Interest Rate), 1970, under which interest on arrears is not to be charged on index-linked loans at a rate exceeding 17% per annum, in that it charges interest on arrears on index-linked loans at the rate of 18.3891% per annum that exceeds the rate allowed. The petitioner attached an expert opinion to the request.

**2.** In addition, there are claims pending against the Bank, including the petitions for approval of class actions in material amounts, which, in the opinion of the Management of the Bank, based on legal opinions regarding the chances of success of these claims, 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 13 April 2014, a petition for approval of a class action was filed with the Tel Aviv District Court against the Bank in an amount of about NIS 184 million. The petitioner claims that when the customer's bank account exceeds the approved credit limit, the Bank refuses to honor standing orders in the account, but charges commission which exceeds the amount of the standing order that was not honored.

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

**B.** On 5 August 2014, a petition was filed with the Tel Aviv District Court to approve a class action against the Bank, Bank Hapoalim, Bank Mizrahi, Israel Discount Bank, First International Bank, Bank Otzar Hachayal, and Mercantile Discount Bank. The plaintiff claims that the respondent banks are in violation of the Banking Rules – Service to the Customer (Fees), in that they charge minimum fees for transferring foreign currency, at different levels, instead of one minimum fee only, which the plaintiff claims is required by the Rules, and that the violation that is shared by all the respondent banks is in fact a restrictive practice that contradicts the Antitrust Law. The amount of damages claimed is estimated by the plaintiff, for all the respondents together, at some NIS 1.5 billion. The Bank's share, according to the plaintiff, is some 30% of the market. In addition, the plaintiff requests that the Court, inter alia, grant an order restricting the banks from charging a fee for a foreign currency transfer to another bank to a maximum of US $30, and the fee for receiving foreign currency from another bank to a maximum amount of US $10.

**C.** On 19 January 2015, a petition was filed in the Tel Aviv District Court (Economic Division), to approve a class action against the Bank, and against 19 other respondents, who were or are directors in the Bank. According to the plaintiffs, as part of investigation proceedings by various agencies in the US, the Bank admitted that it and other companies in the Leumi Group acted to help its (US taxpayer) customers to evade reporting and from tax payments. It is argued that the investigation proceedings led to the Bank writing off NIS 1.438 billion from its equity, and that the members of the Board of Directors who held office in 2002-2010 were negligent in not employing supervision and control that allowed this illegal conduct of the Bank and, as a result, caused damage to members of the Group by writing off funds from the Bank's equity, and cutting the potential return on their investment in the shares of the Bank. The amount of the claim amounts to approximately NIS 475 million and it was argued that minimum damage to the shareholders group that sold their shares between 21 March 2013 (the date of the initial inclusion of a provision in the financial statements for the investigation) and 15 January 2015 ranged from the above amount to NIS 825 million.

**D.** On 11 February 2015, a petition was filed in the Tel Aviv District Court to approve a class action against the Bank for an amount claimed of NIS 2.3 billion. According to the petition, the Bank allegedly managed a "black list" of customers according to which it marks customer with an asterisk in the Bank's systems, for an unlimited period, in a manner that harms or it alleges makes it difficult for them to get credit or otherwise conduct business with the Bank. According to the petition, the management of such a "list" with no transparent criteria is a violation of the law and of legal and behavioral norms.

**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 Keshet, 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.

**B.** On 8 July 2014, a petition for approval of a class action was filed with the Tel-Aviv District Court against IsraCard, Leumi Card, the Bank, and Bank Hapoalim in the sum of NIS 200 million, concerning the charging of exchange commission and exchange rate differences when executing a transaction in foreign currency. According to the plaintiff's claim, exchange commission is charged unlawfully and there is no fair disclosure of its collection or of the exchange rate differences and the method of calculation in the detailed statements sent to the customer. Leumi Card has filed its response to the petition. On 20 January 2015, the Court decided to join proceedings in the petition with a petition for approval of a class action that was filed on a similar matter against the banks.

**C.** On 28 April 2014, a petition for approval of a class action was filed with the Central District Court against Leumi Card, IsraCard, and C.A.L., in the amount of NIS 1.7 billion, relating to the charging of vendors with interchange commission in respect of transactions executed by means of debit cards and prepaid cards that are reloaded in advance. The petitioner claims that the interchange commission charged on these cards (as opposed to credit cards), did not receive approval from the Anti-Trust Court, and is a restrictive arrangement. In addition, the arrangement between the respondents, under which proceeds of transactions are transferred to vendors with a delay of some 20 days, is also a restrictive arrangement or a discriminating condition in a uniform contract. On 24 February, the petitioner submitted a request to the court to remove himself from the petition. The decision of the court has not yet been received.

**D.** On 17 November 2014, a petition for approval of a class action was filed with the Tel Aviv District Court, against Leumi Card for the amount of NIS 952 million. The petitioner claims that Leumi Card is acting illegally in its conduct concerning identification of customers in the IVR system (call forwarding in service centers) which discloses personal details of customers, in contravention of the Protection of Privacy Law. In addition, the petitioner claims that his request to block the possibility of hearing the information concerning his credit card after the identification was not accepted on the grounds that there is no possibility of effecting such a block

**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 2014 to some NIS 2,457 million in nominal values. The value of the assets of the above funds at 31 December 2014 amounts to NIS 5,938 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, 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.

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

**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.

**G. Letters of indemnity**

**1.** 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 cumulative 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.

**2.** 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.

**3.** The Bank has undertaken to indemnify external advisors including in connection with plans for granting of offering securities to officeholders or employees of the Bank or subsidiary companies, as applicable, in respect of an obligation or loss, and in various cases including in respect of other legal expenses in connection with the services given by them to the Bank.

**4.** 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.

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

**5.** 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, including in reference to debts applying to the Bank as a member of the Tel Aviv Securities Exchange.

6. 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.

### H. Credit cards

**1.** 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 the credit card companies during the application of the arrangement.

Since then proceedings have been conducted on the matter between the petitioners and the Anti-Trust Commissioner (hereinafter: "the Commissioner"), in which an expert was appointed by the Court to evaluate the competitive implication of the rate of cross-commission set forth in the arrangement.

On 7 March 2012, the Antitrust Tribunal gave its judicial approval to an agreement submitted by the credit card companies and the Commissioner regarding the rate of cross-commission, which will decrease gradually to 0.7% from July 2014, according to the outline plan for the reduction of cross-commission set forth in the judgment. The arrangement between the Commissioner and the credit card companies is in force until the end of 2018.

**2.** 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.

**3.** 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.

### I. Israel Corporation Ltd. – company included on equity basis

1. Oil Refineries Ltd. (hereinafter – ORL), a company included on equity basis of the Israel Corporation Ltd. and its consolidated company had a working capital deficit at 31 December 2014, and other issues related to the business situation of the company and its cash flows. ORL, its consolidated company and the group companies are taking steps to improve the level of liquidity and the level of profitability whose realization is subject, inter alia, to changes in selling prices and the prices of raw materials. The management of ORL and its consolidated company believes, based on cash flow forecasts stemming from current operations in combination with the steps taken, that ORL and the group companies have sufficient sources of funds in the volume and timing required to meet its liabilities and to finance its future activity in the foreseeable future.

In addition, there are outstanding legal proceedings against ORL, including class actions, and other contingencies. The management of ORL, based on the opinions of their legal advisors, cannot estimate the effect of the said legal proceedings, claims and contingencies, if any, and therefore, no provisions have been made in this regard in the financial statements of the Israel Corporation Ltd. and the above company.

2. On 16 July 2014, all the conditions precedent for the completion of the Israel Corporation's share in the debt arrangement of Zim Integrated Shipping Services Ltd. (hereinafter – Zim) were met, and the arrangement was completed. With the completion of the arrangement, the Israel Corporation ceased its control of Zim and began to report its investment in Zim as a company included on equity basis at its fair value derived from the amount of investment of the Israel Corporation in the equity of Zim under the arrangement. Accordingly, in the financial statements of the Israel Corporation at 31 December 2014, the Israel Corporation reported a profit of about $609 million resulting from the loss of control of Zim and reporting its investment in Zim as a company included on equity basis at its fair value derived from the amount of the investment of the Israel Corporation in the equity of Zim under the arrangement. The Bank reported its share in the said profit of NIS 299 million.
Two petitions have been filed for approval as derivative actions against the Israel Corporation, its controlling owners, several of its serving directors, and Zim, by a number of shareholders of the Israel Corporation in connection with the debt arrangement in Zim.

   In the opinion of the Israel Corporation it is not possible at this early stage to evaluate the chances of the claim and its risks.

3. On 7 January 2015, the Israel Corporation announced the completion of a process of splitting wherein holdings in a number of subsidiaries were transferred from the Israel Corporation to Kenon Holdings, all of whose shares were allocated, prior to the transfer of the assets, to the shareholders in the Israel Corporation (hereinafter, "the split"). The shares of Kenon were listed for trading on the New York Stock Exchange and on the Tel Aviv Stock Exchange at the beginning of January 2015. The Bank's investment in the shares of Kenon is presented in the available-for-sale securities portfolio.

   For further details, see Note 31.C.

**J. Contingent liabilities and other special commitments**

1. 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. According to a settlement agreement signed between the banks and the Anti-Trust Commissioner, it was agreed to cancel the decision and the banks will pay the Treasury an amount of NIS 70 million (the Bank's share amounting to some NIS 21 million), when the Bank will have the possibility of paying the said amount (and the other banks with regard to the amounts relevant to them), instead of a payment to the Treasury and subject to conditions stipulated in agreements with the Commissioner, in the framework of settlement arrangements in a number of petitions for approval of class actions outstanding against the Bank. On 15 June 2014, the Anti-Trust Tribunal approved the agreements between the parties and gave it the force of an agreed order.

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

2. 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 carried out unlawfully. 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 certain employees/managers, and decided to send the case back to the General Prosecutor for rewording and resubmission of the indictment. The General Prosecutor and the complainant appealed the decision. The appeal was approved, the case was sent back to the lower court and hearings commenced in the case.

3. On 1 September 2013, a petition for approval of a derivative action was filed in the Economic Division of the Tel Aviv District Court against former senior officers of the Bank. The petitioner claimed that, as part of investigations of the U.S. tax authorities, it was found that representatives of the Bank and representatives of Bank Leumi USA assisted customers that are U.S. taxpayers to execute transactions that prevented the U.S. tax authorities from collecting taxes from their citizens. The damage caused to the Bank, as claimed by the petitioner, amounts to hundreds of millions of shekels that the Bank plans to pay to the U.S. authorities. The plaintiff argued that, as at the stage the petition was filed, the Bank mentioned a sum of NIS 340 million, with part of the amount paid to consultants and service providers in connection with the investigations. The petitioner claims that the former officers are responsible for the damage caused to the Bank by encouraging it to take part in the illegal activity or at least by doing nothing to prevent it. On 6 January 2015, the petitioner filed an amended petition to approve the filing of a derivative action against officers in the Bank and other corporations controlled by the bank ("Leumi Group") as well as against the Bank's external auditors. According to that claimed in the amended petition, the damage caused to Leumi Group by the investigations of the US authorities and the arrangements signed with them is about NIS 2.1 billion. On 19 February 2015, the Bank filed a petition with the Court to set up an independent claims committee, as mentioned in Section K. below, insofar as it is not deleted outright, to file claims against officeholders and the auditing firms of the Bank, as well as in relation to the advisable course of legal action to the Bank in light of the totality of events in connection with the affair relating to its customers who are taxpayers in the United States.

4. As reported previously, there is an investigation pending by the United States Securities and Exchange Commission (SEC) in connection with the Group's activities vis-à-vis US customers. The Group has raised several issues with the SEC which in the Group’s opinion provide a response to the questions arising in the investigation of the SEC.
According to the legal advice received by the Group from its attorneys in the US, due to the broad discretion given to the SEC and due to the special facts concerning the Group, the Group is unable at this stage to evaluate the amount that the Group may be required to pay, if at all.
Since it is not possible to evaluate the total amount of the expense that may be incurred by the Group regarding this investigation, the Group has not made any provision in its financial statements in respect of it.

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

### K. Arrangement with the U.S. authorities

In 2011, the Bank was informed that an investigation was being carried out against the Bank Leumi Group by the U.S. Department of Justice (DOJ) in connection with the Group's activity with customers who are taxpayers in the United States (hereinafter: "the U.S. customers") of a suspected breach of Federal law in the United States. As part of the investigation, various orders were issued against the Group to obtain information and documents regarding the U.S. customers. Customers and former employees of banks in the Group were summoned to give testimony and documents in connection with the U.S. customers and banking services provided to them by the Group. The Group cooperated with the U.S. authorities in furnishing information and in the required procedural proceedings, according to that permitted under the law. As a part of this cooperation, and in accordance with DOJ directives, an independent and comprehensive examination of the Group's activity vis-à-vis the U.S. customers was carried out by an international firm of accountants.

In 2014, the Bank was informed that, in addition to the aforesaid investigation, the Securities & Exchange Commission (SEC) also opened an investigation of a suspected breach by the Group of the securities laws in the United States, and an additional investigation was opened by the New York Department of Financial Services (NY- DFS) in connection with the Group's activity regarding the U.S. customers.

As a result of the opening of the abovementioned investigations, the Bank included an expense of NIS 396 million in its 2012 financial statements in respect of the expense that was likely to be incurred by the Group as a result of the ongoing investigations by the U.S. authorities regarding the U.S. customers, including the expenses of external consultants and service-providers in connection with the execution of the investigations. The 2013 financial statements included an additional expense of about NIS 236 million and the 2014 financial statements included an expense of some NIS 1,026 million. In total, the Bank included an aggregate of NIS 1,658 million in its financial statements in respect of the aforesaid.

On 22 December 2014, Leumi Group signed arrangements with the DOJ and the DFS, pursuant to which it admitted, inter alia, that from 2000 and until 2010, the Group had willingly assisted in the preparation and submission of false tax returns to the U.S. tax authorities (hereinafter: **"the arrangements"**).

The arrangement with the DOJ was approved by the California Federal Court on 23 December 2014. The arrangement with the DOJ is a deferred prosecution agreement (hereinafter, "DPA"). The arrangement is between the Bank, Bank Leumi Le'Israel Trust Company Ltd, Bank Leumi (Luxembourg) S.A. (Leumi Luxembourg), Leumi Private Bank Ltd. (under its former name of Bank Leumi Switzerland) (hereinafter, "Leumi Switzerland") and Bank Leumi United States (hereinafter, "BLUSA") (all together for the sake of brevity, to be called: "Leumi Group") on the first part, and the United States Department of Justice (hereinafter, "the DOJ") of the second part. Pursuant to the DPA, Leumi Group confirmed that it had willingly assisted U.S. taxpayers who were customers of the Bank in the preparation and submission of false tax returns to the U.S. tax authorities, thereby violating U.S. tax law. Pursuant to the provisions of the DPA, Leumi Group paid an aggregate amount of US$ 270 million, as follows: (a) US$ 71,769,305 as a recovery of unpaid taxes by U.S. customers in respect of interest, dividends and capital gains in relation to the relevant accounts as defined in the agreement, with the recovery amount exceeding the profits earned by Leumi Group in respect of the relevant accts; (b) US$ 157,000,000 as a recovery for Bank Leumi Switzerland in respect of accounts that were maintained with it, this, on the basis of the "Swiss formula"; and (c) a monetary penalty amounting to US$ 41,230,695, in relation to Leumi Group. As part of the DPA, Leumi Group agreed that if it does not meet its obligations according to the DPA within two years of its signing, an indictment will be filed against it. The wording of the indictment was attached to the DPA. Also attached to the DPA was an appendix agreed by Leumi Group of a Statement of Facts. The agreed facts include, inter alia: travel by banking officials to the United States through April 2009; the extension of loans by Leumi USA which were collected under a bank guarantee issued by the Bank, Leumi Luxembourg or Leumi Switzerland and secured by deposits which existed in those banks; the provision of services and the maintenance of Hold Mail accounts with a code number, and offshore companies and accounts in trust companies; and the receipt of deposits of U.S. customers who had left Swiss banks in 2009. In addition, in May 2008, when the DOJ's investigation against UBS became public, a number of senior managers in the Bank viewed the exit of UBS Bank from the U.S. international banking business as a golden opportunity to make contact with customers, and they urged bank officials to suggest that they transfer their accounts to the Bank. Pursuant to the DPA, it was agreed that Leumi Group and its employees will be prohibited from making, in a court proceeding or in any other setting, declarations which are contrary to that stated in the agreement or in the "statement of facts". However, it was clarified in the agreement that, the aforesaid undertaking will not restrict an employee or a former employee of Leumi Group or any other entity from making declarations as part of court proceedings (an investigation or a criminal, administrative or civil proceeding) that may be held in the United States or in another country, providing that the employee or former employee is not authorized to make statements on behalf of any of the companies of Leumi Group. Pursuant to the DPA, the U.S. government undertook, subject to Leumi Group's compliance with its obligations under the DPA, not to open investigations or submit further indictments against Leumi Group in relation to the actions which are the subject of the agreement. The DPA does not preclude the submission of civil actions by the United States government against Leumi Group (including in respect of tax indebtedness of Leumi Group in respect of activity which is the subject of the agreement); does not regulate the investigations by other authorities in connection with the activity of Leumi Group vis-à-vis U.S. customers; and does not restrict the United States government from submitting indictments against any person or entity, including officers and employees of Leumi Group.

