

# LEUMI 2015

## REPORT ON RISKS

The Report on Risks and the description of the main characteristics of regulatory capital instruments issued are included on the Bank's website: [www.bankleumi.co.il](http://www.bankleumi.co.il) and in the Magna website of the Israel Securities Authority : [www.magna.isa.gov.il](http://www.magna.isa.gov.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.

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## **Report on Risks**

The Report on Risks as at 31 December 2015 has been prepared in accordance with the directives and instructions of the Supervisor of Banks that include:

- Disclosure requirements issued by the Basel Committee (Third Pillar requirements)
- Disclosure requirements for risk based on other sources, including disclosure requirements issued by the Financial Stability Committee (FSB) through a Task Force (EDTF).
- Disclosure requirements under the additional requirements in accordance with the report of the Bank of Israel and guidelines.

This report includes information accompanying the consolidated financial statements of Bank Leumi Le-Israel B.M.

### **David Brodet**

Chairman of the Board of Directors

### **Rakefet Russak-Aminoach**

President and Chief Executive Officer

### **Hilla Eran-Zick**

Chief Risk Officer

28 February 2016

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

Bank Leumi and its subsidiary companies constitute one of the largest banking groups in Israel.

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.

To implement its strategy, the Bank is organized into main business lines, concentrating on different market segments, with each business line specializing in providing banking and financial services to a particular customer segment.

Corporate Banking concentrates on servicing major and international companies; Commercial banking concentrates on servicing middle market companies; Retail Banking concentrates on providing banking services mainly to households, small businesses and wealthy customers who require investment solutions at a 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 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. In addition, the Bank has established a Digital Banking Division, whose function is to coordinate the Bank's digital, innovation and marketing activity, including setting up the new Digital Banking as a sub-brand.

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 conducted mostly through the subsidiary, Leumi Partners Ltd.

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, insurance companies and other institutional entities and technology-based solutions (FinTech companies) that focus on areas of banking activity, mainly with retail customers.

## **Purpose of the disclosure**

This publication of the detailed Report on Risks constitutes supplementary information to the financial statements of Bank Leumi Le-Israel B.M. The report is intended to enable readers of the Bank's reports to the public to evaluate significant information included therein with regard to the implementation of the working framework of the Basel Committee, capital, risk exposure, and the working processes of risk assessment.

The information included in this report includes:

- Disclosure requirements published by the Basel Committee (Third Pillar requirements)
- Disclosure requirements on risks based on other sources, including disclosure requirements published by the Financial Stability Board (FSB) via the Task Force (EDTF).
- The disclosure requirements by virtue of the additional requirements pursuant to the Reporting Regulations of the Bank of Israel and its directives.

In order to denote the origin of the various disclosures, this report includes an index of the various disclosure tables, noting the origin of the disclosure as "EDTF" and "Third Pillar", respectively.

## **Principle of disclosure**

On 28 April 2015, a circular was published by the Supervisor of Banks on the subject of "Updating the Report to the Public of a Banking Corporation and of Credit Card Companies", which alters the format of the financial statements to the public of banking corporations and provides additional disclosure requirements in connection with exposure to risks and the way they are managed, with effect from the financial statements ended 31 December 2015 and thereafter.

The aim of the changes is to improve the quality of the reporting to the public by making the information in the report to the public more useful and accessible to the reader of the report, increase uniformity in the banking system in the way reports are presented to the public and devise a format for the annual report to the public that will be based on presentation practices of leading banks in Europe and the United States. One of the key changes is the publication of the Report on Risks on the Internet website, which will include detailed quantitative information and qualitative information on the review of the risks and the way in which they are managed. This report is intended to provide information regarding exposure to risks and the way they are managed.

The report includes the following disclosure requirements:

- Quantitative disclosures of the capital requirements and the risk assets in respect of the credit, market and operational exposures, and qualitative information regarding the way in which these exposures are managed.
- Disclosure on exposures to the other risks to which the Bank is exposed by virtue of the nature of its business activity, such as: legal risk, compliance risk, regulatory risk and environmental risk.
- Remuneration practices of key personnel in the Bank, office-holders and senior management.
- Disclosures by virtue of the recommendations of the EDTF and other sources, as adopted by the Supervisor of Banks.

This report is published for the first time for the year 2015. The report gradually implements the new disclosure requirements and has been prepared according to the disclosure requirements provided in the directives of the Supervisor in the following way:

- With regard to each quantitative figure included for the first time as a result of the new disclosure requirements – comparative data for the previous year were not presented.
- With regard to quantitative figures included in previous disclosures within the framework of the Third Pillar disclosure requirements, including information regarding remuneration, comparative figures for corresponding periods will be stated for the previous reporting period as required in the directives.
- Additional relevant information may be found in the chapter "Review of Risks" in the Report of the Board of Directors and the Management.

## Summary of disclosure tables

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## **Forward-Looking Information in the Report on Risks**

The Report on Risks includes, 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", "scenarios", "stress scenarios", "risk evaluation", "correlation", "distribution" 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 Report on Risks 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. This does not detract from the Bank's reporting obligations according to any law.

## Risk Management in Leumi and Principal Metrics

Risk management is an essential condition for fulfilling ongoing goals and the Group's long-term goals. The Group is engaged in a wide range of activities involving the taking of financial risks, such as credit risks, market and liquidity risks, and other risks which are not financial risks, such as operating risks, including technological and cyber risks, legal risks, regulatory risks, goodwill risks and compliance risks. The main objectives of risk management in Leumi is retaining Group stability and supporting the attainment of the business goals. These goals are achieved while meeting the risk appetite which has been defined and retaining the existence of the proper management, control and reporting mechanisms.

In light of this, the Bank continually carries out activities to upgrade the risk management infrastructure and the analysis of the risk profile, which allows decisions to be made in an educated manner.

**Table 1 - Summary of regulatory ratios and key financial data**

	31 December	
	2015	2014 <sup>(a)</sup> (b)
	NIS millions	
Tier 1 shareholders' equity	29,001	27,723
Overall capital	41,594	42,407
Credit risk	277,034	273,881
Market risk	5,167	10,839
Operational risk	20,432	20,317
	Percentages	
Ratio of Tier 1 shareholders' equity to risk components	9.58	9.09
Total overall capital to risk components	13.74	13.90
Liquidity coverage ratio <sup>(c)</sup>	105	
Leverage ratio <sup>(c)</sup>	6.27	
Rate of balance of allowance for credit losses in respect of credit to the public out of balance of impaired credit to the public	105.9	93.6
Ratio of problem debts to the whole credit portfolio	3.14	3.96
Rate of balance of allowance for credit losses out of credit to the public, net	1.38	1.55
Return on equity	10.3	5.4

(a) Data as at 31 December 2014 have been restated including changes following the change in accounting method for accruing employee rights and implementation of the directives of the Supervisor of Banks on capitalization of software costs.

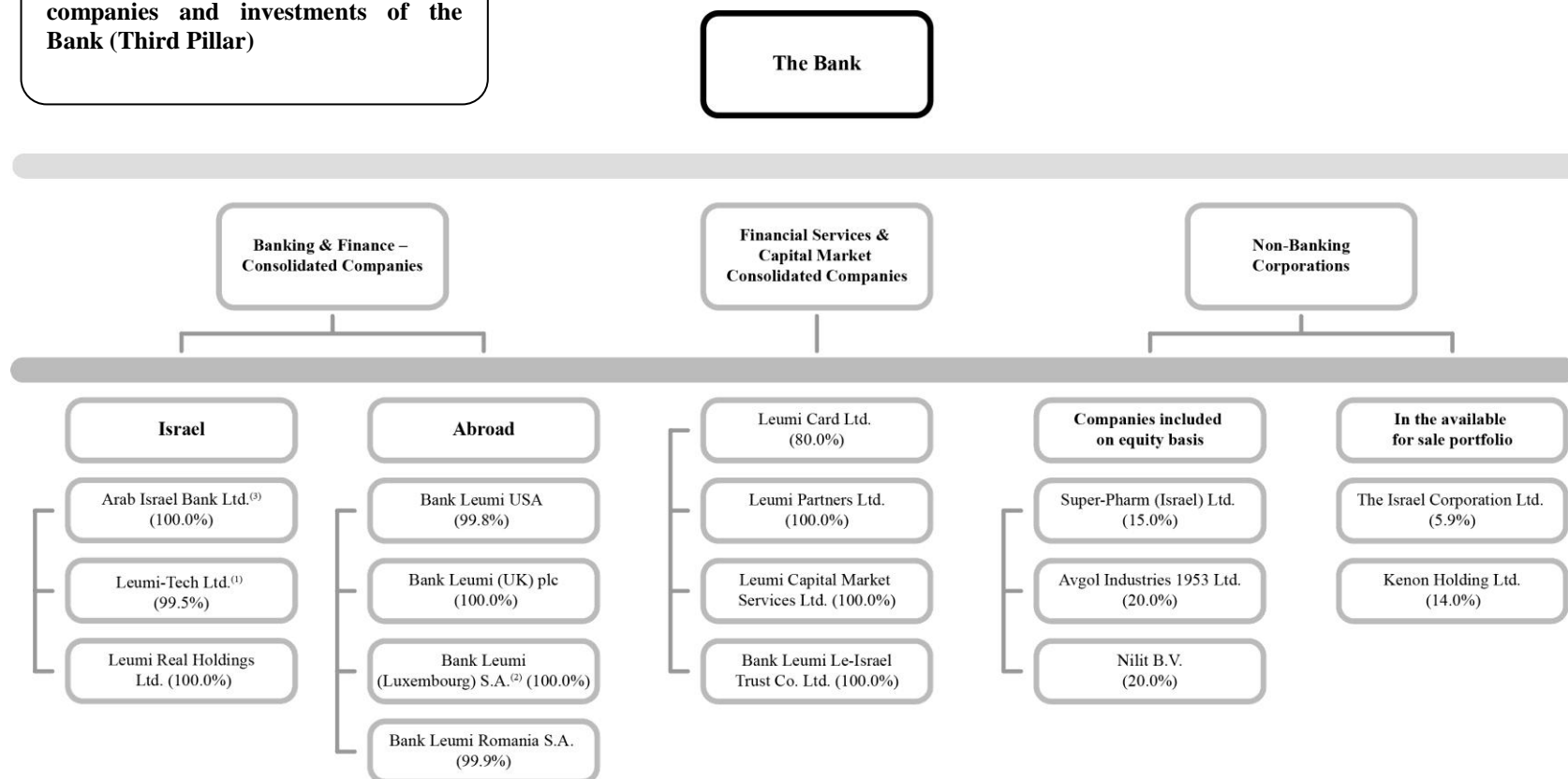
(b) Without the effect of adoption of US GAAP on employee rights that came into effect on 1 January 2015.

(c) Pursuant to Bank of Israel directives, implementation of Basel Committee directives on the leverage ratio and the liquidity coverage ratio were adopted from the second quarter of 2015. Accordingly, comparative figures are not stated.

## Introduction

A. Bank Leumi Le-Israel B.M. ("Leumi"), whose head office is situated in Tel Aviv, Israel, is the parent company of the Leumi Group, which includes the principal investee companies appearing in the Group Structure Chart below:

**Table 2 - Chart of principal investee companies and investments of the Bank (Third Pillar)**



1. Voting rights – 99.8%.
2. In November 2015 an agreement was signed for the sale of customer assets of Leumi Luxembourg. For further information, see Chapter on "Principal Consolidated Companies"
3. The company was merged with and into Bank Leumi on 31 December 2015.

- B.** The consolidation of consolidated companies and the recording of the equity value of companies included on equity basis is done according to generally accepted accounting principles and in accordance with Bank of Israel directives. As at 31 December 2015, there were no differences between the basis of consolidation according to accounting principles and the basis of supervisory consolidation for capital adequacy purposes. However, in computing the regulatory capital, goodwill and intangible assets (approximately NIS 273 million) are deducted from the accounting capital.
- C.** The main regulatory restrictions on the transfer of liquidity resources between the Group companies in Israel and abroad are:
1. The Bank of Israel does not restrict the placement of deposits by the Bank in the Group companies in Israel and abroad. However it has placed restrictions on capital investments and liability notes by the Bank in companies abroad. For every material investment, prior approval of the Bank of Israel is required.
  2. The regulations of the authorities in the United States restrict the local banks in the amount of exposures of any type vis-à-vis related companies. The maximum rate of the exposure to the related company is 10% of the Bank's capital in the United States, and vis-à-vis the Group of which the Bank in the United States is part. The maximum rate is 20% of its capital.
  3. The regulations of the authorities in the United Kingdom restrict the local banks in the amount of exposures of any type vis-à-vis related companies. The maximum rate of exposure vis-à-vis the Group (except for Bank Leumi Le-Israel and its subsidiary in Jersey) is 25% of the capital of the Bank in the United Kingdom. A waiver was reissued by the regulator in the UK for increasing the exposure vis-à-vis Bank Leumi Le-Israel B.M. and Bank Leumi Jersey, so that the maximum rate of exposure regarding them is 100% of the Bank's capital in the United Kingdom.

## **Capital (Third Pillar)**

### **Capital Structure and Capital Adequacy (Third Pillar)**

**Capital attributable to the shareholders of the banking corporation** (hereinafter: "capital") of the Group as at 31 December 2015 amounted to NIS 28,767 million, compared with NIS 25,798 million at the end of 2014, an increase of 11.5%. The increase derives mainly from the increase in other comprehensive income, as detailed above. This capital constitutes the basis for calculating regulatory capital used for calculating the capital adequacy ratio of the Bank with the addition of equity instruments and regulatory adjustments as set out in Proper Conduct of Banking Business Directive No. 202 of the Banking Supervision Department.

The capital attributable to shareholders of the banking corporation in respect of comparative figures has been restated in light of the retroactive implementation of US GAAP regarding employee rights and the directives of the Banking Supervision Department regarding the capitalization of software costs. However, pursuant to the instructions of the Supervisor of Banks, for purposes of calculating regulatory capital used for calculating the capital adequacy ratio of the Bank, the effect on accounting standards on employee rights is not reflected.

## Capital adequacy structure

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 Directive No. 201-211. These directives came into force on 1 January 2014, subject to the transitional provisions of Proper Conduct of Banking Business Directive No. 299 of the Banking Supervision Department.

Measurement of the capital is based on division of capital into Tier capital (including Tier 1 shareholders' equity and additional Tier 1 capital) and Tier 2 capital. The sum of these tiers is called "Capital basis for capital adequacy purposes" or "Regulatory capital" or "Overall capital".