Pursuant to the DPA agreement, inter alia, Leumi Group undertook, with regard to the following conditions: (a) Leumi Switzerland and Leumi Luxembourg will cease absolutely the provision of banking services to U.S. customers ("the exit plan"), within two years from the date of approval of the DPA by the Federal Court. The Bank will forward to the DOJ, bi-monthly reports regarding the compliance of Leumi Switzerland and Leumi Luxembourg with the "exit plan", commencing two months after the date of court approval; (b) The development and implementation of an effective program to guarantee compliance with the provisions of FATCA in the Bank and in all of its subsidiaries, while assimilating internal controls for the prevention of potential breaches (hereinafter – "the compliance with FATCA plan"); (c) The entry of the Bank and its subsidiaries (except for Leumi USA and as required by the FATCA regulations) into the Foreign Financial Institution (FFI) Agreement or Inter-governmental Agreement (IGA) for the implementation of FATCA; (d) The Bank will ensure that compliance with FATCA will include, inter alia: Appointing a global manager for the subject of cross-border activity, who will report to the Chief Risk Officer or Deputy President and CEO. The Cross Border Activity Manager should periodically report to the Audit Committee of the Leumi Israel Board of Directors on the subject of FATCA. (e) Continuing the employment of a designated coordinator for FATCA matters in the Bank, who will report to the Bank's Chief Compliance Officer; (f) Appointing compliance officers for FATCA in the Bank's offices –The compliance officers for FATCA will report to the compliance officers in each office and those, will report directly to the Risk Management Committee of the Board of Directors. On the basis of the abovementioned reports, the Board of Directors will forward, in each office, a status report in relation to compliance with FATCA in each place to the Board of Directors of the Bank; (g) Continuing development and assimilation of: effective controls intended to identify and prevent material breaches of compliance by Leumi Group of FATCA; an employee training program relating to the FATCA regulations and policy and procedures related to the receipt and examination of claims in relation to material failures in internal control on the matter of FATCA; (h) Implementing an updated corporate governance structure, pursuant to which the Chief Compliance Officer will have administrative responsibility for the functioning of the compliance units in all of the lines of business (including private banking) and joint administrative authority (with the direct managers) in relation to those units. In addition, the Chief Risk Officer will have powers to locate relevant topics at the Leumi Group level and to decide on matters of advancement and remuneration of compliance employees, at the level of each division; (i) Closing all of the accounts of recalcitrant customers in Leumi Group, as defined in the FATCA regulations, and determining and applying procedures for preventing assistance on the part of the employees of the group, to recalcitrant customers, in the processes for closing accounts or transferring their assets; (j) Opening new accounts

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

for U.S. customers only on condition that it is assured that they are declared and they will be available for reporting to the U.S. authorities; (k) Furnishing periodic reports of BLUSA in relation to loans which were extended by it and which are secured in SBLC on behalf of the Bank's offices outside the United States. The reports should include confirmation that BLUSA fully complies with the Prohibition of Money Laundering Regulations connected to these loans and that the relevant office has confirmed that the account extending the guarantee in the office complies with the conditions of FATCA. The first report is to be furnished two months following the date of approving the agreement and thereafter, every 180 days, until two years from the date of approving the agreement; (l) In addition, Leumi Group committed to cooperate fully with the U.S. authorities in the future including the retention of documents relating to the activities which are the subject of the DPA and their submission to the authorities, their translation and submission of information regarding some 1,500 customer accounts of the Bank and the Trust Company, pursuant to appropriate judicial orders.

In accordance with a consent order with the New York State Department of Financial Services (hereinafter: "NYDFS", and "the consent order", respectively), Leumi Group paid DFS a civil monetary penalty amounting to US$ 130 million. The consent order includes a list of facts, similar in nature to those set forth in the declaration of facts which represent an appendix to the DPA, for example: travel for banking purposes to the United States through April 2009; the extension of loans by BLUSA which were collected under a bank guarantee issued by the Bank, Leumi Luxembourg or Leumi Switzerland and secured by deposits which existed in those banks with the names of the U.S. customers not appearing on the correspondence related that activity; the provision of services and the maintenance of numbered Holdmail accounts, code and offshore companies and accounts in trust companies, while collecting commissions in respect of the aforesaid activity. In addition, in May 2008, when the DOJ's investigation against UBS became public, a number of senior managers in the Bank viewed the exit of UBS Bank from the U.S. international banking business as a golden opportunity to make contact with customers, and they urged bank officials to suggest that those customers transfer their accounts to the Bank. In addition, in October 2008, a version of an injunction issued by the U.S. authorities to Bank Mizrahi Tefahot reached managers in BLUSA. Nevertheless, Bank Leumi USA continued to extend SBLC loans, including to past customers of Bank Mizrahi, without checking or leaving records in relation to the securities. The number of senior officials operations, compliance and employees in Leumi Group's legal team knew of the improper conduct and despite this, instead of reporting it, actively supported it.

According to the agreement with the NYDFS, the Bank is obliged to comply with the following conditions: (a) Taking disciplinary steps against certain employees; (b) The compliance officer of BLUSA in the relevant period will not fulfill any position related to compliance; (c) Terminating the employment, subject to Israeli law, of an employee who held a central position in the activity outlined above, who was area manager in the relevant period; (d) In addition, the Bank confirmed that two other employees in key positions in the activity outlined above resigned from the Bank as a result of the investigation carried out by the NYDFS; (e) Appointing an independent monitor in BLUSA for a year, to be selected by the NYDFS, whose function is to examine the Bank's compliance program, including the policy and working processes in this context, in order to ensure their compliance with the requirements of the laws of the United States and the State of New York. Within this framework, the monitor is obliged to examine and report, at least, on the following subjects: (i) the Bank's corporate governance foundations and the involvement of the Bank's employees, including office-holders and Bank employees, past and present, in the violations outlined in the consent arrangement; (ii) the efficiency and effectiveness of the Bank's efforts to remedy the inappropriate behavior in the consent arrangement; (iii) an improvement in the Bank's compliance and reporting programs and plans which will assist the Bank in meeting the requirements of the laws of the United States and the State of New York in the future, and which will secure the Bank's security and strength; (f) The Bank and its management will cooperate fully with the monitor and will assist him, inter alia, by allowing access to the relevant Bank employees, files, reports and evidence, whether they are situated in New York, Israel or any other place; (g) Any dispute as regards the extent of authority of the monitor will be settled by the NYDFS after consultation with the Bank and with the monitor; (h) After three months, the monitor is to submit an interim report to the NYDFS and to the Bank, detailing his work and conclusions up to

## Note 18 - Contingent Liabilities and Special Commitments (cont'd)

the date of preparing the report. In addition, the monitor is to submit reports to NYDFS and to the Bank at the time intervals to be decided by the NYDFS; (i) After a year, the monitor is to submit the final report, which will include suggestions for improving the Bank's compliance programs in all matters related to the Laws of the USA and New York; (j) Within thirty days from the date of receiving the final report, the Bank is to furnish the NYDFS with a written program for improving its compliance programs in connection with the laws of the USA and New York. The program should outline the method of implementing the monitor's recommendations or include an explanation of why the recommendations of the monitor have not been implemented.

In order to comply with the provisions of the arrangements as aforesaid, the Bank has appointed a special steering committee which supervises the fulfillment of the Bank's and the offices' undertakings according to the arrangements and submits regular reports thereon to the Bank's management and Board of Directors.

As a result of the investigations, a numbers of actions have been served against the Bank and office-holders who served and who are serving in the Bank.

On 15 February 2015, the Board of Directors decided to establish an independent claims committee in order to make recommendations to the Board of Directors of the Bank on the correct legal course of action for the Bank, in view of all of the circumstances and proceedings relating to the events that led to the Bank's undertaking in arrangements with the U.S. authorities, including to examine (a)whether to serve, and in whose name, one or more monetary claims against any office-holder and/or employee, past or present in the Bank Group, in respect of damages caused to the Bank because of the events which are the subject of the arrangements; (b) whether to work towards one or more of the arrangements in the context of legal proceedings which are pending in connection with U.S. customers, and, if so, in whose name and under what conditions; (c) whether to serve, and in whose name, one or more monetary claims against any office-holder and/or employees, past or present, in the Bank Group, for the return of bonuses on the basis of profits which the corporations of the Bank generated over the years from the customers in relation to whom the Bank has arrived at arrangements with the U.S. authorities.

On 11 March 2015, the Tel-Aviv District Court approved the establishment of the independent claims committee and postponed proceedings in the action for four months, in order to enable the committee to complete its work.

As of the date of the Report, to the best of the Bank's knowledge, further examinations on the aforesaid events are being were carried out by the Supervisor of Banks and by the committee that was appointed by the Attorney-General.

# Note 18A – Derivative Instruments and Hedging Activities

**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.

- Market risks include risks due to changes in interest rates and in foreign exchange rates, the CPI and stock exchange prices/indices and commodity 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 trading volume or a low trading volume in 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 on consolidated basis

| | 31 December 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Interest rate contracts | | | | | |
| | Shekel – index | Other | Foreign currency contracts | Contracts in respect of shares | Commodities and other contracts | Total |
| | NIS millions | | | | | |
| **(1) Nominal amount of derivative instruments** | | | | | | |
| a. Hedging derivatives (a) | | | | | | |
| Forward contracts | - | - | - | - | - | - |
| Swaps | - | 2,468 | - | - | - | 2,468 |
| Total | - | 2,468 | - | - | - | 2,468 |
| Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest | - | 2,468 | - | - | - | 2,468 |
| b. ALM derivatives (a)(b) | | | | | | |
| Futures contracts | - | 12,153 | 372 | 55,940 | 460 | 68,925 |
| Forward contracts | 12,108 | 25,847 | 206,923 | 304 | 39 | 245,221 |
| Exchange-traded options | - | - | - | - | - | - |
| Options written | - | 498 | 17,647 | 12,678 | 56 | 30,879 |
| Options purchased | - | 498 | 17,842 | 12,678 | 56 | 31,074 |
| Other options | | | | | | |
| Options written | - | 12,962 | 30,441 | 2,545 | 242 | 46,190 |
| Options purchased | - | 10,494 | 28,756 | 2,174 | 270 | 41,694 |
| Swaps | 463 | 273,857 | 30,182 | 24,408 | 395 | 329,305 |
| Total | 12,571 | 336,309 | 332,163 | 110,727 | 1,518 | 793,288 |
| Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest | - | 130,205 | - | - | - | 130,205 |
| c. Other derivatives (a) | | | | | | |
| 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 | - | - | 18,397 | - | - | 18,397 |
| Total | - | - | 18,397 | - | - | 18,397 |
| Aggregate total | 12,571 | 338,777 | 350,560 | 110,727 | 1,518 | 814,153 |

(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 on consolidated basis (cont'd)

| | 31 December 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Interest rate contracts | | | | | |
| | Shekel – index | Other | Foreign currency contracts | Contracts in respect of shares | Commodities and other contracts | Total |
| | NIS millions | | | | | |
| **(2) Gross fair value of derivative instruments** | | | | | | |
| a. Hedging derivatives (a) | | | | | | |
| Gross positive fair value | **-** | **1** | **-** | **-** | **-** | **1** |
| Gross negative fair value | **-** | **166** | **-** | **-** | **-** | **166** |
| b. ALM derivatives (a)(b) | | | | | | |
| Gross positive fair value | **241** | **7,864** | **6,927** | **1,804** | **77** | **16,913** |
| Gross negative fair value | **254** | **7,462** | **5,926** | **1,800** | **76** | **15,518** |
| 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 institution is a beneficiary | | | | | | |
| Gross positive fair value | **-** | **-** | **-** | **-** | **-** | **-** |
| Gross negative fair value | **-** | **-** | **-** | **-** | **-** | **-** |
| e. Total | | | | | | |
| Gross positive fair value (c) | **241** | **7,865** | **6,927** | **1,804** | **77** | **16,914** |
| Fair value amounts offset in the balance sheet | **-** | **-** | **-** | **-** | **-** | **-** |
| Book value of assets in respect of derivative instruments | **241** | **7,865** | **6,927** | **1,804** | **77** | **16,914** |
| Of which: book value of assets in respect of derivative instruments not subject to a master netting arrangement or similar arrangements | **5** | **32** | **595** | **46** | **11** | **689** |
| Gross negative fair value (c) | **254** | **7,628** | **5,926** | **1,800** | **76** | **15,684** |
| Fair value amounts offset in the balance sheet | **-** | **-** | **-** | **-** | **-** | **-** |
| Book value of liabilities in respect of derivative instruments | **254** | **7,628** | **5,926** | **1,800** | **76** | **15,684** |
| Of which: book value of liabilities in respect of derivative instruments not subject to a master netting arrangement or similar arrangements | **-** | **9** | **574** | **296** | **12** | **891** |

(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) Of which: gross positive fair value of assets in respect of embedded derivative instruments in the amount of NIS 5 million (gross negative fair value of liabilities in respect of embedded derivative instruments in the amount of NIS 34 million).

## Note 18B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

### a. Scope of activity on consolidated basis (cont'd)

| | 31 December 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Interest rate contracts | | | | | |
| | Shekel – index | Other | Foreign currency contracts | Contracts in respect of shares | Commodities and other contracts | Total |
| | NIS millions | | | | | |
| **(1) Nominal amount of derivative instruments** | | | | | | |
| a. Hedging derivatives (a) | | | | | | |
| Forward contracts | - | - | 1,426 | - | - | 1,426 |
| Swaps | - | 2,581 | - | - | - | 2,581 |
| Total | - | 2,581 | 1,426 | - | - | 4,007 |
| Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest | - | 2,581 (c) | - | - | - | 2,581 |
| b. ALM derivatives (a)(b) | | | | | | |
| Futures contracts | - | 8,320 | 348 | 35,508 | 6,640 | 50,816 |
| Forward contracts | 12,072 | 12,015 | 126,909 | 3 | 181 | 151,180 |
| Exchange-traded options | - | - | - | - | - | - |
| Options written | - | 4,779 | 8,586 | 14,592 | 405 | 28,362 |
| Options purchased | - | 4,779 | 8,762 | 14,592 | 405 | 28,538 |
| Other options | - | - | - | - | - | - |
| Options written | - | 10,710 | 26,974 | 864 | 239 | 38,787 |
| Options purchased | - | 8,102 | 26,143 | 796 | 252 | 35,293 |
| Swaps | 678 | 287,880 | 26,099 | 12,251 | 197 | 327,105 |
| Total | 12,750 | 336,585 | 223,821 | 78,606 | 8,319 | 660,081 |
| Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest | - | 141,554 (c) | - | - | - | 141,554 |
| c. Other derivatives (a) | | | | | | |
| 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 | - | - | 6,543 | - | - | 6,543 |
| Total | - | - | 6,543 | - | - | 6,543 |
| Aggregate Total | 12,750 | 339,166 | 231,790 | 78,606 | 8,319 | 670,631 |

(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 on consolidated basis (cont'd)

| | 31 December 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Interest rate contracts | | | | | |
| | Shekel – index | Other | Foreign currency contracts | Contracts in respect of shares | Commodities and other contracts | Total |
| | NIS millions | | | | | |
| **(2) Gross fair value of derivative instruments** | | | | | | |
| a. Hedging derivatives (a) | | | | | | |
| Gross positive fair value | - | 36 | 37 | - | - | 73 |
| Gross negative fair value | - | 130 | 10 | - | - | 140 |
| b. ALM derivatives (a)(b) | | | | | | |
| Gross positive fair value | 118 | 7,928 | 3,275 | 1,557 | 103 | 12,981 |
| Gross negative fair value | 232 | 7,545 | 3,894 | 1,597 | 95 | 13,363 |
| 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 institution is a beneficiary | | | | | | |
| Gross positive fair value | - | - | - | - | - | - |
| Gross negative fair value | - | - | - | - | - | - |
| e. Total | | | | | | |
| Gross positive fair value | 118 | 7,964 | 3,312 | 1,557 | 103 | 13,054 |
| Fair value amounts offset in the balance sheet | - | - | - | - | - | - |
| Book value of assets in respect of derivative instruments | 118 | 7,964 | 3,312 | 1,557 | 103 | 13,054 |
| Of which: book value of assets in respect of derivative instruments not subject to a master netting arrangement or similar arrangements | 20 | 33 | 250 | 17 | 5 | 325 |
| Gross negative fair value (c) | 232 | 7,675 | 3,904 | 1,597 | 95 | 13,503 |
| Fair value amounts offset in the balance sheet | - | - | - | - | - | - |
| Book value of liabilities in respect of derivative instruments | 232 | 7,675 | 3,904 | 1,597 | 95 | 13,503 |
| Of which: book value of liabilities in respect of derivative instruments not subject to a master netting arrangement or similar arrangements | 54 | 35 | 528 | 315 | 4 | 936 |

(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) Of which: gross negative fair value of liabilities in respect of embedded derivative instruments in the amount of NIS 16 million.

## 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 on consolidated basis**

| | 31 December 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Stock Exchanges | Banks | Dealers/ Brokers | Governments and central banks | Others | Total |
| | NIS millions | | | | | |
| Book balance of assets in respect of derivative instruments (a) (b) | **304** | **9,533** | **2,560** | **6** | **4,511** | **16,914** |
| Gross amounts not offset in the balance sheet: | **-** | **-** | **-** | **-** | **-** | **-** |
| Mitigation of credit risk in respect of financial instruments | **-** | **3,504** | **1,140** | **6** | **888** | **5,538** |
| Mitigation of credit risk in respect of cash collateral received | **-** | **1,015** | **409** | **-** | **-** | **1,424** |
| Net amount of assets in respect of derivative instruments | **304** | **5,014** | **1,011** | **-** | **3,623** | **9,952** |
| Off-balance sheet credit risk in respect of derivative instruments (d) | **-** | **4,089** | **1,196** | **87** | **3,525** | **8,897** |
| Mitigation of off-balance sheet credit risk | **-** | **253** | **71** | **52** | **1,011** | **1,387** |
| Net off-balance sheet credit risk in respect of derivative instruments | **-** | **3,836** | **1,125** | **35** | **2,514** | **7,510** |
| Total credit risk in respect of derivative instruments | **304** | **8,850** | **2,136** | **35** | **6,137** | **17,462** |
| Book balance of liabilities in respect of derivative instruments (a)(c) | **328** | **8,642** | **2,292** | **114** | **4,308** | **15,684** |
| Gross amounts not offset in the balance sheet: | **-** | **-** | **-** | **-** | **-** | **-** |
| Financial instruments | **-** | **3,504** | **1,140** | **6** | **888** | **5,538** |
| Cash collateral pledged | **-** | **695** | **58** | **97** | **101** | **951** |
| Net amount of liabilities in respect of derivative instruments | **328** | **4,443** | **1,094** | **11** | **3,319** | **9,195** |

## 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 on consolidated basis (cont'd)**

| | 31 December 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Stock Exchanges | Banks | Dealers/ Brokers | Governments and central banks | Others | Total |
| | NIS millions | | | | | |
| Book balance of assets in respect of derivative instruments (a) (b) | 139 | 8,722 | 1,933 | 85 | 2,175 | 13,054 |
| Gross amounts not offset in the balance sheet: | - | - | - | - | - | - |
| Mitigation of credit risk in respect of financial instruments | - | 6,652 | 1,755 | - | 821 | 9,228 |
| Mitigation of credit risk in respect of cash collateral received | - | 938 | 90 | 32 | 43 | 1,103 |
| Net amount of assets in respect of derivative instruments | 139 | 1,132 | 88 | 53 | 1,311 | 2,723 |
| Off-balance sheet credit risk in respect of derivative instruments (d) | - | 10,519 | 2,269 | 326 | 11,123 | 24,237 |
| Mitigation of off-balance sheet credit risk | - | 3,290 | 448 | - | 2,960 | 6,698 |
| Net off-balance sheet credit risk in respect of derivative instruments | - | 7,229 | 1,821 | 326 | 8,163 | 17,539 |
| Total credit risk in respect of derivative instruments | 139 | 8,361 | 1,909 | 379 | 9,474 | 20,262 |
| Book balance of liabilities in respect of derivative instruments (a)(c) | 317 | 7,542 | 1,824 | - | 3,820 | 13,503 |
| Gross amounts not offset in the balance sheet: | - | - | - | - | - | - |
| Financial instruments | - | 6,652 | 1,755 | - | 821 | 9,228 |
| Cash collateral pledged | - | 468 | 2 | - | - | 470 |
| Net amount of liabilities in respect of derivative instruments | 317 | 422 | 67 | - | 2,999 | 3,805 |

(a) The Bank did not set off net accounting arrangements.