**Tier 1 shareholders' equity** includes the capital attributable to the shareholders of the banking corporation, and the rights of external shareholders in the capital of consolidated subsidiaries after deducting the surplus capital in their respect. The regulatory adjustments and main deductions from Tier 1 shareholders' equity are intangible assets and goodwill, deferred taxes receivable whose realization is based on future profitability of the banking corporation, deferred taxes receivable net from timing differences, unrealized profits and losses resulting from changes in the fair value of liabilities deriving from changes in the own credit risk of the banking corporation, own investment in ordinary shares including a liability for own acquisition of shares subject to contractual agreements, and investments in the share capital of financial corporations not consolidated in the reports to the public of the banking corporation.

**Additional Tier 1 capital** which comprises capital instruments complying with the criteria determined in Proper Conduct of Banking Business Directive No. 202. There are no capital instruments in this tier in the Leumi Group.

**Tier 2 capital** includes capital instruments and the collective allowance for credit losses.

With regard to capital instruments which were included in Tier 2 capital on 31 December 2013, the transitional provisions and the cap for recognition which was computed to 1 January 2014, according to 80% of the balance of instruments as of 31 December 2013, were determined, and at the beginning of each successive year, this cap is lowered by 10% until 1 January 2022. For 2015, capital instruments and subordinated notes are recognized up to a cap of 70% of their balance in the regulatory capital as at 31 December 2013.

It should be noted that the amount actually recognized as Tier 2 capital is the lower of the amortized amount of the instruments themselves and their recognition cap according to the transitional provisions. From the beginning of 2014, capital instruments to be issued will be required to comply with all the criteria set forth in Proper Conduct of Banking Business Directive No. 202 for the purpose of their inclusion in capital. The main criteria are: the instrument must include: a mechanism for absorbing the losses of the reserve by conversion to ordinary shares or the amortization of the instrument when the Tier 1 shareholders' equity ratio of the banking corporation falls below 5%; an item that provides that upon the occurrence of the defining event for non-compliance (as defined in Appendix E to Proper Conduct of Banking Business Directive No. 202), the instrument will be converted immediately to ordinary shares or will be extinguished, and their repayment period shall not be less than five years; they are issued without collateral; their rights are subordinated to the claims of other creditors of the Bank except for creditors who hold Tier 1 capital; and the amount recognized as Tier 2 capital, as noted, will be reduced by 20% at the beginning of each of the last five years before their maturity.

Pursuant to the Shelf Proposal Report dated 20 January 2016, the Bank issued on 21 January 2016 an amount of NIS 926 million of Series 400 deferred notes, which are eligible for inclusion in Tier 2.

**Table 3 – Capital and capital adequacy (Third Pillar)**

	31 December	
	2015	2014 <sup>(a)(b)</sup>
	NIS millions	
<b>Data</b>		
<b>Capital for purposes of calculating capital ratio</b>		
Tier 1 shareholders' equity, after regulatory adjustments and deductions	29,001	27,723
Tier 2 capital, after deductions	12,593	14,684
Total capital	41,594	42,407
<b>Weighted balances of risk assets</b>	-	-
Credit risk	277,034	273,881
Market risk	5,167	10,839
Operational risk	20,432	20,317
Total weighted balances of risk assets	302,633	305,037
<b>Ratio of capital to risk components</b>		
Ratio of Tier 1 shareholders' equity to risk components	9.58%	9.09%
Ratio of total capital to risk components	13.74%	13.90%
Minimum Tier 1 shareholders' equity required by the Supervisor of Banks <sup>(c)</sup>	9.10%	9.00%
Minimum overall capital ratio required by the Supervisor of Banks <sup>(c)</sup>	12.60%	12.50%

(a) Data as at 31 December 2014 were restated including changes pursuant to change in accounting method for accruing employee rights and implementation of the directives of the Supervisor of Banks on capitalization of software costs.

(b) Excluding the effect of adoption of US GAAP on employee rights that came into effect on 1 January 2015.

(c) Minimum Tier 1 shareholders' equity and overall capital ratio required from 1 January 2015 to 31 December 2016 is 9% and 12.5%, respectively, and from 1 January 2017 they are 10% and 13.5%, respectively. To these ratios there will be added, from 1 January 2015, a capital requirement at a rate reflecting 1% of the balance of housing loans at the reporting date. This requirement is being implemented gradually in equal quarterly amounts from 1 April 2015 to 1 January 2017.

Accordingly, the minimum Tier 1 shareholders' equity ratio and the minimum overall capital required by the Supervisor of Banks as at 1 January 2017, according to data at the reporting date, are 10.27% and 13.77%, respectively.

#### **Effect of the transitional directives on the Tier shareholders' equity ratio**

	31 December	
	2015	2014 <sup>(b)</sup>
	Percentages	
<b>Ratio of capital to risk components</b>		
Ratio of Tier 1 shareholders' equity to risk components before implementation of the effect of the transitional directives <sup>(a)</sup>	8.93%	7.82%
Effect of the transitional directives	0.65%	1.27%
Ratio of Tier 1 shareholders' equity to risk components	9.58%	9.09%

(a) Including the effect of adoption of US GAAP on employee rights that came into effect on 1 January 2015. Comparative figures have been restated to show this effect.

(b) Restated following implementation of the directives of the Supervisor of Banks on capitalization of software costs.

## Restrictions on the capital structure

Proper Conduct of Banking Business Directive No. 202 establishes restrictions on the capital structure:

- Tier 2 capital may not exceed 100% of Tier 1 capital after the required deductions from this capital.
- Capital instruments eligible for inclusion in Tier 2 capital shall not exceed 50% of Tier 1 capital required deductions from this capital. This limit does not include equity instruments that were included prior to this Directive in Upper Tier 2 capital, in the amount of the balance of those instruments as at 31 December 2013 and in accordance with the transitional provisions set out in Proper Conduct of Banking Business Directive No. 299 (Regulatory Capital - Transitional Provisions).

**Table 4 – Structure of capital components for calculating capital ratios (Third Pillar)**

	31 December	
	2015	2014 <sup>(a)(b)</sup>
	NIS millions	
<b>Tier 1 shareholders' equity</b>		
Share capital	7,059	7,059
Premium	1,129	1,129
Retained earnings	21,984	19,202
Unrealized profits (losses) from fair value adjustments of securities available for sale	69	396
Adjustments from translation of financial statements of companies included on equity basis	7	(69)
Capital reserves in respect of share-based payment transactions and loans to employees for the purchase of the bank's shares	13	(29)
Other capital reserves	(600)	48
Non-controlling interests	262	303
Amounts reduced 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 deriving from changes in own credit risk of the Bank	(922)	(316)
Total Tier 1 shareholders' equity after deductions	29,001	27,723
<b>Tier 2 capital</b>		
Capital instruments eligible for inclusion under the transitional provisions in Directive 299	9,438	11,635
Non-controlling interests in subsidiaries under the transitional provisions in Directive 299	12	5
Collective allowance for credit losses before the relevant tax effect	3,143	3,044
Total Tier 2 capital	12,593	14,684
Total capital base for capital adequacy purposes	41,594	42,407

(a) Data as at 31 December 2014 were restated including changes pursuant to change in accounting method for accruing employee rights and implementation of the directives of the Supervisor of Banks on capitalization of software costs.