(b) Of which a book balance of assets in respect of stand-alone derivative instruments in the sum of NIS 16,909 million (31 December 2013 – NIS 13,054 million).

(c) Of which a book balance of liabilities in respect of stand-alone derivative instruments in the sum of NIS 15,650 million (31 December 2013 – NIS 13,487 million).

(d) 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 on consolidated basis

| | 31 December 2014 | | | | |
|---|---|---|---|---|---|
| | Up to three months | From three months to one year | From one to five years | Over five years | Total |
| | NIS millions | | | | |
| **Interest contracts:** | | | | | |
| Shekel – index | **1,297** | **3,203** | **5,696** | **2,375** | **12,571** |
| Other | **18,043** | **75,505** | **158,142** | **87,087** | **338,777** |
| Foreign currency contracts | **221,191** | **91,815** | **19,825** | **17,729** | **350,560** |
| Contracts in respect of shares | **92,157** | **16,928** | **1,642** | **-** | **110,727** |
| Commodities and other contracts | **1,009** | **471** | **38** | **-** | **1,518** |
| Total | **333,697** | **187,922** | **185,343** | **107,191** | **814,153** |

| | 31 December 2013 | | | | |
|---|---|---|---|---|---|
| | Up to three months | From three months to one year | From one to five years | Over five years | Total |
| | NIS millions | | | | |
| **Interest contracts:** | | | | | |
| Shekel – index | 2,151 | 5,044 | 3,748 | 1,807 | 12,750 |
| Other | 36,396 | 62,942 | 145,728 | 94,100 | 339,166 |
| Foreign currency contracts | 151,743 | 47,581 | 11,385 | 21,081 | 231,790 |
| Contracts in respect of shares | 69,192 | 8,597 | 817 | - | 78,606 |
| Commodities and other contracts | 2,214 | 6,079 | 26 | - | 8,319 |
| Total | 261,696 | 130,243 | 161,704 | 116,988 | 670,631 |

## Note 18C – Balances and fair value assessments of financial instruments on consolidated basis

### 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 impaired debts was calculated using interest rates that reflect the inherent high credit risk. In any case, these interest rates reflect the highest rates of interest used by the Group in transactions on the reporting date in the same segment.

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 for credit losses.

## Note 18C – Balances and fair value assessments of financial instruments on consolidated basis (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 default 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 on consolidated basis (cont'd)

| | 31 December 2014 | | | | |
|---|---|---|---|---|---|
| | Book value | Fair value | | | |
| | | Level 1 (a) | Level 2 (a) | Level 3 (a) | Total |
| | NIS millions | | | | |
| **Financial assets** | | | | | |
| Cash and deposits with banks | **60,615** | **43,671** | **15,617** | **1,367** | **60,655** |
| Securities (b) | **52,113** | **30,526** | **17,982** | **3,605** | **52,113** |
| Securities borrowed or purchased under agreements to resell | **2,000** | **2,000** | **-** | **-** | **2,000** |
| Credit to the public, net | **252,480** | **2,109** | **58,238** | **193,571** | **253,918** |
| Credit to governments | **528** | **-** | **51** | **491** | **542** |
| Assets in respect of derivative instruments | **16,909** | **1,360** | **12,546** | **3,003** | **16,909** |
| Other financial assets | **875** | **188** | **-** | **687** | **875** |
| Total financial assets | **385,520** (c) | **79,854** | **104,434** | **202,724** | **387,012** |
| **Financial liabilities** | **-** | **-** | **-** | **-** | **-** |
| Deposits of the public | **303,397** | **2,682** | **169,062** | **134,079** | **305,823** |
| Deposits from banks | **4,556** | **-** | **4,313** | **218** | **4,531** |
| Deposits from governments | **467** | **-** | **400** | **95** | **495** |
| Securities loaned or sold under agreements to repurchase | **1,238** | **1,238** | **-** | **-** | **1,238** |
| Debentures, bonds and subordinated notes | **23,678** | **18,960** | **382** | **6,604** | **25,946** |
| Liabilities in respect of derivative instruments | **15,650** | **1,306** | **14,193** | **151** | **15,650** |
| Other financial liabilities | **7,990** | **176** | **-** | **7,815** | **7,991** |
| Total financial liabilities | **356,976** (c) | **24,362** | **188,350** | **148,962** | **361,674** |
| **Off-balance sheet financial instruments** | **-** | **-** | **-** | **-** | **-** |
| Transactions in which the balance reflects a credit risk | **356** | **-** | **-** | **356** | **356** |

(a) 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.

(b) For further details of the book value and fair value of securities, see Note on Securities.

(c) Of which assets and liabilities of NIS 105,782 million and NIS 132,246 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 on consolidated basis (cont'd)

| | 31 December 2013 | | | | |
|---|---|---|---|---|---|
| | Book | Fair value | | | |
| | value | Level 1 (a) | Level 2 (a) | Level 3 (a) | Total |
| | NIS millions | | | | |
| **Financial assets** | | | | | |
| Cash and deposits with banks | 44,351 | 32,061 | 11,492 | 823 | 44,376 |
| Securities (b) | 63,735 | 45,164 | 15,339 | 3,232 | 63,735 |
| Securities borrowed or purchased under agreements to resell | 1,360 | 1,360 | - | - | 1,360 |
| Credit to the public, net | 240,874 | 2,585 | 67,719 | 172,110 | 242,414 |
| Credit to governments | 558 | - | 47 | 537 | 584 |
| Assets in respect of derivative instruments | 13,054 | 1,272 | 9,971 | 1,811 | 13,054 |
| Other financial assets | 963 | 148 | - | 815 | 963 |
| Total financial assets | 364,895 (c) | 82,590 | 104,568 | 179,328 | 366,486 |
| **Financial liabilities** | - | - | - | - | - |
| Deposits of the public | 286,003 | 2,828 | 141,591 | 143,385 | 287,804 |
| Deposits from banks | 4,310 | - | 3,862 | 434 | 4,296 |
| Deposits from governments | 397 | - | 331 | 83 | 414 |
| Securities loaned or sold under agreements to repurchase | 624 | 624 | - | - | 624 |
| Debentures, bonds and subordinated notes | 25,441 | 22,881 | 387 | 4,816 | 28,084 |
| Liabilities in respect of derivative instruments | 13,487 | 1,281 | 11,827 | 379 | 13,487 |
| Other financial liabilities | 7,779 | 148 | - | 7,590 | 7,738 |
| Total financial liabilities | 338,041 (c) | 27,762 | 157,998 | 156,687 | 342,447 |
| **Off-balance sheet financial instruments** | - | - | - | - | - |
| Transactions in which the balance reflects a credit risk | 289 | - | - | 289 | 289 |

(a) 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.

(b) For further details of the book value and fair value of securities, see Note on Securities.

(c) Of which assets and liabilities of NIS 113,851 million and NIS 94,586 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 consolidated basis

### (a) Items measured for fair value on a recurring basis on consolidated basis

| | 31 December 2014 | | | |
|---|---|---|---|---|
| | 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 | | | |
| **Assets** | | | | |
| **Securities available for sale:** | | | | |
| Israeli government bonds | **12,678** | **1,612** | **-** | **14,290** |
| Foreign government bonds | **3,944** | **771** | **-** | **4,715** |
| Bonds of Israeli financial institutions | **18** | **47** | **-** | **65** |
| Bonds of financial institutions abroad | **409** | **5,267** | **-** | **5,676** |
| Asset-backed (ABS) or mortgage-backed (MBS) bonds | **-** | **5,678** | **2,009** | **7,687** |
| Other bonds in Israel | **641** | **266** | **-** | **907** |
| Other bonds abroad | **1,026** | **1,576** | **-** | **2,602** |
| Shares and mutual funds available for sale | **1,584** | **-** | **-** | **1,584** |
| Total securities available for sale | **20,300** | **15,217** | **2,009** | **37,526** |
| **Securities held for trading:** | | | | |
| Israeli government bonds | **7,523** | **392** | **-** | **7,915** |
| Foreign government bonds | **496** | **9** | **-** | **505** |
| Bonds of Israeli financial institutions | **374** | **-** | **-** | **374** |
| Bonds of financial institutions abroad | **-** | **266** | **-** | **266** |
| Asset-backed (ABS) or mortgage-backed (MBS) bonds | **-** | **1,438** | **-** | **1,438** |
| Other bonds in Israel | **319** | **-** | **-** | **319** |
| Other bonds abroad | **-** | **660** | **-** | **660** |
| Shares and mutual funds held for trading | **1,514** | **-** | **-** | **1,514** |
| Total securities held for trading | **10,226** | **2,765** | **-** | **12,991** |
| **Assets in respect of derivative instruments:** | | | | |
| Shekel-index contracts | **-** | **96** | **145** | **241** |
| Interest contracts | **9** | **7,428** | **423** | **7,860** |
| Foreign currency contracts | **5** | **4,366** | **2,307** | **6,678** |
| Share contracts | **707** | **656** | **64** | **1,427** |
| Commodity and other contracts | **13** | **-** | **64** | **77** |
| Activity in the Maof market | **626** | **-** | **-** | **626** |
| Total assets in respect of derivative instruments | **1,360** | **12,546** | **3,003** | **16,909** |
| **Others:** | | | | |
| Credit and deposits in respect of the lending of securities | **2,109** | **5** | **-** | **2,114** |
| Securities borrowed or purchased under agreements to resell | **2,000** | **-** | **-** | **2,000** |
| Other | **181** | **-** | **-** | **181** |
| Total others | **4,290** | **5** | **-** | **4,295** |
| **Total assets** | **36,176** | **30,533** | **5,012** | **71,721** |

## Note 18D – Items measured for fair value on consolidated basis (cont'd)

### (a) Items measured for fair value on a recurring basis on consolidated basis (cont'd)

| | 31 December 2014 | | | |
|---|---|---|---|---|
| | 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 | | | |
| **Liabilities:** | | | | |
| **Liabilities in respect of derivative instruments:** | | | | |
| Shekel-index contracts | **-** | **213** | **41** | **254** |
| Interest contracts | **9** | **7,619** | **-** | **7,628** |
| Foreign currency contracts | **5** | **5,582** | **110** | **5,697** |
| Share contracts | **707** | **715** | **-** | **1,422** |
| Commodity and other contracts | **12** | **64** | **-** | **76** |
| Activity in the Maof market | **573** | **-** | **-** | **573** |
| Total liabilities in respect of derivative instruments | **1,306** | **14,193** | **151** | **15,650** |
| **Others:** | | | | |
| Deposits in respect of the lending of securities | **2,680** | **23** | **11** | **2,714** |
| Securities loaned or sold under agreements to repurchase | **1,238** | **-** | **-** | **1,238** |
| Other | **176** | **-** | **-** | **176** |
| Total others | **4,094** | **23** | **11** | **4,128** |
| **Total liabilities** | **5,400** | **14,216** | **162** | **19,778** |

## Note 18D – Items measured for fair value on consolidated basis (cont'd)

### (a) Items measured for fair value on a recurring basis on consolidated basis (cont'd)

| | 31 December 2013 | | | |
|---|---|---|---|---|
| | 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 | | | |
| **Assets** | | | | |
| **Securities available for sale:** | | | | |
| Israeli government bonds | 29,185 | 1,551 | - | 30,736 |
| Foreign government bonds | 3,087 | 749 | 7 | 3,843 |
| Bonds of Israeli financial institutions | 45 | 60 | - | 105 |
| Bonds of financial institutions abroad | 371 | 4,789 | 120 | 5,280 |
| Asset-backed (ABS) or mortgage-backed (MBS) | 97 | 5,516 | 1,733 | 7,346 |
| Other bonds in Israel | 381 | 331 | 9 | 721 |
| Other bonds abroad | 821 | 1,181 | - | 2,002 |
| Shares and mutual funds available for sale | 1,465 | - | - | 1,465 |
| Total securities available for sale | 35,452 | 14,177 | 1,869 | 51,498 |
| **Securities held for trading:** | | | | |
| Israeli government bonds | 7,104 | - | - | 7,104 |
| Foreign government bonds | 772 | 256 | - | 1,028 |
| Bonds of Israeli financial institutions | 327 | - | - | 327 |
| Bonds of financial institutions abroad | - | 116 | - | 116 |
| Asset-backed (ABS) or mortgage-backed (MBS) | - | 279 | - | 279 |
| Other bonds in Israel | 409 | - | - | 409 |
| Other bonds abroad | 9 | 511 | - | 520 |
| Shares and mutual funds held for trading | 1,091 | - | - | 1,091 |
| Total securities held for trading | 9,712 | 1,162 | - | 10,874 |
| **Assets in respect of derivative instruments:** | | | | |
| Shekel-index contracts | - | 32 | 86 | 118 |
| Interest contracts | 22 | 7,551 | 391 | 7,964 |
| Foreign currency contracts | 5 | 1,834 | 1,334 | 3,173 |
| Share contracts | 739 | 510 | - | 1,249 |
| Commodity and other contracts | 59 | 44 | - | 103 |
| Activity in the Maof market | 447 | - | - | 447 |
| Total assets in respect of derivative instruments | 1,272 | 9,971 | 1,811 | 13,054 |
| **Others:** | | | | |
| Credit and deposits in respect of the lending of securities | 2,585 | - | - | 2,585 |
| Securities borrowed or purchased under agreements to resell | 1,360 | - | - | 1,360 |
| Other | 148 | - | - | 148 |
| Total others | 4,093 | - | - | 4,093 |
| **Total assets** | 50,529 | 25,310 | 3,680 | 79,519 |

## Note 18D – Items measured for fair value on consolidated basis (cont'd)

### (a) Items measured for fair value on a recurring basis on consolidated basis (cont'd)

| | 31 December 2013 | | | |
|---|---|---|---|---|
| | 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 | | | |
| **Liabilities:** | | | | |
| **Liabilities in respect of derivative instruments:** | | | | |
| Shekel-index contracts | - | 157 | 75 | 232 |
| Interest contracts | 22 | 7,653 | - | 7,675 |
| Foreign currency contracts | 14 | 3,430 | 304 | 3,748 |
| Share contracts | 739 | 551 | - | 1,290 |
| Commodity and other contracts | 59 | 36 | - | 95 |
| Activity in the Maof market | 447 | - | - | 447 |
| Total liabilities in respect of derivative instruments | 1,281 | 11,827 | 379 | 13,487 |
| **Others:** | | | | |
| Deposits in respect of the lending of securities | 2,828 | 17 | - | 2,845 |
| Securities loaned or sold under agreements to repurchase | 624 | - | - | 624 |
| Other | 148 | - | - | 148 |
| Total others | 3,600 | 17 | - | 3,617 |
| **Total liabilities** | 4,881 | 11,844 | 379 | 17,104 |

## Note 18D – Items measured for fair value on consolidated basis (cont'd)

### (b) Items measured for fair value on a non-recurring basis on consolidated basis

| | **31 December 2014** | | | | |
|---|---|---|---|---|---|
| | 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 | Total profit (loss) from changes in value for the period |
| | NIS millions | | | | |
| Collateral-dependent impaired credit | **-** | **-** | **1,518** | **1,518** | **(274)** |
| Other assets | **-** | **-** | **-** | **-** | **-** |
| **Total** | **-** | **-** | **1,518** | **1,518** | **(274)** |

| | 31 December 2013 | | | | |
|---|---|---|---|---|---|
| | 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 | Total profit (loss) from changes in value for the period |
| | NIS millions | | | | |
| Collateral-dependent impaired credit | - | - | 2,119 | 2,119 | (236) |
| Other assets | - | - | - | - | - |
| **Total** | - | - | 2,119 | 2,119 | (236) |

## Note 18E – Changes in items measured for fair value on a recurring basis included in Level 3 on consolidated basis (cont'd)

| | For the year ended 31 December 2014 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Total realized and unrealized profits (losses) | | | | | | | | | |
| | Fair value at beginning of the year | In profit and loss | In other compre-hensive profit | Acquisitions and issues | Sales | Extinguish-ments | Adjustments from translation of financial statements | Transfers to Level 3 | Transfers from Level 3 | Fair value at 31 December 2014 | Unrealized profits (losses) in respect of instruments held at 31 December 2014 |
| | NIS millions | | | | | | | | | | |
| **Assets** | | | | | | | | | | | |
| **Securities available for sale:** | | | | | | | | | | | |
| Israeli government bonds | - | - | - | - | - | - | - | - | - | - | - |
| Foreign government bonds | **7** | - | - | - | **(7)** | - | - | - | - | - | - |
| Bonds of financial institutions in Israel | - | - | - | - | - | - | - | - | - | - | - |
| Bonds of financial institutions abroad | **120** | **(1)** | - | - | - | **(119)** | - | - | - | - | - |
| ABS / MBS | **1,733** | **77** | **(5)** | **557** | **(160)** | **(192)** | **(1)** | - | - | **2,009** | **289** |
| Others in Israel | **9** | - | - | - | - | **(9)** | - | - | - | - | - |
| Others abroad | - | - | - | - | - | - | - | - | - | - | - |
| Total bonds available for sale | **1,869** | **76** | **(5)** | **557** | **(167)** | **(320)** | **(1)** | - | - | **2,009** | **289** |
| Shares available for sale | - | - | - | - | - | - | - | - | - | - | - |
| Total bonds for trading | - | - | - | - | - | - | - | - | - | - | - |
| Shares for trading | - | - | - | - | - | - | - | - | - | - | - |
| **Assets in respect of derivative instruments:** | | | | | | | | | | | |
| Shekel-index contracts | **86** | **18** | - | - | - | - | - | **41** | - | **145** | **88** |
| Interest contracts | **391** | **137** | - | - | - | **(105)** | - | - | - | **423** | **73** |
| Foreign currency contracts | **1,334** | **(622)** | - | **1,595** | - | - | - | - | - | **2,307** | **2,046** |
| Share contracts | - | **64** | - | - | - | - | - | - | - | **64** | **64** |
| Commodity and other contracts | - | **64** | - | - | - | - | - | - | - | **64** | **64** |
| Activity in the Maof market | - | - | - | - | - | - | - | - | - | - | - |
| Total assets in respect of derivative instruments | **1,811** | **(339)** | - | **1,595** | - | **(105)** | - | **41** | - | **3,003** | **2,335** |
| Total others | - | - | - | - | - | - | - | - | - | - | - |
| **Total assets** | **3,680** | **(263)** | **(5)** | **2,152** | **(167)** | **(425)** | **(1)** | **41** | - | **5,012** | **2,624** |
| **Liabilities** | | | | | | | | | | | |
| **Liabilities in respect of derivative instruments:** | | | | | | | | | | | |
| Shekel-index contracts | **75** | **(71)** | - | - | - | - | - | **37** | - | **41** | **38** |
| Interest contracts | - | - | - | - | - | - | - | - | - | - | - |
| Foreign currency contracts | **304** | **(194)** | - | - | - | - | - | - | - | **110** | **(181)** |
| Share contracts | - | - | - | - | - | - | - | - | - | - | - |
| Commodity and other contracts | - | - | - | - | - | - | - | - | - | - | - |
| Activity in the Maof market | - | - | - | - | - | - | - | - | - | - | - |
| Total liabilities in respect of derivative instruments | **379** | **(265)** | - | - | - | - | - | **37** | - | **151** | **(143)** |
| Total others | - | **11** | - | - | - | - | - | - | - | **11** | **11** |
| **Total liabilities** | **379** | **(254)** | - | - | - | - | - | **37** | - | **162** | **(132)** |

## Note 18E – Changes in items measured for fair value on a recurring basis included in Level 3 on consolidated basis (cont'd)

| | For the year ended 31 December 2013 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Total realized and unrealized profits (losses) | | | | | | | | | |
| | Fair value at beginning of the year | In profit and loss | In other compre-hensive profit | Acquisitions and issues | Sales | Extinguish-ments | Adjustments from translation of financial statements | Transfers to Level 3 | Transfers from Level 3 | Fair value at 31 December 2013 | Unrealized profits (losses) in respect of instruments held at 31 December 2013 |
| | NIS millions | | | | | | | | | | |
| **Assets** | | | | | | | | | | | |
| **Securities available for sale:** | | | | | | | | | | | |
| Israeli government bonds | - | - | - | - | - | - | - | - | - | - | - |
| Foreign government bonds | 11 | (1) | - | - | (4) | - | 1 | - | - | 7 | - |
| Bonds of financial institutions in Israel | - | - | - | - | - | - | - | - | - | - | - |
| Bonds of financial institutions abroad | 123 | (2) | - | - | - | (1) | - | - | - | 120 | - |
| ABS / MBS | 1,401 | (97) | (15) | 1,006 | (445) | (118) | 1 | - | - | 1,733 | 8 |
| Others in Israel | - | (8) | - | - | - | (2) | - | 19 | - | 9 | - |
| Others abroad | 74 | (1) | - | - | - | (73) | - | - | - | - | - |
| Total bonds available for sale | 1,609 | (109) | (15) | 1,006 | (449) | (194) | 2 | 19 | - | 1,869 | 8 |
| Shares available for sale | - | - | - | - | - | - | - | - | - | - | - |
| Total bonds for trading | - | - | - | - | - | - | - | - | - | - | - |
| Shares for trading | - | - | - | - | - | - | - | - | - | - | - |
| **Assets in respect of derivative instruments:** | | | | | | | | | | | |
| Shekel-index contracts | 117 | (55) | - | - | - | - | - | 38 | (14) | 86 | 37 |
| Interest contracts | 573 | (99) | - | - | - | (83) | - | - | - | 391 | (364) |
| Foreign currency contracts | 619 | (482) | - | 1,197 | - | - | - | - | - | 1,334 | (98) |
| Share contracts | 14 | (14) | - | - | - | - | - | - | - | - | - |
| Commodity and other contracts | 12 | (12) | - | - | - | - | - | - | - | - | - |
| Activity in the Maof market | - | - | - | - | - | - | - | - | - | - | - |
| Total assets in respect of derivative instruments | 1,335 | (662) | - | 1,197 | - | (83) | - | 38 | (14) | 1,811 | (425) |
| Total others | - | - | - | - | - | - | - | - | - | - | - |
| **Total assets** | 2,944 | (771) | (15) | 2,203 | (449) | (277) | 2 | 57 | (14) | 3,680 | (417) |
| **Liabilities** | | | | | | | | | | | |
| **Liabilities in respect of derivative instruments:** | | | | | | | | | | | |
| Shekel-index contracts | 154 | (76) | - | - | - | - | - | 19 | (22) | 75 | (66) |
| Interest contracts | - | - | - | - | - | - | - | - | - | - | - |
| Foreign currency contracts | 318 | (14) | - | - | - | - | - | - | - | 304 | 13 |
| Share contracts | - | - | - | - | - | - | - | - | - | - | - |
| contracts | - | - | - | - | - | - | - | - | - | - | - |
| Activity in the Maof market | - | - | - | - | - | - | - | - | - | - | - |
| Total liabilities in respect of derivative instruments | 472 | (90) | - | - | - | - | - | 19 | (22) | 379 | (53) |
| Total others | - | - | - | - | - | - | - | - | - | - | - |
| **Total liabilities** | 472 | (90) | - | - | - | - | - | 19 | (22) | 379 | (53) |

## Note 18F – Quantitative information on items measured for fair value included in Level 3 on consolidated basis

### As at 31 December 2014

### A. Quantitative information regarding fair value measurement in Level 3 (in NIS millions)

| | Fair value | Assessment technique | Unobservable inputs | Range | Average (3) |
|---|---|---|---|---|---|
| **A. Items measured for fair value on a recurring basis** | | | | | |
| **Assets** | | | | | |
| **Securities available for sale (1)** | | | | | |
| Asset-backed securities (ABS) or Mortgage-backed securities (MBS) | 2,009 | Discounting cash flows | Margin | 70-160 bp | 115 bp |
| | | | Probability of default | 2.5%-6% | 4.25% |
| | | | Rate of early repayment | 20% | 20% |
| | | | Loss rate | 30% | 30% |
| **Assets in respect of derivative instruments (2)** | | | | | |
| Shekel-index interest contracts | 89 | Discounting cash flows | Inflation forecasts | 0.1%-0.39% | 0.25% |
| | 56 | Discounting cash flows | Transaction counterparty risk | 0.03%-100% (*) | 1.69% |
| Interest contracts | 423 | Discounting cash flows | Transaction counterparty risk | 0.03%-100% (*) | 1.69% |
| Foreign currency contracts | 178 | Discounting cash flows | Inflation forecasts | 0.1%-0.39% | 0.25% |
| | 2,129 | Discounting cash flows | Transaction counterparty risk | 0.03%-100% (*) | 1.69% |
| Shares contracts | 64 | Discounting cash flows | Transaction counterparty risk | 0.03%-100% (*) | 1.69% |
| Commodities contracts | 64 | Discounting cash flows | Transaction counterparty risk | 0.03%-100% (*) | 1.69% |
| **Liabilities** | | | | | |
| **Liabilities in respect of derivative instruments (2)** | | | | | |
| Interest contracts | 41 | Discounting cash flows | Inflation forecasts | 0.1%-0.39% | 0.25% |
| Foreign currency contracts | 110 | Discounting cash flows | Inflation forecasts | 0.1%-0.39% | 0.25% |
| **B. Items measured for fair value on a non-recurring basis** | | | | | |
| Collateral-contingent impaired debt | 1,518 | Fair value of collateral | | | |

* In respect of a failed counterparty.

### B. Qualitative information regarding fair value measurement in Level 3

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. Unobservable inputs used for the fair value measurement of derivatives are the credit risk of the counterparty to the transaction and the forecast rate of inflation. The higher/lower the credit risk of the counterparty to the transaction, the lower/higher will be the fair value of the transaction.
   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 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 fair value of the transactions will increase (decrease).
3. The average figure referring to the unobservable parameter of "Transaction counterparty risk" reflects a weighted average.

## Note 18G – Quantitative information on items measured for fair value included in Level 3 on consolidated basis (cont'd)

### As at 31 December 2013

### A. Quantitative information regarding fair value measurement in Level 3 (in NIS million)

| | Fair value | Assessment technique | Unobservable inputs | Range | Average (3) |
|---|---|---|---|---|---|
| **A. Items measured for fair value on a recurring basis** | | | | | |
| **Assets** | | | | | |
| **Securities available for sale (1)** | | | | | |
| Asset-backed securities (ABS) or Mortgage-backed securities (MBS) | 1,733 | Discounting cash flows | Margin | 75-240 bp | 167 bp |
| | | | Probability of default | 2.5%-6% | 4.25% |
| | | | Rate of early repayment | 10%-20% | 15% |
| | | | Loss rate | 30%-40% | 35% |
| **Assets in respect of derivative instruments (2)** | | | | | |
| Shekel-index interest contracts | 86 | Discounting cash flows | Inflation forecasts | 0.19%-1.66% | 0.90% |
| Interest contracts | 391 | Discounting cash flows | Transaction counterparty risk | 0.03%-100%(*) | 1.34% |
| Foreign currency contracts | 247 | Discounting cash flows | Inflation forecasts | 0.19%-1.66% | 0.90% |
| | 1,087 | Discounting cash flows | Transaction counterparty risk | 0.03%-100%(*) | 1.34% |
| **Liabilities** | | | | | |
| **Liabilities in respect of derivative instruments (2)** | | | | | |
| Interest contracts | 75 | Discounting cash flows | Inflation forecasts | 0.19%-1.66% | 0.90% |
| Foreign currency contracts | 304 | Discounting cash flows | Inflation forecasts | 0.19%-1.66% | 0.90% |
| **B. Items measured for fair value on a non-recurring basis** | | | | | |
| Collateral-contingent impaired debt | 2,119 | Fair value of collateral | | | |

* In respect of a failed counterparty.

### B. Qualitative information regarding fair value measurement in Level 3

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. Unobservable inputs used for the fair value measurement of derivatives are the credit risk of the counterparty to the transaction and the forecast rate of inflation. The more the credit risk of the counterparty to the transaction increases (decreases), the fair value of the transactions will decrease (increase).
   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 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 fair value of the transactions will increase (decrease).

3. The average figure relating to the unobservable parameter of "transaction counterparty risk" reflects a weighted average.

## Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies

**Control of the Bank**

**Bank without a controlling core**

As of 24 March 2012, the Bank is defined, pursuant to the provisions of the law, as a banking corporation without a controlling core and with no shareholder specified as the controlling shareholder in the Bank.

On 2 October 2014, the Bank was notified that Shlomo Eliahu Holdings Ltd. ("Shlomo Eliahu"), which holds securities of the Bank and which, together with companies of the Migdal Holdings Insurance and Finance Group Ltd. ("Migdal"), are considered as interested parties in the Bank by virtue of their joint holdings, sold its entire holdings in the shares of the Bank. As a result of the abovementioned sale, Shlomo Eliahu and Migdal ceased to be interested parties in the Bank.

For updated information regarding the holdings of interested parties in the Bank, see Immediate Report on the state of the holdings of interested parties and senior officers, dated 5 February 2015.

## Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies

### A. Balance sheet and off-balance sheet balances

| | 31 December 2014 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 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:** | | | | | | | | | | | | | |
| Deposits in banks | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Securities (e) | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Credit to the public | - | - | 17 | 18 | - | - | 942 | - | - | 539 | 539 | 1,303 | 1,700 |
| Allowance for credit losses | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Credit to the public, net | - | - | 17 | 18 | - | - | 942 | - | - | 539 | 539 | 1,303 | 1,700 |
| Investments in companies included on equity basis (e) | - | - | - | - | - | - | - | - | - | 2,216 | 2,216 | - | - |
| Other assets | - | - | - | - | - | - | 86 | - | - | 6 | 7 | 51 | 76 |
| **Liabilities:** | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Deposits of the public | - | - | 37 | 39 | 3 | 3 | 7,383 | 3 | 3 | 2,511 | 2,727 | 919 | 1,102 |
| Deposits from banks | - | - | - | - | - | - | - | - | - | 1 | 25 | - | - |
| Debentures, bonds and subordinated notes | - | - | 2 | 2 | - | - | 2,784 | - | - | - | - | - | - |
| Other liabilities | - | - | 2 | 3 | - | - | 120 | - | - | 35 | 102 | 20 | 82 |
| Credit risk in off-balance sheet items (g) | - | - | 12 | 12 | - | - | 630 | - | - | 46 | 46 | 616 | 811 |

(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 2014, holdings of interested parties and related parties in the equity of the Bank were NIS 125,076 nominal value of shares in the Bank.

(g) Credit risk in 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. Balance sheet and off-balance sheet balances (cont'd)

| | 31 December 2013 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 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:** | | | | | | | | | | | | | |
| Deposits in banks | - | - | - | - | - | - | 7 | - | - | - | - | - | - |
| Securities (e) | - | - | - | - | - | - | 293 | - | - | - | - | - | - |
| Credit to the public, net | 173 | 173 | 37 | 37 | 941 | 941 | 2,137 | - | - | 253 | 331 | 1,648 | 2,103 |
| Investments in companies included on equity basis (e) (h) | - | - | - | - | - | - | - | - | - | 1,689 | 2,122 | - | - |
| Other assets | - | - | - | - | 129 | 129 | 176 | - | - | 5 | 19 | 10 | 42 |
| **Liabilities:** | | | | | | | | | | | | | |
| Deposits of the public | 29 | 36 | 29 | 41 | 8,544 | 8,544 | 6,240 | 6 | 17 | 859 | 1,322 | 369 | 531 |
| Deposits from banks | - | - | - | - | - | - | 190 | - | - | 24 | 38 | - | - |
| Debentures, bonds and subordinated notes | - | - | 2 | 2 | 3,232 | 3,232 | 684 | 2 | 3 | - | - | - | - |
| Other liabilities | - | - | 3 | 3 | 180 | 180 | 383 | - | - | 104 | 120 | 63 | 84 |
| Credit risk in off-balance sheet items (g) | - | 10 | 18 | 18 | 1,856 | 1,856 | 1,695 | - | - | 37 | 73 | 996 | 996 |

(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 2013, holdings of interested parties and related parties in the equity of the Bank were NIS 177,108,758 nominal value of shares in the Bank.

(g) Credit risk in 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

| | **2014** | | | | | |
|---|---|---|---|---|---|---|
| | Interested parties | | | Related parties held by the banking corporation | | |
| | Shareholders Controlling owners | Key management personnel (a) | Others (b) | Subsidiaries (unconsolidated) | Companies on equity basis or companies held under joint control | Others (c) |
| | (NIS millions) | | | | | |
| Net interest income (expenses) | **-** | **-** | **(16)** | **-** | **5** | **70** |
| Non-interest income (expenses) | **(1)** | **-** | **(54)** | **-** | **(38)** | **53** |
| Of which: management fees and services | **-** | **-** | **14** | **-** | **-** | **8** |
| Operating and other expenses (e | **-** | **(49)** | **1** | **-** | **(26)** | **-** |
| Total | **(1)** | **(49)** | **(69)** | **-** | **(59)** | **123** |

| | 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Interested parties | | | Related parties held by the banking corporation | | |
| | Shareholders Controlling owners | Key management personnel (a) | Others (b) | Subsidiaries (unconsolidated) | Companies on equity basis or companies held under joint control | Others (c) |
| | (NIS millions) | | | | | |
| Net interest income (expenses) | 59 | 1 | (321) | (4) | 7 | 87 |
| Non-interest income (expenses) | - | - | (589) | - | (31) | (8) |
| Of which: management fees and services | - | - | 16 | - | - | 12 |
| Operating and other expenses (e | - | (76) | 44 | - | (19) | - |
| Total | 59 | (75) | (866) | (4) | (43) | 79 |

| | 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Interested parties | | | Related parties held by the banking corporation | | |
| | Shareholders Controlling owners | Key management personnel (a) | Others (b) | Subsidiaries (unconsolidated) | Companies on equity basis or companies held under joint control | Others (c) |
| | (NIS millions) | | | | | |
| Net interest income (expenses) (d) | 15 | (1) | (18) | - | 2 | 83 |
| Non-interest income (expenses) | (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 |

(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

| | **2014** | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|
| | 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 banking corporation or on its behalf (a) (b) (c) | **36** | **23** | 62 | 28 | 57 | 24 |
| Directors not employed by the banking corporation or on its behalf (a) | **10** | **16** | 11 | 14 | 11 | 16 |

(a) Does not include salary tax expenses.