(b) Excluding the effect of adoption of US GAAP on employee rights that came into effect on 1 January 2015.



**Table 5 - Composition of regulatory capital with references to the supervisory balance sheet (Third Pillar)**

	31 December 2015		31 December 2014 <sup>(a)(b)</sup>		
	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Reference to the regulatory balance sheet
<b>Tier 1 shareholders' equity: instruments and retained earnings</b>					
Ordinary share capital issued by the banking corporation and premium on ordinary shares included in Tier 1 shareholders' equity	8,188	-	8,188	-	1
Retained earnings, including dividend proposed or declared after the balance sheet date	21,984	-	19,202	-	2
Accumulated other comprehensive income and retained earnings that were disclosed	(511)	(894)	346	-	3
Tier 1 shareholders' equity instruments issued by the banking corporation for inclusion in regulatory capital in the transitional period	-	-	-	-	-
Existing capital injections from the public sector that will be recognized up to 1 January 2018	-	-	-	-	-
Ordinary shares issued by subsidiaries of the banking corporation (minority interests) that were consolidated and were held by a third party	262	117	303	151	4
Tier 1 shareholders' equity before regulatory adjustments and deductions	29,923	-	28,039	151	
<b>Tier 1 shareholders' equity: regulatory adjustments and deductions</b>					
Stability adjustments to appraisal	-	-	-	-	-
Goodwill	273	-	163	-	6
Other intangible assets excluding mortgage servicing rights, less deferred taxes payable	-	-	26	-	7
Deferred taxes receivable whose use is based on future profitability of the banking corporation	2	4	4	17	8
Total accumulated other comprehensive income in respect of cash flow hedges of items not shown in the balance sheet at fair value	-	-	-	-	-
Shortfall between provision and expected losses	-	-	-	-	-
Increase in shareholders' equity deriving from securitization transactions	-	-	-	-	-
Unrealized profits and losses resulting from changes in fair value of liabilities deriving from changes in the own credit risk of the banking corporation. In addition, with reference to liabilities in respect of derivative instruments, all derivative value adjustments (DVA) deriving from the own credit risk of the Bank are to be deducted	6	10	2	10	9
Excess of provision over reserve, less deferred taxes payable that will be removed if the asset becomes impaired or will be deleted pursuant to the Public Reporting Directives	-	-	-	-	-
Own investment in ordinary shares, held directly or indirectly (including liability to purchase shares subject to contractual agreements).	-	-	-	-	-

See notes on page 21

	31 December 2015		31 December 2014 <sup>(a)(b)</sup>		
	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Reference to the regulatory balance sheet
Mutual cross holdings in ordinary shares of financial corporations	-	-	-	-	-
Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation does not exceed 10% of the ordinary share capital issued by the financial corporation (in an amount exceeding 10% of Tier 1 shareholders' equity)	-	-	-	-	-
Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation exceeds 10% of the ordinary share capital issued by the financial corporation	-	-	-	-	-
Mortgage servicing rights whose total exceeds 10% of the Tier 1 shareholders' equity	-	-	-	-	-
Deferred taxes receivable created as a result of timing differences, whose total exceeds 10% of the Tier 1 shareholders' equity	640	960	121	483	10
Total mortgage servicing rights, deferred taxes receivable created as a result of timing differences and investments exceeding 10% of the ordinary share capital issued by financial corporations, which exceed 15% of the Tier 1 shareholders' equity of the banking corporation	-	-	-	-	-
Of which:	-	-	-	-	-
In respect of investments exceeding 10% of the ordinary share capital issued by financial corporations	-	-	-	-	-
In respect of mortgage servicing rights	-	-	-	-	-
Of which: deferred taxes receivable created as a result of timing differences	-	-	-	-	-
Additional regulatory adjustments and deductions determined by the Supervisor of Banks	-	-	-	-	-
Of which: in respect of investments in capital of financial corporations	-	-	-	-	-
Of which: in respect of mortgage servicing rights	-	-	-	-	-
Tier 1 shareholders' equity	-	-	-	-	-
<b>Regulatory adjustments in Tier 1 shareholders' equity that are subject to treatment required before adoption of Directive 202 pursuant to Basel III</b>	-	-	-	-	-
Deductions applying to Tier 1 shareholders' equity since there is insufficient additional Tier 1 shareholders' equity and Tier 2 capital to cover	-	-	-	-	-
Total of all regulatory adjustments and deductions to Tier 1 shareholders' equity	922	-	316	-	-
Tier 1 shareholders' equity	29,001	-	27,723	-	-

	31 December 2015		31 December 2014 <sup>(a)(b)</sup>		
	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Reference to the regulatory balance sheet
<b>Additional Tier 1 capital : instruments</b>	-	-	-	-	-
Additional Tier 1 share capital instruments issued by the banking corporation and premium on these instruments	-	-	-	-	-
Of which: classified as share capital pursuant to the Public Reporting Directives	-	-	-	-	-
Of which: classified as liability pursuant to the Public Reporting Directives	-	-	-	-	-
Additional Tier 1 capital : Instruments issued by the corporation that are eligible for inclusion in regulatory capital in the transitional period	-	-	-	-	-
Additional Tier 1 capital instruments issued by subsidiaries of the banking corporation and held by third party investors	-	-	-	-	-
Of which: additional Tier 1 capital instruments issued by subsidiaries of the banking corporation and held by third party investors, that are deducted gradually from additional Tier 1 capital	-	-	-	-	-
Additional Tier 1 capital before deductions	-	-	-	-	-
<b>Additional Tier 1 capital: deductions</b>	-	-	-	-	-
Own investment in capital instruments included in Tier 1 shareholders' equity, held directly or indirectly (including liability to purchase instruments subject to contractual agreements).	-	-	-	-	-
Mutual cross holdings in ordinary shares of financial corporations included in additional Tier 1 capital	-	-	-	-	-
Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation does not exceed 10% of the ordinary share capital issued by the financial corporation	-	-	-	-	-
Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation exceeds 10% of the ordinary share capital issued by the financial corporation	-	-	-	-	-
Additional deductions determined by the Supervisor of Banks	-	-	-	-	-
financial corporations	-	-	-	-	-
Of which: additional deductions in Tier 1 shareholders' equity not included in the framework of Section 41.A (detail if material)	-	-	-	-	-
Deductions in additional Tier 1 capital that are subject to treatment required before adoption of Directive 202 pursuant to Basel III	-	-	-	-	-
Deductions applying to additional Tier 1 capital since there is insufficient Tier 2 capital to cover the deductions	-	-	-	-	-
Total of all deductions in additional Tier 1 capital	-	-	-	-	-
Additional Tier 1 capital	-	-	-	-	-
Tier 1 shareholders' equity	<b>29,001</b>	-	27,723	-	-