(b) Of which: short term employee benefits NIS 27 million, post retirement benefits NIS 9 million, other long term benefits NIS 0 million (2013 - short term employee benefits NIS 46 million, post retirement benefits NIS 6 million, other long term benefits NIS 0 million; 2012 - short term employee benefits NIS 36 million, post retirement benefits NIS 20 million, other long term benefits NIS 1 million).

(c) In 2014 no share-based payments were made (in 2013 - NIS 10 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 3,219 thousand (2013 - NIS 3,351 thousand, 2012 – NIS 2,901 thousand).

### D. Total interest income, net before expenses in respect of credit losses in transactions by the Bank and consolidated companies with interested parties and related parties

| | **2014** | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|
| | **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) | | (NIS millions) | | (NIS millions) | |
| **a) In respect of assets** | | | | | | |
| From credit to the public | **101** | **11** | 183 | 13 | 123 | 15 |
| **b) In respect of liabilities** | | | | | | |
| On deposits of the public | **(37)** | **(6)** | (204) | (6) | (24) | (12) |
| On deposits from banks | **-** | **-** | (11) | - | (1) | (1) |
| On other liabilities | **(5)** | **-** | (139) | - | (17) | - |
| Total interest income, net | **59** | **5** | (171) | 7 | 81 | 2 |

## Note 20 – Interest income and expenses

| | **2014** | 2013 | 2012 |
|---|---|---|---|
| | NIS millions | | |
| **A. Interest income** (a) | | | |
| Credit to the public | **9,053** | 10,678 | 11,578 |
| Credit to governments | **18** | 23 | 21 |
| Deposits with banks | **82** | 75 | 95 |
| Deposits with Bank of Israel and cash | **146** | 316 | 515 |
| Interest income from securities borrowed or purchased under agreements to resell | **11** | 20 | 45 |
| Bonds (b) | **702** | 1,022 | 1,253 |
| Total interest income | **10,012** | 12,134 | 13,507 |
| **B. Interest expenses** (a) | | | |
| Deposits of the public | **(1,585)** | (3,149) | (4,441) |
| Deposits from governments | **(6)** | (8) | (14) |
| Deposits from banks | **(46)** | (37) | (58) |
| Debentures, bonds and subordinated notes | **(9)** | (14) | (31) |
| Interest expense from securities loaned or sold under agreements to repurchase | **(1,003)** | (1,569) | (1,555) |
| Total interest expenses | **(2,649)** | (4,777) | (6,099) |
| **Total interest income, net** | **7,363** | 7,357 | 7,408 |
| **C. Details of the net effect of hedging derivative financial instruments on interest income and expenses (b)** | | | |
| Interest income | **(45)** | (49) | (50) |
| Interest expenses | **-** | - | (9) |
| **D. Details of interest income on accrual basis from bonds** | | | |
| Available for sale | **593** | 814 | 966 |
| Held for trading | **109** | 208 | 287 |
| Total included in interest income | **702** | 1,022 | 1,253 |

(a) Including effective component of hedge relationships.

(b) Including interest in respect of mortgage-backed bonds (MBS) in the amount of NIS 77 million (2013 - NIS 125 million, 2012 - NIS 68 million).

(c) Details of effect of hedging derivative instruments in sub-paragraphs A. and B.

## Note 21 – Non-interest financing income

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | 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 (a) | **10** | 12 | 6 |
| Net income (expenses) in respect of ALM derivative instruments (b) | **1,909** | (1,392) | (690) |
| Total from activities in derivative instruments | **1,919** | (1,380) | (684) |
| **A.2 From investment in bonds** | | | |
| Gains on sale of debentures available for sale (i) | **208** | 225 | 313 |
| Losses on sale of debentures available for sale (g) (i) | **(3)** | (16) | (22) |
| Total from investment in debentures | **205** | 209 | 291 |
| **A.3 Exchange rate differentials, net** | **(2,252)** | 1,580 | 597 |
| **A.4 Gains (losses) on investment in shares** | | | |
| Gains from sale of shares available for sale (d) (i) | **497** | 616 | 81 |
| Losses on sale of shares available for sale (h) (i) | **(55)** | (78) | (171) |
| Gain from sale of shares in companies included on equity basis | **-** | 18 | 24 |
| Dividend from shares available for sale | **10** | 27 | 54 |
| Loss on sale of shares in companies included on equity basis | **-** | (3) | - |
| Total from investment in shares | **452** | 580 | (12) |
| **A.5 Gains (losses), net in respect of loans sold (c)** | **28** | 99 | - |
| **Total non-interest financing income in respect of activities not for trading purposes** | **352** | 1,088 | 192 |
| **B. Non-interest financing income from activities for trading purposes** | | | |
| Net income in respect of other derivative instruments | **(13)** | 4 | 11 |
| Realized and unrealized profits (losses) from fair value adjustment of bonds for trading, net (e) | **423** | (54) | 229 |
| Realized and unrealized profits from fair value adjustment of shares for trading, net (f) | **33** | 89 | 10 |
| Dividend received from shares held for trading | **-** | - | 2 |
| Total from trading activities | **443** | 39 | 252 |
| **Total non-interest financing income in respect of activities not for trading purposes** | **795** | 1,127 | 444 |

(a) Excluding effective component of hedging relationships.

(b) Derivative instruments which constitute part of the Bank's assets and liability management system and were not designated for hedging relationships.

(c) During 2014 loans were sold in the amount of NIS 344 million (2013 – NIS 713 million).

(d) Including mainly profit on the sale of Tower, Mobileye, Partner, and Otzar Hityashvet Hayehudit in the amounts of NIS 150 million, NIS 144 million, NIS 70 million, and NIS 30 million, respectively, before the effect of tax (2013 - Migdal and Caesarstone in the amounts of NIS 358 million, and NIS 86 million, respectively).

(e) Of which part of the profits (losses) of NIS 33 million (2013 and 2012 - NIS 26 million and NIS 192 million, respectively), relating to bonds held for trading still held as of balance sheet date.

(f) Of which part of the profits (losses) of NIS 58 million (2013 and 2012 - NIS 76 million and NIS 12 million, respectively), relating to shares held for trading still held as of balance sheet date.

(g) Including provisions for impairment relating to bonds held for trading in the amount of NIS 1 million (2013 – NIS 11 million).

(h) Including provisions for impairment relating to shares held for trading in the amount of NIS 12 million (2013 – NIS 7 million; 2012 - NIS 160 million).

(i) Classified to accumulated other comprehensive income.

## Note 22 – Commissions

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | NIS millions | | |
| Ledger fees | **821** | 833 | 868 |
| Conversion differences | **318** | 289 | 298 |
| Handling of credit | **196** | 332 | 358 |
| Commissions for distribution of financial products (a) | **244** | 202 | 185 |
| Foreign trade activities | **117** | 122 | 129 |
| Income from transactions in securities and certain derivative instruments | **816** | 817 | 835 |
| Credit cards | **939** | 907 | 864 |
| Management fees and commission on life insurance and home insurance | **42** | 47 | 42 |
| Net income from servicing credit portfolios | **30** | 31 | 37 |
| Management, operations, and custody for institutional entities (b) | **50** | 57 | 51 |
| Commissions on financing transactions | **487** | 450 | 425 |
| Other commissions | **107** | 101 | 107 |
| Total operating commissions | **4,167** | 4,188 | 4,199 |

(1) Mainly distribution fees of mutual funds.
(2) Mainly operations of provident funds.

## Note 23 - Other Income

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | NIS millions | | |
| Profit from the realization of assets received for settlement of loans | **1** | 1 | 1 |
| Profits from severance pay funds | **71** | 129 | 95 |
| Capital gain from sale of buildings and equipment | **85** | 35 | 6 |
| Capital loss from sale of buildings and equipment | **(1)** | (4) | (4) |
| Other, net | **55** | 41 | 33 |
| Total other income | **211** | 202 | 131 |

## Note 24 - Salaries and Related Expenses

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | NIS millions | | |
| Salaries | **3,015** | 3,210 | 3,024 |
| Early retirement expenses (a) | **-** | 75 | 323 |
| Severance pay, provident fund, training fund, pension, vacation and long service bonus | **1,134** | 939 | 729 |
| Expense deriving from share-based payment transactions | **-** | 10 | - |
| National Insurance and VAT on salaries | **714** | 755 | 655 |
| Other related expenses | **199** | 208 | 217 |
| Supplementary provisions for related expenses as a result of changes in salaries in the accounting year | **(94)** | (64) (b) | 362 (b) |
| Total salaries and related expenses | **4,968** | 5,133 | 5,310 |
| Of which: salaries and related expenses abroad | **685** | 525 | 642 |

(a) Expenses related to early retirement of employees as part of the plan for structural change in the Bank.

(b) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

## Note 25 - Other Expenses

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | NIS millions | | |
| Marketing and advertising | **280** | 274 | 267 |
| Legal, audit and professional consultants | **294** | 285 | 321 |
| Communications - postage, telephone, delivery services, etc. | **159** | 171 | 171 |
| Computers (a) | **197** | 240 | 240 |
| Office expenses | **75** | 74 | 79 |
| Insurance | **29** | 26 | 21 |
| Training | **22** | 22 | 19 |
| Commissions | **187** | 164 | 162 |
| Loss in respect of assets received in settlement of loans | **(1)** | 3 | 12 |
| Other (b) (c) | **1,265** | 579 | 676 |
| Total other expenses | **2,507** | 1,838 | 1,968 |

(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.C.

(c) Including expenses in respect of the investigation by US authorities, about NIS 1,026 million (2013 - NIS 236 million, 2012 – NIS 400 million) – see Note 18.K.

# Note 26 – Provision for taxes on profit

## A. Composition

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | NIS millions | | |
| **Current taxes:** | | | |
| In respect of current year | **1,506** | 1,419 | 1,400 |
| In respect of prior years | **(54)** | 99 | 46 |
| Total current taxes | **1,452** | 1,518 | 1,446 |
| Add (less) changes in deferred taxes | | | |
| In respect of accounting year (a) | **(171)** | 25 | (593) |
| In respect of prior years (a) | **-** | (146) | (53) |
| Total changes in deferred taxes | **(171)** | (121) | (646) |
| Provision for taxes on income | **1,281** | 1,397 | 800 |
| Of which: provision for taxes abroad | **13** | 61 | 74 |
| **Deferred taxes:** | | | |
| Creation and reversal of temporary differences | **(171)** | 25 | (593) |
| Change in tax rate | **-** | (146) | (53) |
| Total deferred taxes | **(171)** | (121) | (646) |

(a) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

## B. Reconciliation between the theoretical amount of tax applicable if the profit were liable for tax at the statutory rate of tax in Israel, and the provision for taxes on the profit appearing in the statement of profit and loss:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | **37.7%** | 36.2% | 35.5% |
| | NIS millions | | |
| **Statutory tax rate applying to a banking corporation** | | | |
| Tax at the statutory tax rate | **1,038** | 1,345 | 648 |
| Tax (tax saving) resulting from: | | | |
| Income of foreign consolidated companies | **(21)** | 29 | 2 |
| Tax exempt and at preferred rates | **(40)** | (19) | (17) |
| Depreciation differences, depreciation adjustment and capital gain | **(6)** | 25 | 4 |
| Other non-deductible expenses | **444** | 93 | 171 |
| Timing differences for which deferred taxes have not been recorded | **(53)** | (42) | (12) |
| Income of Israeli consolidated companies | **(66)** | (33) | (25) |
| Change in deferred taxes due to change in tax rates | **-** | (146) | (53) |
| Taxes in respect of prior years | **(54)** | 99 | 46 |
| Other | **39** | 46 | 36 |
| Provision for taxes on profit | **1,281** | 1,397 | 800 |

.

## Note 26 – Provision for taxes on profit (cont'd)

**Changes in tax legislation**

The rate of profits tax and payroll tax applying to financial institutions is 18% from 2 June 2013.

The rate of companies tax is 26.5% from 1 January 2014 (in 2013 – 25%).

The statutory rate of tax applying to financial institutions in 2014 and thereafter is 37.71% (in 2013 – 36.21%).

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. In addition, on 27 January 2014, the Reliefs and Encouraging of Activity in the Capital Market (Legislative Amendments) Law, 2014 was published, pursuant to which the rate of insurance collected from employers in respect of the part of the salary exceeding 60% of the average salary in the economy will increase in January 2014, January 2015, and January 2016 to 6.75%, 7.25%, 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 2014 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.

**C.** On 26 February 2008, the Amendment to the Income Tax (Adjustments for Inflation) Law, 1985 (hereinafter – the Adjustments Law) 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.** 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.

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.

## Note 26 – Provision for taxes on profit (cont'd)

**E.** Final assessments have been issued to the Bank and the principal consolidated companies for all years up to and including the tax year 2010.

**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 95 million (31 December 2013 – about NIS 63 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. 1. Components of deferred tax assets and the deferred tax reserve are as follows:

| | **2014** | 2013 | **2014** | 2013 |
|---|---|---|---|---|
| | NIS millions | | Average tax rate in percent | |
| **Deferred tax assets** | | | | |
| From allowance for credit losses | **1,197** | 1,077 | **38%** | 38% |
| From provision for vacation and bonuses | **355** | 349 | **38%** | 38% |
| From surplus provision for severance pay and pension over funds allocated (a) (b) | **1,829** | 1,787 | **38%** | 38% |
| From interest not credited to current income | **61** | 72 | **41%** | 40% |
| From tax deductions carried forward | **21** | 55 | **25%** | 36% |
| From activity abroad | **6** | 7 | **38%** | 38% |
| From securities | **-** | 30 | **-** | 42% |
| From adjustment of depreciable non-monetary assets | **-** | 5 | **-** | 22% |
| Other – from non-monetary assets | **85** | 63 | **24%** | 21% |
| Total | **3,554** | 3,445 | | |
| **Deferred tax reserve** | | | | |
| From securities | **(69)** | - | **24%** | - |
| In respect of investments in investee companies | **(181)** | (106) | **22%** | 22% |
| From tax deductions carried forward | **(257)** | (264) | **34%** | 36% |
| From activity abroad | **(24)** | (22) | **38%** | 38% |
| From adjustment of depreciable non-monetary assets | **(49)** | (58) | **26%** | 28% |
| From activity abroad | **(580)** | (450) | | |
| Deferred taxes receivable, net | **2,974** | 2,995 | | |
| Deferred taxes included: (a) | | | | |
| In "Other assets" (b) | **3,194** | 3,135 | | |
| In "Other liabilities" | **(220)** | (140) | | |
| Deferred tax assets, net | **2,974** | 2,995 | | |

(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.

(b) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

## Note 26 – Provision for taxes on profit (cont'd)

**G. 2. Movement in deferred tax assets and liabilities relating to the following items:**

| **For the period ended 31 December 2014** | | | | |
|---|---|---|---|---|
| | 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 |
| | (NIS millions) | | | |
| Balance of deferred tax asset (liability) at 1 January 2014 | **1,077** | **349** | **1,787** | **72** |
| Changes charged to profit and loss | **120** | **6** | **42** | **(11)** |
| Changes charged to equity | **-** | **-** | **-** | **-** |
| Adjustments from translation of financial statements | - | - | - | - |
| Balance of deferred tax asset (liability) at 31 December 2014 | **1,197** | **355** | **1,829** | **61** |
| Deferred tax asset | **1,197** | **355** | **1,829** | **61** |
| Balances available for offsetting | | | | |
| Deferred tax asset at 31 December 2014 | | | | |
| Deferred tax liability | **-** | **-** | **-** | **-** |
| Balances available for offsetting | | | | |
| Deferred tax liability at 31 December 2014 | | | | |

| For the period ended 31 December 2013 | | | | |
|---|---|---|---|---|
| | Allowance for credit losses | Provision for vacation and bonuses | Surplus of funds over reserve for severance pay and pension (a) | Interest not charged to annual income |
| | NIS millions | | | |
| Balance of deferred tax asset (liability) at 1 January 2013 | 1,020 | 325 | 1,771 | 70 |
| Changes charged to profit and loss | 9 | 7 | (69) | 2 |
| Changes charged to equity | - | - | - | - |
| Adjustments from translation of financial statements | - | - | - | - |
| Effect of the change in the rate of tax | 48 | 17 | 85 | - |
| Balance of deferred tax asset (liability) at 31 December 2013 | 1,077 | 349 | 1,787 | 72 |
| Deferred tax asset | 1,077 | 349 | 1,787 | 72 |
| Balances available for offsetting | | | | |
| Deferred tax asset at 31 December 2013 | | | | |
| Deferred tax liability | - | - | - | - |
| Balances available for offsetting | | | | |
| Deferred tax liability at 31 December 2013 | | | | |

(a) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.
(b) Reclassified.

| Deductions 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 |
|---|---|---|---|---|---|---|---|
| **55** | **7** | **30** | **(106)** | **(259)** | **(22)** | **5** | **2,995** |
| **(34)** | **65** | **41** | **(186)** | **2** | **(2)** | **31** | **74** |
| **-** | **(41)** | **(140)** | **111** | **-** | **-** | **-** | **(70)** |
| - | (25) | - | - | - | - | - | (25) |
| **21** | **6** | **(69)** | **(181)** | **(257)** | **(24)** | **36** | **2,974** |
| **21** | **6** | **-** | **-** | **-** | **-** | **85** | **3,554** |
| | | | | | | | **(360)** |
| | | | | | | | **3,194** |
| **-** | **-** | **(69)** | **(181)** | **(257)** | **(24)** | **(49)** | **(580)** |
| | | | | | | | **(360)** |
| | | | | | | | **(220)** |

| Deductions 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 |
|---|---|---|---|---|---|---|---|
| 70 | 3 | (135) | (191) | (256) | (22) | (16) | 2,639 |
| (15) | (36) | (40) | 161 | (3) | - | 21 | 37 |
| - | 23 | 203 | (70) | - | - | - | 156 |
| - | 17 | - | - | - | - | - | 17 |
| - | - | 2 | (6) | - | - | - | 146 |
| 55 | 7 | 30 | (106) | (259) | (22) | 5 | 2,995 |
| 55 | 7 | 30 | - | 5 | - | 63 | 3,445 |
| | | | | | | | (310) |
| | | | | | | | 3,135 |
| - | - | - | (106) | (264) | (22) | (58) | (450) |
| | | | | | | | (310) |
| | | | | | | | (140) |

# Note 26 – Provision for taxes on profit (cont'd)

**G.** **3. Taxes on income recognized directly in equity:**

| | **2014** | | | 2013 (b) | | | 2012 (b) | | |
|---|---|---|---|---|---|---|---|---|---|
| | 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 | **459** | **41** | **418** | (318) | (23) | (295) | (53) | 6 | (59) |
| Profits (losses) net in respect of net hedges of investments in foreign currency | **(267)** | **(98)** | **(169)** | 203 | 73 | 130 | 4 | 1 | 3 |
| Financial assets available for sale | **355** | **140** | **215** | (518) | (203) | (315) | 1,067 | 354 | 713 |
| Other comprehensive income in respect of companies included on equity basis | **(108)** | **(30)** | **(78)** | (6) | 6 | (12) | - | - | - |
| Retained earnings in respect of companies included on equity basis | **92** | **17** | **75** | 26 | (9) | 35 | (11) | (2) | (9) |
| Change in accounting method for accumulating employee rights (a) | **-** | **-** | **-** | - | - | - | 496 | 174 | 322 |
| Implementation of IAS 12 | **-** | **-** | **-** | - | - | - | - | 43 | (43) |
| Total taxes recognized in equity | **531** | **70** | **461** | (613) | (156) | (457) | 1,503 | 576 | 927 |

(a) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.
(b) Reclassified.

**H.** Deferred taxes have been calculated at the statutory tax rate applying to the companies at the time of utilization.

**I.** Under an arrangement with the tax authorities from 14 April 2005, the Bank is entitled as from 2004 to offset, 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, whichever the lower. Under a further letter for the arrangement on 29 June 2014, the Bank is permitted commencing in the 2011 tax year to offset US$ 54 million but no more than US$ 3 million per year or the tax liability in Israel, whichever the lower. If the offset amount is less than US$ 3 million in a specific year, the difference between the offset amount and US$ 3 million may be carried forward and offset in future years, so that the offset amount in the year will be up to US$ 5 million of the tax liability in Israel, whichever the lower. The amounts not yet offset from the tax liability and in respect of which a future tax saving was not recorded in the balance sheet as of 31 December 2014 are about US$ 45 million. Utilization of these amounts in the future will be possible if the total tax rate applicable to the Bank on its income in Israel is higher than the tax rate to applicable to the foreign subsidiaries.

## Note 27 – Operating segments and geographic areas

**Description of Operating Segments**

The Bank in Israel is organized in four business lines. 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 lines.

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 Operating Segments**

**Pursuant to Bank of Israel directives, an operating 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 operating 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 in all stages of their lives.

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

3. Corporate Banking - providing banking and financial services to major companies and international companies in the economy for their operations in Israel and abroad, and providing banking and financial services for the construction and real estate sector.

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 to private customers 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 and investing 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 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 operating segment is carried out according to quantitative criteria and additional criteria, such as: size of the approved facility and business turnover, 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/operating 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 held.

**Financial Measurement System**

The basis of the current system ("Bachan 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 operating 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 whose functional currency is the same as the functional currency of the Bank.

### 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 1 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 2 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. Interest income from management of the nostro is recorded 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 pursuant to the directives of the Bank of Israel.

## Note 27 – Operating segments and geographic areas (cont'd)

**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. This pricing is a system in which the transaction cost is calculated taking into account the type of transaction, the type of customer performing it, and the channel in which the transaction was performed.

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, a comparison is made of the rate of Return on Risk-Adjusted Capital (RORAC) of operating segments according to the standardized approach. In addition, reference is made also in internal measurement of the risk-adjusted return according to the advances approach. 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 First Pillar principles in Basel. Credit risks are calculated on the basis of weighted risk assets in the units, and operational and market risks 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.

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 (Pillar 1 capital, Pillar 2 capital and the balance of the capital in respect of extreme scenarios and the balance of equity).

.

# Note 27 – Operating segments and geographic areas (cont'd)

## A. Information on operating segments

### for the year ended 31 December 2014

| | Household segment | Small Business segment | Corporate segment | Commer -cial segment | Private Banking segment | Financial Manage -ment segment | Other | Total consol- idated |
|---|---|---|---|---|---|---|---|---|
| | NIS millions | | | | | | | |
| **Interest income, net:** | | | | | | | | |
| From outside entities - | **3,057** | **1,170** | **1,936** | **1,658** | **(8)** | **(450)** | **-** | **7,363** |
| Intersegmental - | **(430)** | **(130)** | **(684)** | **(195)** | **290** | **1,137** | **12** | **-** |
| **Non-interest income:** | | | | | | | | |
| From outside entities - | **1,639** | **548** | **1,137** | **521** | **567** | **694** | **67** | **5,173** |
| Intersegmental - | **181** | **(40)** | **(364)** | **50** | **30** | **118** | **25** | **-** |
| **Total income** | **4,447** | **1,548** | **2,025** | **2,034** | **879** | **1,499** | **104** | **12,536** |
| **Expenses (income) in respect of credit losses** | **407** | **182** | **(489)** | **153** | **14** | **205** | **-** | **472** |
| **Operating and other expenses** | **3,791** | **876** | **635** | **1,024** | **1,927** | **1,099** | **(41)** | **9,311** |
| **Profit before taxes** | **249** | **490** | **1,879** | **857** | **(1,062)** | **195** | **145** | **2,753** |
| Provision for taxes | **76** | **195** | **704** | **327** | **(15)** | **(31)** | **25** | **1,281** |
| **Profit (loss) after taxes** | **173** | **295** | **1,175** | **530** | **(1,047)** | **226** | **120** | **1,472** |
| Group equity in after-tax operating profits of companies included on equity basis, net of tax effect | **5** | **-** | **-** | **-** | **-** | **37** | **-** | **42** |
| **Net profit (loss)** | | | | | | | | |
| Before attribution to non-controlling interests | **178** | **295** | **1,175** | **530** | **(1,047)** | **263** | **120** | **1,514** |
| Attributable to non-controlling interests | **(30)** | **(3)** | **(5)** | **(3)** | **29** | **-** | **-** | **(12)** |
| **Attributable to shareholders of the banking corporation** | **148** | **292** | **1,170** | **527** | **(1,018)** | **263** | **120** | **1,502** |
| Return on capital (percentage profit on relative share of equity of the segment in risk assets), attributed to shareholders of the banking corporation | **2.1%** | **14.4%** | **14.9%** | **10.1%** | **(112.0%)** | **8.2%** | **14.9%** | **5.5%** |

# Note 27 – Operating segments and geographic areas (cont'd)

| | Household segment | Small Business segment | Corporate segment | Commer-cial segment | Private Banking segment | Financial Manage-ment segment | Other | Total consol-idated |
|---|---|---|---|---|---|---|---|---|
| | NIS millions | | | | | | | |
| Average balance of assets | **105,959** | **23,953** | **60,920** | **53,365** | **10,638** | **114,850** | **8,365** | **378,050** |
| Including: investments in companies included on equity basis | **2** | **-** | **-** | **-** | **-** | **1,845** | **-** | **1,847** |
| Average balance of liabilities | **117,416** | **24,913** | **28,386** | **60,197** | **35,218** | **81,919** | **2,458** | **350,507** |
| Average balance of risk assets | **75,690** | **21,259** | **84,375** | **54,199** | **7,749** | **35,403** | **8,711** | **287,386** |
| Average balance of assets of mutual funds and training funds | **76,133** | **4,188** | **1,879** | **5,967** | **10,926** | **113,742** | **-** | **212,835** |
| Average balance of securities | **47,523** | **9,162** | **58,714** | **49,329** | **79,493** | **376,643** | **-** | **620,864** |
| Average balance of other assets under management | **3,586** | **184** | **192** | **497** | **82** | **-** | **1** | **4,542** |
| Interest income, net: | | | | | | | | |
| Margin on credit-granting activities | **2,092** | **908** | **1,220** | **1,163** | **86** | **3,804** | **12** | **9,285** |
| Margin on deposit-taking activities | **535** | **132** | **32** | **300** | **196** | **(3,117)** | **-** | **(1,922)** |
| **Total interest income, net** | **2,627** | **1,040** | **1,252** | **1,463** | **282** | **687** | **12** | **7,363** |

## Note 27 – Operating segments and geographic areas (cont'd)

### A. Information on operating segments (cont'd)

**for the year ended 31 December 2013[a]**

| | Household segment | Small Business segment | Corporate segment | Commer-cial segment | Private Banking segment | Financial Manage-ment segment | Other | Total consol-idated |
|---|---|---|---|---|---|---|---|---|
| | NIS millions | | | | | | | |
| **Interest income, net:** | | | | | | | | |
| From outside entities - | 2,941 | 1,125 | 2,528 | 1,656 | (72) | (821) | - | 7,357 |
| Intersegmental - | (294) | (177) | (1,144) | (282) | 364 | 1,521 | 12 | - |
| **Non-interest income:** | | | | | | | | |
| From outside entities - | 1,640 | 588 | 80 | 492 | 533 | 2,040 | 144 | 5,517 |
| Intersegmental - | 166 | (42) | 567 | 83 | 77 | (733) | (118) | - |
| **Total income** | 4,453 | 1,494 | 2,031 | 1,949 | 902 | 2,007 | 38 | 12,874 |
| **Expenses (income) in respect of credit losses** | 179 | 112 | (166) | 186 | 9 | (52) | - | 268 |
| **Operating and other expenses** | 4,094 | 931 | 688 | 1,076 | 1,108 | 1,055 | (60) | 8,892 |
| **Profit (loss) before taxes** | 180 | 451 | 1,509 | 687 | (215) | 1,004 | 98 | 3,714 |
| Provision for (benefit from) taxes | 49 | 160 | 537 | 275 | 16 | 303 | 57 | 1,397 |
| **Profit (loss) after taxes** | 131 | 291 | 972 | 412 | (231) | 701 | 41 | 2,317 |
| Group equity in after-tax operating profits of companies included on equity basis, net of tax effect | 4 | - | - | - | - | (297) | - | (293) |
| **Net profit (loss)** | | | | | | | | |
| Before attribution to non-controlling interests | 135 | 291 | 972 | 412 | (231) | 404 | 41 | 2,024 |
| Attributable to non-controlling interests | (27) | (4) | (6) | (3) | (4) | 2 | - | (42) |
| **Attributable to shareholders of the banking corporation** | 108 | 287 | 966 | 409 | (235) | 406 | 41 | 1,982 |
| Return on capital (percentage profit on relative share of equity of the segment in risk assets), attributed to shareholders of the banking corporation | 1.9% | 17.3% | 12.0% | 9.1% | (24.8%) | 10.1% | 8.4% | 7.8% |

## Note 27 – Operating segments and geographic areas (cont'd)

| | Household segment | Small Business segment | Corporate segment | Commer-cial segment | Private Banking segment | Financial Manage-ment segment | Other | Total consol-idated |
|---|---|---|---|---|---|---|---|---|
| | NIS millions | | | | | | | |
| Average balance of assets | 96,033 | 22,599 | 66,634 | 51,342 | 11,864 | 113,601 | 8,058 | 370,131 |
| Including: investments in companies included on equity basis | 2 | - | - | - | - | 1,971 | - | 1,973 |
| Average balance of liabilities | 124,043 | 22,704 | 27,548 | 51,626 | 36,884 | 79,208 | 2,740 | 344,753 |
| Average balance of risk assets | 68,277 | 19,898 | 90,729 | 53,726 | 9,285 | 32,304 | 6,625 | 280,844 |
| Average balance of assets of mutual funds and training funds | 63,654 | 3,091 | 2,366 | 5,153 | 8,181 | 95,879 | - | 178,324 |
| Average balance of securities | 48,172 | 6,914 | 59,121 | 46,652 | 77,301 | 307,190 | - | 545,350 |
| Average balance of other assets under management | 4,357 | 210 | 212 | 653 | 188 | - | 2 | 5,622 |
| Interest income, net: | | | | | | | | |
| Margin on credit-granting activities | 1,858 | 788 | 1,336 | 1,082 | 86 | 6,265 | 12 | 11,427 |
| Margin on deposit-taking activities | 789 | 160 | 48 | 292 | 206 | (5,565) | - | (4,070) |
| **Total interest income, net** | 2,647 | 948 | 1,384 | 1,374 | 292 | 700 | 12 | 7,357 |

(a) Reclassified.

# Note 27 – Operating segments and geographic areas (cont'd)

## A. Information on operating segments (cont'd)

**for the year ended 31 December 2012**

| | Household segment | Small Business segment | Corporate segment | Commer -cial segment | Private Banking segment | Financial Manage -ment 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 | 586(a) | 517 | 606 | 872 (a) | 20 | 4,774 |
| Intersegmental - | 230 | (44) | 52(a) | 39 | 51 | (273) (a) | (55) | - |
| **Total income** | 4,651 | 1,431 | 2,186 | 1,947 | 1,007 | 981 | (21) | 12,182 |
| **Expenses (income) in respect of credit losses** | 71 | 84 | 933 | 176 | 1 | (29) | - | 1,236 |
| **Operating and other expenses** | 3,872 | 858 | 651 | 1,083 | 898 | 1,826 (b) | (68) | 9,120 |
| **Profit (loss) before taxes** | 708 | 489 | 602 | 688 | 108 | (816) | 47 | 1,826 |
| Provision for (benefit from) taxes | 236 | 167 | 204 | 252 | 31 | (258) (b) | 168 | 800 |
| **Profit (loss) after taxes** | 472 | 322 | 398 | 436 | 77 | (558) | (121) | 1,026 |
| Companies included on equity basis after the effect of taxes | 2 | - | - | - | - | (69) | - | (67) |
| Before attribution to non-controlling interests | 474 | 322 | 398 | 436 | 77 | (627) | (121) | 959 |
| Attributable to non-controlling interests | (27) | (3) | (5) | (2) | - | - | - | (37) |
| **Attributable to shareholders of the banking corporation** | 447 | 319 | 393 | 434 | 77 | (627) | (121) | 922 |
| Return on capital (percentage profit on relative share of equity of the segment in risk assets), attributed to shareholders of the banking corporation | 9.6% | 21.1% | 4.3% | 10.0% | 7.9% | (18.3%) | (29.0%) | 3.8% |

## Note 27 – Operating segments and geographic areas (cont'd)

| | Household segment | Small Business segment | Corporate segment | Commer-cial segment | Private Banking segment | Financial Manage-ment segment | Other | Total consol-idated |
|---|---|---|---|---|---|---|---|---|
| | NIS millions | | | | | | | |
| Average balance of assets | 87,317 | 20,788 | 76,624 | 51,196 | 13,315 | 111,914(b) | 6,262 | 367,416 |
| Including: investments in companies included on equity basis | 2 | - | - | - | - | 2,201 | - | 2,203 |
| Average balance of liabilities | 133,814 | 20,213 | 30,280 | 50,486 | 39,536 | 66,743(b) | 1,793 | 342,865 |
| 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 | 4,898 (a) | 56,944 | 42,919 | 77,169(a) | 249,613 (a) | - | 480,708 |
| Average balance of other assets under management | 5,134 | 226 | 226 | 685 | 227 | - | 8 | 6,506 |
| Interest income, net: | | | | | | | | |
| Margin on credit-granting activities | 1,726 | 739 | 1,484 | 1,070 | 97 | 7,211 | 14 | 12,341 |
| Margin on deposit-taking activities | 1,073 | 185 | 64 | 321 | 253 | (6,829) | - | (4,933) |
| **Total interest income, net** | 2,799 | 924 | 1,548 | 1,391 | 350 | 382 | 14 | 7,408 |

(a) Reclassified.

## Note 27 – Operating segments and geographic areas (cont'd)

### B. Information on activity by geographic area[(a)]

| 31 December 2014 | Israel | USA | UK | Switzerland | Luxembourg | Romania | Others | Total outside of Israel | Total consoli-dated |
|---|---|---|---|---|---|---|---|---|---|
| | NIS millions | | | | | | | | |
| Total income (b) | **11,143** | **673** | **423** | **251** | **(36)** | **63** | **19** | **1,393** | **12,536** |
| Net profit attributable to shareholders of the banking corporation | **2,279** | **(224)** | **73** | **(554)** | **(29)** | **(58)** | **15** | **(777)** | **1,502** |
| Total assets | **359,835** | **20,225** | **8,778** | **5,105** | **756** | **1,249** | **186** | **36,299** | **396,134** |
| Credit to the public, net | **229,314** | **14,363** | **6,242** | **1,259** | **406** | **841** | **55** | **23,166** | **252,480** |
| Deposits of the public | **272,452** | **16,471** | **7,200** | **4,955** | **1,368** | **818** | **133** | **30,945** | **303,397** |

| 31 December 2013 | Israel | USA | UK | Switzerland | Luxembourg | Romania | Others | Total outside of Israel | Total consoli-dated |
|---|---|---|---|---|---|---|---|---|---|
| | NIS millions | | | | | | | | |
| Total income (b) | 11,537 | 642 | 217 | 307 | 99 | 49 | 23 | 1,337 | 12,874 |
| Net profit attributable to shareholders of the banking corporation | 2,029 | 66 | (67) | (57) | 15 | (7) | 3 | (47) | 1,982 |
| Total assets | 338,322 | 18,055 | 9,272 | 5,999 | 1,279 | 1,282 | 331 | 36,218 | 374,540 |
| Credit to the public, net | 217,381 | 12,926 | 7,155 | 1,917 | 447 | 849 | 199 | 23,493 | 240,874 |
| Deposits of the public | 256,586 | 13,982 | 7,510 | 5,406 | 1,610 | 707 | 202 | 29,417 | 286,003 |

| 31 December 2012 | Israel | USA | UK | 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 | 776 | 90 | 42 | (18) | 14 | 8 | 10 | 146 | 922 |

(a) The classification was made according to the location of the office.
(b) Interest income net and non-interest income.