	31 December 2015		31 December 2014 <sup>(a)(b)</sup>		
	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Reference to the regulatory balance sheet
<b>Tier 2 capital: Instruments and allowances</b>	-	-	-	-	-
Instruments issued by the banking corporation (that are not included in Tier 1 shareholders' equity) and premium on these instruments	-	-	-	-	-
Tier 2 capital instruments issued by the corporation that are eligible to be included in the regulatory capital in the transitional period	9,438	-	11,635	-	11
Tier 2 capital instruments issued by subsidiaries of the banking corporation to third party investors	12	-	5	-	5
Of which: Tier 2 capital instruments issued by subsidiaries of the banking corporation and held by third party investors, that are deducted gradually from Tier 2 capital	12	-	5	-	-
Collective allowances for credit losses by the relevant tax effect	3,143	-	3,044	-	12
Tier 2 capital before deductions	12,593	-	14,684	-	-
<b>Tier 2 capital: deductions</b>					
Own investment in Tier 2 capital instruments, held directly or indirectly (including liability to purchase instruments subject to contractual agreements).	-	-	-	-	-
Mutual cross holdings in Tier 2 capital of financial corporations	-	-	-	-	-
Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation does not exceed 10% of the ordinary share capital issued by the financial corporation	-	-	-	-	-
Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation exceeds 10% of the ordinary share capital issued by the financial corporation	-	-	-	-	-
Additional deductions determined by the Supervisor of Banks	-	-	-	-	-
Of which: in respect of investments in capital of financial corporations	-	-	-	-	-
Of which additional deductions in Tier 2 capital	-	-	-	-	-
<b>Regulatory adjustments in Tier 1 shareholders' equity subject to treatment required before adoption of Directive 202 pursuant to Basel III</b>					
Total regulatory adjustments to Tier 2 capital	-	-	-	-	-
Tier 2 capital	12,593	-	14,684	-	-
Total capital	41,594	-	42,407	-	-
Total risk assets weighted in accordance with the treatment required before adoption of Directive 202 pursuant to Basel III	964	-	500	-	-
Of which: other deferred tax assets	964	-	500	-	13
Total weighted risk assets	302,633	-	305,037	-	-

	31 December 2015		31 December 2014 <sup>(a)(b)</sup>		
	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Regulatory capital	Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III	Reference to the regulatory balance sheet
<b>Capital ratios and capital buffers</b>					
Tier 1 shareholders' equity (as percentage of weighted risk assets)	9.58%	-	9.09%	-	-
Tier 1 capital (as percentage of weighted risk assets)	9.58%	-	9.09%	-	-
Overall capital (as percentage of weighted risk assets)	13.74%	-	13.90%	-	-
Minimum Tier 1 shareholders' equity determined by the Supervisor of Banks	9.10%	-	9.00%	-	-
Minimum Tier 1 capital determined by the Supervisor of Banks	-	-	-	-	-
Minimum overall capital determined by the Supervisor of Banks	12.60%	-	12.50%	-	-
<b>Amounts below the deduction threshold (before risk weighting)</b>					
Investments in capital of financial corporations (excluding banking corporations and their subsidiaries) not exceeding 10% of the ordinary share capital issued by the financial corporation and that are below the deduction threshold	663	-	188	-	14
Investments in capital of financial corporations (excluding banking corporations and their subsidiaries) exceeding 10% of the ordinary share capital issued by the financial corporation and that are below the deduction threshold	183	-	148	-	15
Mortgage servicing rights	-	-	-	-	-
Deferred taxes receivable created as a result of timing differences that are below the deduction threshold	2,964	-	2,780	-	16
<b>Ceiling for inclusion of allowances in Tier 2</b>					
Allowance eligible for inclusion in Tier 2 with reference to exposures under the Standardized Approach, before implementation of the ceiling	3,143	-	3,044	-	-
Ceiling for inclusion in Tier 2 under the Standardized Approach	3,463	-	3,424	-	-
Allowance eligible for inclusion in Tier 2 with reference to exposures under the Internal Ratings Approach, before implementation of the ceiling	-	-	-	-	-
Ceiling for inclusion in Tier 2 under the Internal Ratings Approach	-	-	-	-	-
<b>Capital instruments not eligible as regulatory capital subject to the transitional provisions</b>					
Amount of the present ceiling for instruments included in Tier 1 shareholders' equity subject to the transitional provisions	-	-	-	-	-
Amount deducted from Tier 1 shareholders' equity due to the ceiling	-	-	-	-	-
Amount of the present ceiling for instruments included in additional Tier 1 capital subject to the transitional provisions	-	-	-	-	-
Amount deducted from additional Tier 1 due to the ceiling	-	-	-	-	-
included in Tier 2 capital subject to the transitional provisions	10,181	-	11,635	-	-
Amount deducted from Tier 2 capital due to the ceiling	-	-	138	-	-

(a) Data as at 31 December 2014 were restated including changes pursuant to change in accounting method for accruing employee rights and implementation of the directives of the Supervisor of Banks on capitalization of software costs.

(b) Excluding the effect of adoption of US GAAP on employee rights that came into effect on 1 January 2015.

**Table 6 - Composition of the regulatory balance sheet with references to components of regulatory capital (Third Pillar)**

	<b>31 December 2015</b>	31 December 2014 (a)(b)	Reference to regulatory capital components
	NIS millions		
<b>Assets</b>			
Cash and deposits in banks	<b>60,455</b>	60,615	-
Securities <sup>1</sup>	<b>69,475</b>	52,113	-
<sup>1</sup> Of which: investments in capital of financial corporations that do not exceed 10% of the share capital of the financial corporation	-	-	-
<sup>1</sup> Of which: Other securities	<b>68,812</b>	51,925	-
Credit to the public	<b>265,070</b>	256,468	-
Allowance for credit losses <sup>1</sup>	<b>(3,671)</b>	(3,988)	-
<sup>1</sup> Of which: collective allowance for credit losses included	<b>(2,805)</b>	(2,709)	<b>12</b>
<sup>1</sup> Of which: allowance for credit losses not included in regulatory capital	<b>(866)</b>	(1,279)	-
Credit to the public, net	<b>261,399</b>	252,480	-
Credit to governments	<b>453</b>	528	-
Investments in companies included on equity basis <sup>1</sup>	<b>924</b>	2,216	-
<sup>1</sup> Of which: investments in capital of financial corporations that exceed 10% of the share capital of the financial corporation	-	-	-
<sup>1</sup> Of which: Other securities	<b>183</b>	148	<b>15</b>
Goodwill <sup>1</sup>	<b>255</b>	121	<b>6</b>
Intangible asset <sup>1</sup>	-	27	<b>7</b>
Buildings and equipment	<b>3,095</b>	3,162	-
Other assets <sup>1</sup>	<b>7,666</b>	5,711	-
<sup>1</sup> Of which: deferred tax assets <sup>2</sup>	<b>4,570</b>	3,404	-
<sup>2</sup> Of which: deferred tax assets except for those attributed to t	<b>2</b>	4	<b>8</b>
<sup>2</sup> Of which: deferred tax liability in respect of intangible assets:	-	-	<b>7</b>
<sup>2</sup> Of which: deferred taxes attributed to timing differences, whose total exceeds 10% of the Tier 1 shareholders' equity	<b>640</b>	121	<b>10</b>
<sup>2</sup> Of which: deferred taxes attributed to timing differences, whose total does not exceed 10% of the Tier 1	<b>2,964</b>	2,784	<b>16</b>
<sup>2</sup> Of which: other deferred tax assets pursuant to the transitional provisions	<b>964</b>	494	<b>13</b>
<sup>1</sup> Of which: additional other assets	<b>3,096</b>	2,307	-
Intangible assets and goodwill	<b>18</b>	43	-
<sup>1</sup> Of which: goodwill	<b>18</b>	43	<b>6</b>
<sup>1</sup> Of which: intangible asset	-	-	<b>7</b>
Securities borrowed or purchased under resell agreements	<b>1,764</b>	2,000	-
Assets in respect of derivative instruments	<b>11,250</b>	16,909	-
<b>Total assets</b>	<b>416,499</b>	395,777	-

(a) Data as at 31 December 2014 were restated including changes pursuant to change in accounting method for accruing employee rights and implementation of the directives of the Supervisor of Banks on capitalization of software costs.