## Note 28 - Earmarked deposits, credit and deposits from earmarked deposits

| | **31 December 2014** | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| **Credit and deposits from earmarked deposits** | | |
| Total credit to the public | **102** | 111 |
| **Earmarked deposits** | | |
| Deposits of the public | **1** | 2 |
| Deposits from banks | **-** | 4 |
| Deposits from the government | **63** | 60 |
| Total | **64** | 66 |

## Note 29 – Accumulated Other Comprehensive Income (Loss)

### A. Changes in accumulated other comprehensive income (loss), after the effect of tax

| | For the year ended 31 December 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Other comprehensive income before attribution to non-controlling interests | | | | | |
| | Adjustments for presentation of securities available for sale at fair value | Translation adjustments (a), net after effect of hedges (b) | Banking corporation's share in other comprehensive income of investee companies dealt with under the equity method | Total | Other comprehensive income attributed to non-controlling interests | Other comprehensive income attributed to shareholders of the Bank |
| | NIS millions | | | | | |
| **Balance at 1 January 2012** | (219) | (93) | 112 | (200) | (1) | (199) |
| Net change during the year | 713 | (56) | - | 657 | - | 657 |
| **Balance at 31 December 2012** | 494 | (149) | 112 | 457 | (1) | 458 |
| Net change during the year | (315) | (165) | (12) | (492) | (3) | (489) |
| **Balance at 31 December 2013** | **179** | **(314)** | **100** | **(35)** | **(4)** | **(31)** |
| Net change during the year | **215** | **249** | **(78)** | **386** | **-** | **386** |
| **Balance at 31 December 2014** | **394** | **(65)** | **22** | **351** | **(4)** | **355** |

(a) Adjustments from translation of financial statements of foreign operations whose functional currency differs from the functional currency of the banking corporation, including adjustments in respect of companies included on equity basis.

(b) Profit (loss) in respect of hedging net investment in foreign currency.

## Note 29 – Accumulated Other Comprehensive Income (Loss) (cont'd)

### B. Changes in components of accumulated other comprehensive income (loss), before and after the effect of tax

| | **2014** | | | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Before tax | Tax effect | After tax | Before tax | Tax effect | After tax | Before tax | Tax effect | After tax |
| | NIS millions | | | | | | | | |
| **Changes in components of other comprehensive income (loss) before attribution to non-controlling interests:** | | | | | | | | | |
| **Adjustments for presentation of securities available for sale at fair value** | | | | | | | | | |
| Unrealized profits (losses) from adjustments to fair value | **1,002** | **(273)** | **729** | 229 | 2(c) | 231(c) | 1,268 | (403)(c) | 865 |
| (Profits) losses in respect of securities available for sale reclassified to the statement of profit and loss | **(647)** | **133** | **(514)** | (747) | 201(c) | (546) | (201) | 49(c) | (152) |
| **Net change in the period** | **355** | **(140)** | **215** | (518) | 203 | (315) | 1,067 | (354) | 713 |
| **Translation adjustments (a)** | | | | | | | | | |
| statements | **459** | **(41)** | **418** | (318) | 23(c) | (295) | (59) | - | (59) |
| Hedges (b) | **(267)** | **98** | **(169)** | 203 | (73)(c) | 130 | 4 | (1) | 3 |
| **Net change in the period** | **192** | **57** | **249** | (115) | (50) | (165) | (55) | (1) | (56) |
| **Banking corporation's share in other comprehensive income of investee companies dealt with under the equity base method** | **(108)** | **30** | **(78)** | (6)(c) | (6)(c) | (12)(c) | (1)(c) | 1(c) | - |
| **Net change in the period** | **(108)** | **30** | **(78)** | (6) | (6) | (12) | (1) | 1 | - |
| **Total net change in the period** | **439** | **(53)** | **386** | (639) | 147 | (492) | 1,011 | (354) | 657 |
| **Changes in components of other comprehensive income attributed to non-controlling interests:** | | | | | | | | | |
| **Total net change in the period** | **-** | **-** | **-** | (3) | - | (3) | 1 | (1) | - |
| **Changes in components of other comprehensive income (loss) attributed to shareholders of the banking corporation:** | | | | | | | | | |
| **Total net change in the period** | **439** | **(53)** | **386** | (636) | 147 | (489) | 1,010 | (353) | 657 |

(a) Adjustments from translation of financial statements of foreign operations whose functional currency differs from the functional currency of the banking corporation, including adjustments in respect of companies included on equity basis. If material, separate disclosure is to be made of the amount of adjustments in respect of companies included on equity basis.

(b) Profit (loss) in respect of hedging net investment in foreign currency.

(c) Reclassified.

# Note 30 - Condensed Financial Statements of the Bank

## A. Balance Sheet of the Bank as at 31 December 2014

| | 31 December 2014 | 31 December 2013 |
|---|---|---|
| | NIS millions | |
| **Assets** | | |
| Cash and deposits with banks | **57,276** | 40,413 |
| Securities | **43,669** | 57,203 |
| Securities borrowed or purchased under agreements to repurchase | **2,000** | 1,360 |
| Credit to the public | **224,308** | 212,933 |
| Allowance for credit losses | **(3,118)** | (2,993) |
| Credit to the public, net | **221,190** | 209,940 |
| Credit to governments | **477** | 516 |
| Investments in investee companies | **13,584** | 13,168 |
| Buildings and equipment | **3,094** | 3,131 |
| Assets in respect of derivative instruments | **16,702** | 12,960 |
| Other assets | **4,535** | 4,263 (a) |
| Total assets | **362,527** | 342,954 |
| **Liabilities and equity capital** | | |
| Deposits of the public | **287,378** | 273,186 |
| Deposits from banks | **8,889** | 7,522 |
| Deposits from governments | **123** | 155 |
| Securities loaned or sold under agreements to resell | **1,238** | 624 |
| Subordinated notes | **5,953** | 6,526 |
| Liabilities in respect of derivative instruments | **15,497** | 13,344 |
| Other liabilities | **15,356** | 15,468 (a) |
| Total liabilities | **334,434** | 316,825 |
| Equity attributable to shareholders of the banking corporation | **28,093** | 26,129 (a) |
| Total liabilities and equity | **362,527** | 342,954 |

(a) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

## Note 30 - Condensed Financial Statements of the Bank (cont'd)

### B. Condensed Statement of Profit and Loss

### for the year ended 31 December 2014

| | 2014 | 2013 | 2012 (a) |
|---|---|---|---|
| | NIS millions | | |
| Interest income | **8,508** | 10,627 | 10,859 |
| Interest expenses | **2,546** | 4,648 | 5,521 |
| Net interest income | **5,962** | 5,979 | 5,338 |
| Expenses in respect of credit losses | **195** | 27 | 1,069 |
| Net interest income after expenses in respect of credit losses | **5,767** | 5,952 | 4,269 |
| **Non-interest income** | | | |
| Non-interest financing income | **384** | 928 | 386 |
| Commissions | **2,808** | 2,817 | 2,769 |
| Other income | **171** | 165 | 110 |
| Total non-interest income | **3,363** | 3,910 | 3,265 |
| **Operating and other expenses** | | | |
| Salaries and related expenses | **3,826** | 4,174 (b) | 4,124 (b) |
| Maintenance and depreciation of buildings and equipment | **1,403** | 1,465 | 1,400 |
| Other expenses | **1,101** | 1,233 | 1,270 |
| Total operating and other expenses | **6,330** | 6,872 | 6,794 |
| Profit before taxes | **2,800** | 2,990 | 740 |
| Provision for taxes on profit | **1,124** | 1,180 (b) | 419 (b) |
| Profit after taxes | **1,676** | 1,810 | 321 |
| companies after the effect of tax | **(174)** | 172 | 601 |
| **Net profit** | **1,502** | 1,982 | 922 |

(a) Figures for 2012 do not include Leumi Mortgage which was merged with the Bank in 2013.
(b) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

## Note 30 - Condensed Financial Statements of the Bank (cont'd)

### C. Statement of Cash Flows

### for the year ended 31 December 2014

| | 2014 | 2013 | 2012 (a) |
|---|---|---|---|
| | NIS millions | | |
| **Cash flows from operating activities** | | | |
| Net profit for the year | **1,502** | 1,982 (b) | 922 (b) |
| **Adjustments:** | | | |
| Bank's share in undistributed profits of investee companies | **190** | (51) | (497) |
| Other, net (including provisions for doubtful debts and impairment of securities) | **(1,795)** | (1,554) (b) | 12,676 (b) |
| **Net cash from operating activities** | **(103)** | 377 | 13,101 |
| **Cash flows from investment activities** | | | |
| Acquisition of shares in investee companies | **3** | - | (65) |
| Change in cash resulting from merger of an investee company | **-** | (5) | (24,723) |
| Other | **16,387** | (7,618) | (5,858) |
| **Net cash from investment activities** | **16,390** | (7,623) | (30,646) |
| **Cash flows from financing activities** | | | |
| Redemption of bonds, notes and subordinated notes | **(855)** | (582) | (2,554) |
| Other | **1** | 1 | - |
| **Net cash from financing activities** | **(854)** | (581) | (2,554) |
| **Increase (decrease) in cash and cash equivalents** | **15,433** | (7,827) | (20,099) |
| **Balance of cash at beginning of year** | **37,014** | 45,460 | 65,684 |
| **Effect of exchange rate changes on blances of cash and cash equivalents** | **698** | (619) | (125) |
| **Balance of cash and cash equivalents at end of year** | **53,145** | 37,014 | 45,460 |

(a) Figures for 2012 do not include Leumi Mortgage which was merged with the Bank in 2013.
(b) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

### Interest and taxes paid and/or received and dividends received

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | NIS millions | | |
| Interest received | **9,128** | 10,912 | 10,939 |
| Interest paid | **(3,602)** | (5,242) | (5,798) |
| Dividends received | **22** | 137 | 136 |
| Taxes paid on income | **(1,420)** | (1,036) | (785) |

# Note 30 - Condensed Financial Statements of the Bank (cont'd)

## D. Information on the basis of historical nominal values for tax purposes

| | **31 December 2014** | 31 December 2013(b) |
|---|---|---|
| | NIS millions | |
| Total assets | **360,934** | 341,524 |
| Total liabilities | **334,376** | 316,760 |
| Shareholders' equity | **26,558** | 24,763 |
| Net profit (a) | **1,303** | 2,388 |

(a) Not including profits (losses) of companies included on equity basis, as required under generally accepted accounting principles in Israel.

(b) Restated pursuant to a change in accounting method for accumulating employee rights, see Note 1.R.

# Note 31 – Events after the Balance Sheet Date and Other Issues

## A. Merger of Leumi Finance

On 11 November 2014, the Board of Directors of the Bank and the Board of Directors of Leumi Finance approved the merger of Leumi Finance with and into the Bank. On 4 January 2015, the merger was completed and the merger certificate was received from the Registrar of Companies according to which the Bank absorbed Leumi Finance. The merger which was executed is a statutory merger, 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 (New Version), 1963 (hereinafter: "the Ordinance"), whereby Leumi Mortgage transferred its assets and liabilities to the Bank, such that on completion of the merger, Leumi Finance ceased to exist.

Until the date of the merger, Leumi Finance operated in the area of raising sources of finance in Israel for the Bank, through public and private offerings of securities which did not confer the right to participate in Leumi Finance and were not convertible, such as bonds, subordinated notes, and subordinated capital notes (hereinafter: "Leumi Finance liability notes").

There was no change in the terms of the liability notes as a result of the merger.

**Aim of the merger:**
The merger serves both a business and an economic purpose and its objects, *inter alia*, are to bring significant savings in operating expenses and costs.

**Approval of the Tax Authority – Replacement of the liability notes incidental of the merger**
On 26 November 2014, approval was received from the Tax Authority pursuant to which the replacement of Leumi Finance liability notes with the new liability notes ("the approval") will not be considered as a sale in the hands of the holders of the Leumi Finance liability notes pursuant to the provisions of the Ordinance and tax continuity will apply. According to the approval for the purpose of computing the gain on the initial sale of the new liability notes in the future, the original price and the purchase date will be determined for tax purposes, according to the original price and purchase date of Leumi Finance liability notes prior to the merger. In accordance with the terms of the approval, the Bank and Leumi Finance furnished the Tax Authority with notice of their consent to accept all of the terms of the approval, to the letter and without qualification.

**Ruling of the Tax Authority – Change in structure in Leumi Group**
On 9 December 2014, the ruling of the Tax Authority ("tax ruling") was given, confirming that the details of the merger plan, as conveyed in a request submitted to the Tax Authority, and subject to compliance with the terms provided in the Ordinance, comply with the conditions set forth in Section 103C of the Ordinance.

**1.** The main points of the tax ruling are as follows:

**1.1** The date of the merger was set at 31 December 2014 ("the merger date").

**1.2** No new rights in the Bank will be allocated to the shareholders therein because of the merger. Accordingly, on the sale of the Bank's shares, the cost of investment in the shares of Leumi Finance will not be added to the original price of the shares as aforesaid. The cost/investment amount will be canceled, and will not be permitted in any way for tax purposes, either directly or indirectly. In addition, the assets and liabilities transferred to the Bank will be subject to the provisions of Section 103E of the Ordinance, and no additional amount in excess of their original price will be attributed to them, as it was in Leumi Finance.

**1.3** No expense and/or loss whatsoever will be allowed in the hands of the Bank and/or a third party thereto due to the merger.

**1.4** Every expense and/or deduction accrued in Leumi Finance and in the Bank through the date of the merger and not allowed for tax purposes through this date ("the expenses"), and if they were allowed as a deduction a loss, would be incurred at the merger date, will be computed as a part of the losses of Leumi Finance and/or the Bank, as appropriate, through the merger date, and the provisions of Section 103H of the Ordinance will apply, all this, if they were allowed as a deduction for tax purposes within two years of the merger date. It was clarified that the provisions of this section do not contain anything to detract from the provisions of Section 103H of the Ordinance. In addition, it was clarified that there is nothing in the tax ruling that precludes the approval of the allowance of the expenses as stated in this section, which will be examined by the assessing officer.

**2.** General clarifications

**2.1** If it becomes clear that the provisions of the terms set forth in Section 103C of the Ordinance are not fulfilled ("a breach"), the Bank and Leumi Finance will be liable to taxes and compulsory payments from which an exemption thereto was given, with the addition of linkage differences and interest from the merger date and through the date of payment, and all in accordance with the provisions of the Section 103J of the Ordinance. In the case in question, an expert's valuation of Leumi Finance as of the merger date in accordance with the Income Tax Rules (Request for the Prior Approval for a Merger Plan), 1995, will be submitted to the assessing officer immediately prior to the date of the breach. The aforesaid valuation will require the approval and consent of the assessing officer.

**2.2** The tax ruling is contingent on the complete fulfillment of the other conditions stipulated in the Ordinance and the tax ruling, including the terms relating to the required period, as defined in Section 103 of the Ordinance, the effective date of which is the merger date.

**2.3** The Bank and Leumi Finance have undertaken to include a note on the fact of making a change of structure in their financial statements and in the tax reconciliations, and the terms of the tax ruling will be set forth therein. The note is presented from the first statements to be submitted following the receipt of the tax ruling.

**2.4** The tax ruling does not constitute any approval of making an assessment and/or confirmation of the facts presented by the Bank and Leumi Finance. The facts presented as aforesaid can and will be examined by the assessing officer.

**2.5** The tax ruling was given on the basis of the presentations and documents submitted in writing and verbally, including those set forth in the tax ruling, subject to the terms in Part Two of the Ordinance. The tax ruling will be retroactively cancelled if it becomes clear that the details and facts which were furnished pursuant to the request for the ruling are materially incorrect or incomplete, or if it becomes clear that material details set forth are not fulfilled or that the conditions stipulated by the manager in the tax ruling have not been fulfilled.

**2.6** It is clarified that all expenses related, directly and indirectly, to this change in structure, including legal expenses, audit fees, the cost of experts, consultants and fees, will not be allowed as a deduction, directly and/or indirectly, for parties participating in the change in the structure outlined in the tax ruling and/or a party related thereto, as a deduction or as an expense pursuant to Section 17 of the Ordinance.

**2.7** Leumi and Leumi Finance have undertaken, jointly and severally, to confirm in writing to the Mergers and Splits Dept in the Tax Authority and to the Assessing Officer, within 30 days from the date of receiving the tax ruling, that they agree to accept all of the terms of the tax ruling to the letter and without qualification. Such confirmations have been furnished as required.

## Note 31 – Events after the Balance Sheet Date and Other Issues

### B. Cooperation arrangement with Julius Baer Bank and the sale of operations in Switzerland

According to the cooperation arrangement, Leumi Group will refer existing and future customers who have a need for private banking in Europe to Julius Baer, and at the same time, the Julius Baer group will refer existing and future customers who have banking requirements in Israel to Leumi.
In addition, in the context of the cooperation, the office in Switzerland, Leumi Private Bank, sold to Julius Baer its assets as defined in the agreement, for consideration of CHF 10 million, in excess of the net value of the assets transferred, subject to adjustments. At the same time as the completion of the transaction and in coordination with the relevant authorities, Leumi Private Bank is taking steps to close its banking activity, and to allocate its shareholders' equity as a dividend to the Bank.
The agreement between Leumi Private Bank and Julius Baer includes an undertaking for various indemnities, most for a period of two years from the date of transferring the assets transferred, and five years on certain grounds, chief of which are fines or settlement amounts imposed on Julius Baer by a any government authority and/or in respect of reasonable costs and expenses which Julius Baer will bear in connection with a claim or investigation by any government authority in connection with businesses transferred to it from Leumi Provision Bank and arising before the date of the transfer. The amount of indemnity is limited to the amount derived from the shareholders' equity of the units in Switzerland and Luxembourg, as at 31 March 2014 (around CHF 250 million). The undertaking for indemnification is backed by a guarantee of the Bank for the event that Leumi Private is unable to fulfill the indemnity undertaking.
According to the Bank's assessment, the transaction will not have a significant impact on the Group's operating results and financial position.