(b) Excluding the effect of adoption of US GAAP on employee rights that came into effect on 1 January 2015.

<b>Liabilities and capital</b>	<b>2015</b>	<b>2014</b>	
Deposits of the public	<b>328,693</b>	303,397	-
Deposits from banks	<b>3,859</b>	4,556	-
Deposit from governments	<b>750</b>	467	-
Debentures and subordinated notes <sup>1</sup>	<b>21,308</b>	23,678	-
<sup>1</sup> Of which subordinated notes not recognized as regulatory capital	<b>11,870</b>	12,043	-
<sup>1</sup> Of which subordinated notes recognized as regulatory capital <sup>2</sup>	<b>9,438</b>	11,635	-
<sup>2</sup> Of which: eligible as regulatory capital components	-	-	-
<sup>2</sup> Of which: ineligible as regulatory capital components and subject to transitional provisions	<b>9,438</b>	11,635	<b>11</b>
Other liabilities	<b>20,746</b>	18,715	-
<sup>1</sup> Of which: collective allowance for credit losses included in Tier 2	<b>338</b>	335	<b>12</b>
Securities lent and sold under resell agreements	<b>938</b>	1,238	-
Liability in respect of derivative instruments <sup>1</sup>	<b>11,098</b>	15,650	-
<sup>1</sup> Of which; in respect of own credit risk	<b>6</b>	2	<b>9</b>
Total liabilities	<b>387,392</b>	367,701	-
Non-controlling interests 1	<b>340</b>	340	-
<sup>1</sup> Of which: non-controlling interests that can be attributed to Tier 1 shareholders' equity	<b>262</b>	303	<b>4</b>
<sup>1</sup> Of which: non-controlling interests that can be attributed to Tier capital	<b>12</b>	5	<b>5</b>
Capital attributed to shareholders of the banking corporation <sup>1</sup>	<b>28,767</b>	27,736	-
<sup>1</sup> Of which: ordinary share capital	<b>7,059</b>	7,059	<b>1</b>
<sup>1</sup> Premium on ordinary shares	<b>1,129</b>	1,129	<b>1</b>
<sup>1</sup> Of which: retained earnings	<b>21,984</b>	19,202	<b>2</b>
<sup>1</sup> Of which: unrealized profits (losses) from adjustments of securities available for sale to fair value	<b>69</b>	396	<b>3</b>
<sup>1</sup> Of which: net losses from adjustments from translation of financial statements	<b>7</b>	(69)	<b>3</b>
<sup>1</sup> Of which: other reserves	<b>9</b>	19	<b>3</b>
<sup>1</sup> Of which: Profits (losses) from adjustments in respect of employee benefits included in regulatory capital	<b>(596)</b>	-	<b>3</b>
<sup>1</sup> Of which: Profits (losses) from adjustments in respect of employee benefits not included in regulatory capital	<b>(894)</b>	-	-
Total shareholders' equity	<b>29,107</b>	28,076	-
<b>Total liabilities and capital</b>	<b>416,499</b>	<b>395,777</b>	

(a) Data as at 31 December 2014 were restated including changes pursuant to change in accounting method for accruing employee rights and implementation of the directives of the Supervisor of Banks on capitalization of software costs.

(b) Excluding the effect of adoption of US GAAP on employee rights that came into effect on 1 January 2015.

**Table 7 - Report on the changes in the composition of regulatory capital (EDTF)**

	For the year ended 31 December
	<b>2015</b>
	NIS millions
<b>Tier 1 shareholders' equity</b>	
Balance at the beginning of the year	27,723 <sup>(a)(b)</sup>
Net profit for the period	2,782
Unrealized profits (losses) from adjustment of securities available for sale	(327)
Capital reserve of loans to employees for the purchase of shares of the Bank	42
Capital reserve for share-based payment transactions	10
Capital reserve in respect of employee benefits	(596)
Other capital reserve	13
Minority interests	(40)
<b>Deductions</b>	-
Goodwill and intangible assets	(84)
Deferred taxes in respect of future profitability	2
Deferred taxes in respect of timing differences	(520)
Accumulated profits/losses resulting from changes in own credit risk on financial liabilities at fair value	(4)
Net increase in Tier 1 shareholders' equity	1,278
Balance at the end of the year	29,001
<b>Tier 2 capital</b>	-
Balance at the beginning of the year	14,684
Subordinated notes	(2,198)
Minority interests	8
Expenses in respect of collective allowance	99
Net decrease in Tier 2 capital	(2,091)
Balance at the end of the year	12,593
Total overall capital at the end of the year	41,594

(a) Data as at 31 December 2014 were restated including changes pursuant to change in accounting method for accruing employee rights and implementation of the directives of the Supervisor of Banks on capitalization of software costs.

(b) Excluding the effect of adoption of US GAAP on employee rights that came into effect on 1 January 2015.



## **Capital adequacy**

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

### **Capital adequacy targets prescribed by the Bank of Israel:**

Pursuant to Proper Conduct of Banking Business Directive No. 201, "Measurement and Capital Adequacy – Introduction, Application and Calculation of Requirements", all banking corporations are 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 constitute 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. In addition, all banking corporations in Israel are required to comply with an overall capital ratio of 12.5%, as of 1 January 2015. A large banking corporation will be required to comply with an overall capital ratio of 13.5%, as of 1 January 2017. Provisions regarding the above additional capital requirements apply to Leumi.

On 28 September 2014, the Supervisor of Banks published a circular for an amendment to Proper Conduct of Banking Business Directive No. 329 - "Limitations on Issuing (על פי האתר של הפיקוח) Housing Loans". Pursuant to the amended directive, the banking corporation will be required to increase the Tier 1 shareholders' equity target and the overall capital target by 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 percentages from 1 April 2015 until 1 January 2017. The effect of the amendments to the regulation on Leumi Group at the final effective date is estimated at 0.27%, which will be added respectively to the minimum capital adequacy ratio required in Tier 1 shareholders' equity and in the overall capital. Compliance with these targets will be achieved gradually.

In light of the above, the minimum required capital target applicable to the Bank as of 31 December 2015 is:

Tier 1 shareholders' equity target – 9.1%

Overall capital target – 12.6%

### **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 hold a level of capital adequacy higher than the minimum that will be periodically specified by the Bank of Israel and not less than the rate required to cover the risks as estimated in the ICAAP process. In addition, targets have been defined that the Group wishes to meet in the event of a stress scenario.

As part of the regulatory review procedure, the Supervisor instructed the determination of internal capital targets which will suit the Bank's risk profile. Further thereto, the Board of Directors of the Bank approved an increase in the Bank's internal Tier 1 shareholders' equity such that from 31 December 2017, it will stand at 10.5%. The Board of Directors of the Bank will meet to discuss this target again no later than the end of 2016.

The accounting standard for employee rights implemented for the first time in January 2015, is a factor that impacts and is expected to impact, most significantly, Leumi's Tier 1 shareholders' equity, particularly due to the fact that the measurement of the liability is in accordance with market interest rates which are at historically low levels and due to high fluctuation that is inherent in this measurement.

The Bank examines and implements a number of ways to moderate the volatility in equity arising from the standards - such as a purchase, directly or indirectly, of instruments that hedge the effect of changes in the market interest rates factors (wholly or partly) used to discount obligations for employee rights.

In addition, the expected overall decrease in equity due to write-downs of equity instruments attributed to Tier 2 capital issued prior to the entry into force of the directives for the implementation of Basel III, and lowering the ceiling of the amount recognized in equity of these capital instruments.

As of December 2015, the Tier 1 capital adequacy ratio of the Bank is 9.58%. The Bank is prepared to meet capital targets by 1 January 2017. The completion of the required capital (in excess of the regulatory capital deriving from its current profitability after deducting the increase in risk assets and the impact of the transitional provisions) is made by:

- **Managing the increase in risk assets** – this is by optimizing the risk assets (optimizing collateral, etc.), investment in nostro assets that require lower capital allocation, selective management of credits by industry sectors and risk, syndication, and reinsurance cross-section.

#### **Two significant steps that the Bank has taken:**

- (A) The Bank is in the process of engagement with international reinsurers, with high international rating, for the purchase of insurance for the portfolio of guarantees by virtue of the Sale (Apartments) Law and obligations to issue such guarantees. Purchasing insurance is intended mainly to reduce the capital earmarked for credit risk arising from the issuance of guarantees, by using the policy as a "credit risk mitigator", pursuant to Proper Conduct of Banking Business Directive No. 203. Upon completion of the move, an improvement of 0.22% to 0.28% is expected in the capital adequacy ratio of Tier 1 shareholders' equity. The completion of the contract and issuance of policies is expected in the near future.
- (B) The Bank is having advanced discussions with institutional investors from the Harel Insurance & Finance Group for providing jointly housing loans secured by, among other things, mortgages and pledges of contractual rights regarding land. According to the agreement being formulated, which is subject to regulatory approvals, the participation rate of Harel in any joint loan may not exceed 50%. Total cumulative loans to be provided by Harel in 2016 will not exceed NIS 4 billion, and in 2017 will not exceed an amount to be defined but in any event will not be less than NIS 4 billion.
- According to the draft FAQ circular of the Bank of Israel dated 4 February 2016, there will be no deduction threshold contained in Section 13 of Proper Conduct of Banking Business Directive No. 202 on the deferred tax asset, net resulting from differences in the timing and probability of realization is high. The deferred tax asset above-mentioned is to be weighted as a risk asset at the rate of 250%. The update is expected to reduce the regulatory deductions from the Bank's capital and improve capital adequacy. However, it is not possible at this stage to estimate the exact impact on the Bank's capital.

- **Converting employee rights to shares of the Bank** - On 17 February 2016 a special collective agreement was signed between representatives of the employees of the Bank and the Bank, under which various rights accrued in favor of employees in the Bank, will be converted into shares of the Bank to be issued to employees in the amount of those rights, based on the amount in which those rights are recorded in the Bank's books. If and to the extent that the move will be completed and carried out for the target amount for conversion, NIS 1.15 billion, it is expected to increase the Tier 1 shareholders' equity capital adequacy by about 0.37%.

**Below is an analysis of the sensitivity to the main factors affecting Leumi Group's capital adequacy:**

- Changing the total of risk assets – Leumi's risk assets at the end of December 2015 amounted to approximately NIS 302.7 billion. Each 1% increase in risk assets (about NIS 3 billion) will reduce Tier 1 shareholders' equity ratio by 0.09 % and the overall capital ratio by 0.14%.
- Accumulated profit or a change in the capital reserve – the Tier 1 shareholders' equity of Leumi at the end of December 2015 amounted to NIS 29.0 billion. Total overall capital amounted to NIS 41.6 billion. Any accumulation of net profit and / or positive movement in the capital reserve in the amount of NIS 1 billion, will improve Tier 1 shareholders' equity ratio and the overall capital ratio by 0.33%.
- Accounting standards regarding employee rights - according to this standard, the actuarial liability for employees discounted at market interest rates affected by the Israeli government bonds curve and the US AA corporate bonds spread. An increase of 0.1% over the interest rate curve for discounting, assuming the curve rises and falls uniformly, and without regard to hedging activities the Bank has adopted so far, means an increase of approximately 0.07% with respect to Tier 1 shareholders' equity ratio and overall capital ratio (under the transitional provisions, the effect is more moderate. Only 40% of the effect in 2015 and an additional 20% in each subsequent year).

The above capital adequacy ratio policy relates to future transactions of the Bank, and is considered "forward-looking information"

**Regulatory changes that may affect capital requirements and planning:**

**Streamlining operations**

On 12 January 2016, the Supervisor of Banks issued a letter entitled "Operational Streamlining of the Banking System." Pursuant to the letter, the Boards of Directors of banking corporations are to draft a multi-year outline plan to improve efficiency. A banking corporation that meets the conditions set in the letter will receive relief so that it can recognize the impact of the program over five years on a straight line basis for the calculation of capital adequacy.

The Bank is in the process of designing a multi-year streamlining plan.

**Capital requirements for exposures to key counterparties**

On 22 October 2015, the Supervisor of Banks issued a circular entitled "Capital Requirements for Exposures to Key Counterparties" ((henceforth: the "Circular"). The circular amends the provisions of Proper Conduct of Banking Business Directives No. 203 and 204 in order to adapt them to the recommendations of the Basel Committee with regard to capital requirements in respect of the exposures of banks to key counterparties. The circular specifies the new guidelines, which will apply to key counterparty exposures incurred in OTC derivatives transactions, derivatives transactions quoted on the stock exchange and securities financing transactions. The

guidelines distinguish between a key counterparty that is not eligible and a key counterparty that is eligible, whereby for the latter reduced capital requirements were set.

The above instructions are likely to increase the Bank's capital requirements in respect of such exposures, although at this stage the Bank is preparing to implement the Directive and is examining the effect on the capital ratios.

The above information regarding capital adequacy and its management refers to future operations of the Bank, and is considered "forward-looking information".

### **Capital planning in the Group**

The management of capital is a process which comes to ensure that the Group complies with the minimum capital requirements (which are included in the risk appetite), while fulfilling the business strategy for future years.

Capital planning takes into account the growth in the activity of the various profit centers in the Group and other factors affecting the Bank's compliance with capital requirements, such as current profits, changes included in other comprehensive income, regulatory adjustments and the effect of transitional provisions, the rate of increase in the volume of balance sheet assets and risk assets, etc.

Multi-year follow-up takes place of the capital adequacy position, and recommendations for courses of action are formulated accordingly. Simulations, sensitivity analyses and stress scenarios are carried out, with the aim of examining the various assumptions on the basis of which the forecasts have been made, and their impact on the forecast of the Group's capital adequacy ratios. The assumptions include, inter alia, a change in macro-variables, such as exchange rates and yields, changes in business activity which will be reflected in a change in the volume of the risk assets and in the total profit that will be accrued, as well as a change in other comprehensive income, chiefly as a result of the impact of accounting standards regarding employee rights.