### C. The Israel Corporation Ltd.

On 7 January 2015, the Israel Corporation announced the completion of a process of splitting wherein holdings in a number of subsidiaries were transferred from the Israel Corporation to Kenon Holdings, all of whose shares were allocated, prior to the transfer of the assets, to the shareholders in the Israel Corporation (hereinafter, "the split"). The shares of Kenon are listed for trading on the New York Stock Exchange and on the Tel Aviv Stock Exchange. At the beginning of January 2015, the Bank's investment in the shares of Kenon will be presented in the available-for-sale securities portfolio.
In anticipation of the aforementioned split, the Bank updated the Banking Supervision Department, that as a result of the split, the Bank will hold two non-bank corporations. The Banking Supervision Department notified the Bank that it will allocate dates to it for reducing the rates of shareholding. As of the date of the report, no provisions as to the last date for reducing the holdings had been received.
On 11 February 2015, the Bank sold 531,550 shares of the Israel Corporation Ltd. to a number of entities (hereinafter, "the purchasers") at a price of NIS 1,330 per share and aggregate consideration of NIS 707 million. The shares sold represent 6.904% of the issued and paid-up capital of the Israel Corporation.
The transactions noted above expected to yield for the Bank, a total of NIS 547 million, before the effect of tax, which is expected to be included in the financial statements for the first quarter of 2015. An estimate of the profit was computed on the basis of the cost of the shares of the Israel Corporation in the Bank's books, in accordance with the financial statements of 31 December 2014, and after adjustment of this cost for a dividend which was paid by the Israel Corporation in January 2015.
Following the sale, shares of the Israel Corporation representing 11.1% of the issued and paid-up share capital of the Israel Corporation will be left in the hands of the Bank.

## Note 31 – Events after the Balance Sheet Date and Other Issues

For the purpose of preparing the Bank's audited financial statements as of 31 December 2014, and in order to include the data of the Israel Corporation, on the basis of the audited statements, on 4 March 2015, the Bank obtained approval from the Bank of Israel to publish the 2014 financial statements on the date after the publication date of the audited financial statements if the Israel Corporation for 2014, and no later than 31 March 2015. Accordingly, the Bank's financial statements for 2014 include the Bank's share in the results of the Israel Corporation for 2014 in its entirety.

In accordance with a directive of the Banking Supervision Department, dated 4 March 2015, in order for the Bank to include the results of the Israel Corporation in the financial statements for the first quarter of 2015, the Bank will publish its financial statements to 31 March 2015, through 31 May 2015 (instead of through 15 May 2015, pursuant to the date provided in the directives of the Banking Supervision Department). In addition, a directive of the Banking Supervision Department determined that the Bank will take steps to discontinue its significant influence in the Israel Corporation, including by way of a permanent waiver of the Bank's representation in the board of directors of the Israel Corporation and its right to appoint directors therein.

The right of the Bank to appoint directors in the Israel Corporation was set out in the shareholders agreement signed on 5 September 1999 (an agreement which was amended several times) between the bank and the companies controlling the Israel Corporation (hereinafter: "the shareholders agreement").

On 15 March 2015, the Board of Directors of the Bank resolved to confirm the cancelation of a shareholder agreement, and pursuant thereto, to waive the right to recommend the appointment of directors in the Israel Corporation.

Further to this resolution, a document was signed between the Bank and the companies which hold a controlling interest in the Israel Corporation, pursuant to which the shareholder agreement was canceled, including the right to recommend the appointment of directors. In addition, a notice was sent to the Israel Corporation by the two directors, who were appointed to the Israel Corporation in accordance with the Bank's recommendation, on the termination of their term of office in the Israel Corporation, with effect from 30 March 2015.

Following the cancelation of the shareholders agreement, the bank lost significant influence over the Israel Corporation, and so, commencing on 31 March 2015, the Bank will discontinue applying the equity base method, with regard to its investment in the Israel Corporation, and will classify its investment as an investment in an available for sale security. In accordance with the instructions of the Banking Supervision Department, on this date the Bank will recognize the difference between the book value of the investment in the Israel Corporation as a company included on equity basis, and its fair vale, under other comprehensive income.

### Collective Wage Agreement

In January 2015, a new collective agreement was signed in the Bank, which will be in effect for four years, which reduces the liabilities in respect of employee rights which are recorded in the Bank's books and increases the Bank's capital.

Pursuant to the letter of the Supervisor of Banks from 11 February 2015, the Bank is required not to charge the effect of the changes in the collective wage agreement in its annual report for 2014.

# CONDENSED FINANCIAL STATEMENTS OF PRINCIPAL CONSOLIDATED COMPANIES

# Bank Leumi USA

## Chairman of the Board: D. Brodet

## President and Chief Executive Officer: A. Mendelson

### Condensed Consolidated Balance Sheet as at 31 December 2014 (US$ millions)

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilities and equity** | | |
| Cash and deposits with banks | **313** | 520 | | | |
| Securities | **925** | 711 | Deposits | **4,401** | 4,422 |
| Loans | **3,659** | 3,678 | Other liabilities | **169** | 132 |
| Buildings and equipment | **61** | 36 | Capital notes | **90** | 90 |
| Other assets | **244** | 246 | Capital resources | **542** | 547 |
| Total assets | **5,202** | 5,191 | Total liabilities and capital resources | **5,202** | 5,191 |

### Condensed Statement of Profit and Loss for the year ended 31 December 2014 (US$ millions)

| | 2014 | 2013 |
|---|---|---|
| Interest income, net | **140** | 136 |
| Expenses in respect of credit losses | **19** | 11 |
| Profit from interest income, net after expenses in respect of credit losses | **121** | 125 |
| Non-interest income | **44** | 42 |
| Operating and other expenses | **206** | 148 |
| Profit (loss) before taxes | **(41)** | 19 |
| Provision for taxes | **9** | 8 |
| Net profit (loss) | **(50)** | 11 |

# Leumi Private Bank

## Chairman of the Board: Prof. D. Tsiddon[(a)]

## Chief Executive Officer: A. Zilberberg

### Condensed Consolidated Balance Sheet as at 31 December 2014 (CHF millions)

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilities and equity** | | |
| Cash and deposits with banks | **901** | 902 | Deposits from banks | **8** | 14 |
| Loans | **321** | 492 | Deposits and other accounts | **1,435** | 1,406 |
| Securities | **326** | 291 | Subordinated notes | **50** | 50 |
| Other assets | **41** | 26 | Capital resources and reserves | **96** | 241 |
| Total assets | **1,589** | 1,711 | Total liabilities and capital resources | **1,589** | 1,711 |
| Total customer investments (off-balance sheet) | **4,225** | **5,162** | | | |

### Condensed Statement of Profit and Loss for the year ended 31 December 2014 (CHF millions)

| | 2014 | 2013 |
|---|---|---|
| Interest income, net | **13** | 15 |
| Non-interest income | **46** | 65 |
| Operating and other expenses | **200** | 68 |
| Profit (loss) before taxes | **(141)** | 12 |
| Provision for taxes | **-** | 5 |
| Net profit (loss) | **(141)** | 7 |

(a) Began serving on 20 February 2014. Until this date, the position was held by Ms. G. Maor.

# Bank Leumi (UK) plc
## Chairman of the Board: Y. Minz
## Chief Executive Officer: E. Katzav[(a)]

**Condensed Consolidated Balance Sheet as at 31 December 2014 (£ millions)**

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilities and equity** | | |
| Cash and deposits with banks | **336** | 290 | Deposits | **1,208** | 1,327 |
| Loans | **1,026** | 1,244 | Deposits from banks | **15** | 55 |
| Securities | **73** | 64 | Subordinated notes | **84** | 84 |
| Equipment and buildings | **6** | 6 | Other liabilities | **13** | 19 |
| Other assets | **13** | 10 | Capital resources | **134** | 129 |
| Total assets | **1,454** | 1,614 | Total liabilities and capital resources | **1,454** | 1,614 |

**Condensed Statement of Profit and Loss for the year ended 31 December 2014 (£ millions)**

| | 2014 | 2013 |
|---|---|---|
| Non-interest income | **42** | 42 |
| Expenses in respect of credit losses | **13** | 34 |
| Interest income, net after expenses in respect of credit losses | **29** | 8 |
| Non-interest income | **14** | 14 |
| Operating and other expenses | **33** | 29 |
| Profit (loss) before taxes | **10** | (7) |
| Provision for (benefit from) taxes | **3** | (2) |
| Net profit (loss) | **7** | (5) |

(a) Began serving on 1 August 2014. Until this date, the position was held by Mr. L. Weiss.

# Bank Leumi (Luxembourg) S.A.
## Chairman of the Board: Prof. D. Tsiddon[(a)]
## General Manager: G. Karni

### Condensed Consolidated Balance Sheet as at 31 December 2014 (€ millions)

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilities and equity** | | |
| Cash and deposits with banks | **308** | 404 | Deposits of the public | **265** | 312 |
| Securities | **28** | 28 | Deposits from banks | **120** | 171 |
| Credit to the public | **86** | 93 | Other liabilities | **3** | 3 |
| Other assets | **4** | 4 | Total liabilities | **388** | 486 |
| | | | Shareholders' equity | **38** | 43 |
| Total assets | **426** | 529 | Total liabilities and capital means | **426** | 529 |

### Condensed Statement of Profit and Loss for the year ended 31 December 2014 (€ millions)

| | 2014 | 2013 |
|---|---|---|
| Net interest income | **5** | 5 |
| Non-interest income | **6** | 6 |
| Operating and other expenses | **14** | 8 |
| Profit (loss) before taxes | **(3)** | 3 |
| Provision for taxes | **-** | - |
| Net profit (loss) | **(3)** | 3 |

(a) Began serving on 10 March 2014. Until this date the position was held by Prof. N. Trachtenberg.

# Bank Leumi Romania S.A.

**Chairman of the Board: Y. Minz**

**Executive President: L. Mitrache**

**Condensed Consolidated Balance Sheet as at 31 December 2014 (RON millions)***

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilitities and equity** | | |
| Cash and deposits in banks | **296** | 266 | | | |
| Loans | **798** | 797 | Deposits | **777** | 665 |
| Securities | **95** | 110 | Deposits from banks | **272** | 301 |
| Equipment and buildings | **27** | 19 | Other liabilities | **7** | 6 |
| Other assets | **15** | 6 | Capital resources | **175** | 226 |
| Total assets | **1,231** | 1,198 | Total liabilities and capital means | **1,231** | 1,198 |

**Condensed Statement of Profit and Loss for the year ended 31 December 2014 (RON millions)***

| | 2014 | 2013 |
|---|---|---|
| Net interest income | **44** | 45 |
| Expenses in respect of credit losses | **65** | 7 |
| Net interest income after expenses in respect of credit losses | **(21)** | 38 |
| Non-interest income | **27** | 19 |
| Operating and other expenses | **57** | 55 |
| Profit before taxes | **(51)** | 2 |
| Tax expenses | **-** | - |
| Net profit (loss) | **(51)** | 2 |

* 1 RON = NIS 1.0535.

# Arab Israel Bank Ltd.
## Chairman of the Board: Z. Nahari[(a)]
## Chief Executive Officer: D. Gitter

### Condensed Consolidated Balance Sheet as at 31 December 2014 (NIS millions)

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilities and equity** | | |
| Cash and deposits with banks | **1,962** | 1,679 | | | |
| Securities | **407** | 460 | Deposits of the public | **4,795** | 4,593 |
| Credit to the public | **5,133** | 4,640 | Deposits from banks | **1,744** | 1,346 |
| Allowance for credit losses | **(68)** | (59) | Subordinated notes | **103** | 104 |
| Credit to the public, net | **5,065** | 4,581 | Other liabilities | **281** | 273 |
| Buildings and equipment | **68** | 73 | Total liabilities | **6,923** | 6,316 |
| Other assets | **74** | 76 | Equity | **653** | 553 |
| Total assets | **7,576** | 6,869 | Total liabilities and capital means | **7,576** | 6,869 |

### Condensed Statement of Profit and Loss for the year ended 31 December 2014 (NIS millions)

| | 2014 | 2013 |
|---|---|---|
| Net interest income | **321** | 294 |
| Expenses in respect of credit losses | **17** | 9 |
| Net interest income after expenses in respect of credit losses | **304** | 285 |
| Non-interest income | **120** | 128 |
| Operating and other expenses | **261** | 249 |
| Profit before taxes | **163** | 164 |
| Provision for taxes | **63** | 58 |
| Net profit | **100** | 106 |
| Dividend paid | **-** | 80 |

(a) From 1 April 2015, Mr. Danny Cohen will serve as Chairman of the Board of Directors.

# Leumi Card Ltd.
## Chairman of the Board: T. Yassur
## Chief Executive Officer: H. Heller

### Condensed Consolidated Balance Sheet as at 31 December 2014 (NIS millions)

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilities and equity** | | |
| Cash and deposits with banks | **82** | 59 | | | |
| Receivables in respect of credit card activity | **10,625** | 9,483 | | | |
| Allowance for credit losses | **(79)** | (72) | | | |
| Receivables in respect of credit card activity, net | **10,546** | 9,411 | Credit from banking corporations | **2,705** | 1,902 |
| Investment in companies included on equity basis and others | **3** | 2 | Payables in respect of credit card activity | **6,489** | 6,254 |
| Equipment | **206** | 194 | Other liabilities | **149** | 161 |
| Other assets | **58** | 53 | Equity | **1,552** | 1,402 |
| Total assets | **10,895** | 9,719 | Total liabilities and capital means | **10,895** | 9,719 |

### Condensed Statement of Profit and Loss for the year ended 31 December 2014 (NIS millions)

| | 2014 | 2013 |
|---|---|---|
| Income from credit card transactions | **854** | 830 |
| Net interest income | **159** | 154 |
| Other income | **2** | 3 |
| Expenses in respect of credit losses | **25** | 10 |
| Operating and other expenses | **714** | 705 |
| Profit before taxes | **276** | 272 |
| Provision for taxes on profit | **81** | 76 |
| Profit after taxes | **195** | 196 |
| Company's share in profits after the effect of taxes of companies included on equity basis | **5** | 4 |
| Net profit | **200** | 200 |
| Dividend paid | **50** | 30 |

# Leumi Partners Ltd.
## Chairman of the Board: Prof. D. Tsiddon
## Chief Executive Officer: Y. Bloch

### Condensed Consolidated Balance Sheet as at 31 December 2014 (NIS millions)

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilities and equity** | | |
| Cash and deposits with banks | **155** | 262 | | | |
| Securities | **1,454** | 1,222 | | | |
| Deposits in banks | **3** | 3 | | | |
| Investment in investee companies | **778** | 420 | Other liabilities | **123** | 35 |
| Fixed assets | **3** | 3 | Capital notes | **1,113** | 1,158 |
| Other assets | **10** | 4 | Equity | **1,167** | 721 |
| Total assets | **2,403** | 1,914 | Total liabilities and capital means | **2,403** | 1,914 |

### Condensed Statement of Profit and Loss for the year ended 31 December 2014 (NIS millions)

| | 2014 | 2013 |
|---|---|---|
| Net interest income (expenses) | **17** | (6) |
| Non-interest income | **299** | 242 |
| Operating and other expenses | **43** | 40 |
| Profit before taxes | **273** | 196 |
| Provision for taxes | **2** | 3 |
| Profit after taxes | **271** | 193 |
| Company’s share in the net profits of companies included on equity basis | **37** | 33 |
| Net profit | **308** | 226 |

# Leumi Finance Company Ltd.[b]

## Chairman of the Board: Y. Marmari

## Chief Executive Officer: O. Shlosman

### Condensed Consolidated Balance Sheet as at 31 December 2014 (NIS millions) [a]

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilities and equity** | | |
| Cash and deposits in banks | **17,884** | 19,063 | Debentures and subordinated notes | **17,717** | 18,906 |
| Other assets | **1** | - | Equity | **168** | 157 |
| Total assets | **17,885** | 19,063 | Total liabilities and capital means | **17,885** | 19,063 |

### Condensed Statement of Profit and Loss for the year ended 31 December 2014 (NIS millions)

| | 2014 | 2013 |
|---|---|---|
| Net interest income | **20** | 23 |
| Management and general expenses | **3** | 3 |
| Profit before taxes | **17** | 20 |
| Provision for taxes | **6** | 8 |
| Net profit | **11** | 12 |
| Dividend paid | **-** | 13 |

(a) The financial statements have been prepared by the company in accordance with International Financial Reporting Standards (IFRS).

(b) The company merged with and into Bank Leumi on 4 January 2015.

# Leumi-Tech Ltd.[(a)]

## Chairman of the Board: Prof. D. Tsiddon

## Chief Executive Officer: J. Zaidman Oron [(b)]

### Condensed Consolidated Balance Sheet as at 31 December 2014 (NIS millions)

| | 2014 | 2013 | | 2014 | 2013 |
|---|---|---|---|---|---|
| **Assets** | | | **Liabilities and equity** | | |
| Cash and deposits in banks | **744** | 53 | Deposits from banks | **24** | 41 |
| Credit to the public | **203** | 381 | Other liabilities | **6** | 3 |
| T-bills | **72** | 590 | Total liabilities | **30** | 44 |
| Other assets | **10** | 11 | Equity | **999** | 991 |
| Total assets | **1,029** | 1,035 | Total liabilities and capital means | **1,029** | 1,035 |

### Condensed Statement of Profit and Loss for the year ended 31 December 2014 (NIS millions)

| | 2014 | 2013 |
|---|---|---|
| Net interest income | **12** | 31 |
| Income in respect of credit losses | **(1)** | - |
| Net interest income before expenses in respect of credit losses | **13** | 31 |
| Non-interest income | **14** | 5 |
| Operating expenses | **14** | 8 |
| Profit before taxes | **13** | 28 |
| Provision for taxes | **5** | 5 |
| Net profit | **8** | 23 |

(a) The name of the company was changed on 31 December 2013. Until that date the name of the company was Leumi Leasing & Investments Ltd.
(b) Began serving on 1 January 2014. Until this date the position was held by Mr. Y. Weizmann.