This analysis is conducted together with and on a consistent basis with the planning of the Bank's leverage ratio and liquidity requirements, with the aim of ensuring compliance with the range of requirements of the Working Framework of the Basel Committee, and from an overall perspective of managing the Bank's balance sheet and exposures.

**Table 8 - Risk components and capital requirements in respect of credit risk, market risk and operational risk (Third Pillar)**

	31 December			
	2015		2014 <sup>(d)</sup>	
	Risk assets and capital requirements in respect of credit risk deriving from exposures of :			
	Risk assets	Capital requirements <sup>(b)</sup>	Risk assets	Capital requirements <sup>(b)</sup>
	NIS millions			
Sovereign debts	923	116	856	107
Debts of public sector entities	2,734	344	2,564	321
Debts of banking corporations	3,693	465	5,455	682
Debts of securities	173	22	161	20
Debts of corporations	106,737	13,449	110,313	13,789
Debts collateralised by commercial real estate	51,497	6,489	48,529	6,066
Retail exposures to individuals	33,421	4,211	30,488	3,811
Small business loans	11,567	1,457	10,662	1,333
Housing mortgages	45,119	5,685	42,457	5,307
Securitization	578	73	723	90
Other assets	18,952	2,388	19,268	2,409
Risk assets and capital requirements in respect of CVA risk	1,640	207	2,405	301
Total in respect of credit risk <sup>(a)</sup>	277,034	34,906	273,881	34,236
Risk assets and capital requirements in respect of market risk <sup>(a)</sup>	5,167	651	10,839	1,355
Risk assets and capital requirements in respect of operational risk <sup>(a)</sup>	20,432	2,574	20,317	2,540
Total risk assets and capital requirements <sup>(b)(c)</sup>	302,633	38,131	305,037	38,131
Total overall capital	41,594		42,407	
Ratio of overall capital to risk components	13.74%		13.90%	
Ratio of Tier 1 shareholders' equity to risk components	9.58%		9.09%	
Ratio of minimum Tier 1 shareholders' equity required by the Supervisor of Banks <sup>(e)</sup>	9.10%		9.00%	
Ratio of minimum overall capital required by the Supervisor of Banks <sup>(e)</sup>	12.60%		12.50%	

(a) Risk weighted assets according to the Standardized Approach.

(b) According to 2.6% and 12.5% pursuant to the minimum ratio required at 31 December 2015 and 31 December 2014 respectively.

(c) Additional capital buffers calculated in respect of the Second Pillar.

(d) The data as at 31 December 2015 are without the effect of adoption of US GAAP on employee rights which came into force on 1 January 2015.

(e) The minimum Tier 1 shareholders' equity ratio required and the minimum total equity ratio required from 1 January 2015 until 31 December 2016 are 9% and 12.5%, respectively, and from 1 January 2017 and 10% and 13.5%, respectively. To these ratios, from 1 January 2015, there is added a capital requirement at a rate expressing 1% of the balance of housing loans at the reporting date. This requirement is being implemented gradually in equal quarterly amounts from 1 April 2015 to 1 January 2017. Accordingly, the minimum Tier 1 shareholders' equity ratio and the minimum total equity ratio required by the Supervisor of Banks as at 1 January 2017, according to data at the reporting date, are 10.27% and 13.77%, respectively.

**Table 9 - Capital adequacy ratio on consolidated basis and principal subsidiaries according to Basel**

	31 December			
	2015	2014	2015	2014
	Overall capital ratio		Tier 1 shareholders' equity ratio	
	Percentages			
Leumi Consolidated	13.74%	13.90%	9.58%	9.09%
Arab Israel Bank <sup>(a)</sup>	13.22%	13.24%	12.13%	12.15%
Leumi Card	17.82%	17.20%	16.89%	16.20%
Bank Leumi USA <sup>(b)</sup>	15.13%	13.45%	12.33%	11.02%

(a) Arab Israel Bank was merged with Bank Leumi as at 31 December 2015.

(b) Capital requirements are in accordance with local regulation. Until 1 January 2015, the U.S. office was not required to calculate capital adequacy pursuant to Basel III, and accordingly the ratios shown are in accordance with Basel I.

**Table 10 - Components of risk-weighted assets by business activity (EDTF)**

Measuring exposures to the different risks is based on the balances in the Bank's books as prepared in accordance with generally accepted accounting principles applicable to the Bank and in accordance with specific calculation provisions set forth in Directives 203-209. The measurement may vary according to changes in these rules and provisions and other changes, such as changes in the size and composition of the portfolio, changes in portfolio quality and economic data, changes in calculation methods including risk mitigation techniques (CRM). Risk exposures presented below are based on the rules defined for the calculation of regulatory capital required to support these risks. In addition, the exposures below are presented in accordance with allocation to lines of business activity as reflected in the report on the Bank's operating segments with allocation by risk assets associated with each line of activity.

## Balances of risk assets by operating segment

	31 December 2015							
	House- holds	Private banking	Small busi- nesses	Commer- cial	Corporate	Financial manage- ment	Others	Total
	NIS millions							
Sovereign debts	-	-	-	-	-	923	-	923
Debts of public sector entities	-	-	-	-	2,013	721	-	2,734
Debts of banking corporations	-	-	-	-	-	3,693	-	3,693
Debts of securities companies	-	-	-	-	-	173	-	173
Debts of corporations	-	-	-	33,775	51,984	20,977	-	106,737
Debts collateralised by commercial real estate	-	-	-	20,281	31,215	-	-	51,497
Retail exposures to individuals	31,255	2,166	-	-	-	-	-	33,421
Small business loans	3,808	264	1,049	2,539	3,908	-	-	11,567
Housing mortgages	42,195	2,924	-	-	-	-	-	45,119
Securitization	-	-	-	-	-	578	-	578
Other assets	-	-	-	-	-	-	18,952	18,952
CVA	-	-	-	-	-	1,640	-	1,640
<b>Total credit risk</b>	<b>77,257</b>	<b>5,354</b>	<b>1,049</b>	<b>56,595</b>	<b>89,121</b>	<b>28,705</b>	<b>18,952</b>	<b>277,034</b>
Market risk	-	-	-	-	-	5,167	-	5,167
Operational risk	5,712	396	1,573	3,809	5,863	2,366	712	20,432
<b>Total risk assets</b>	<b>82,970</b>	<b>5,750</b>	<b>2,622</b>	<b>60,405</b>	<b>94,985</b>	<b>36,238</b>	<b>19,664</b>	<b>302,633</b>

Table 11 - Movements in risk-weighted assets (EDTF)

### Changes in credit risk assets

	For the year ended 31 December 2015 NIS millions
Opening balance	273,881
New transactions	104,388
Transactions that were concluded	(82,276)
Partial repayments	(16,082)
Change in rating	(658)
Exchange rate differentials	(801)
Entry / exit from failure	220
Derivative transactions, net	(2,227)
Other	589
Closing balance	277,034

**Changes in market risk assets**

	For the year ended 31 December 2015 NIS millions
Opening balance	<b>10,839</b>
Interest risk - decrease in open positions	<b>(3,175)</b>
Foreign currency risk - reduction in open short positions in dollars	<b>(1,154)</b>
Shares risk - reduction in futures contracts and options on stock indices	<b>(1,155)</b>
Options risk - reduction in foreign currency option scenarios	<b>(188)</b>
Closing balance	<b>5,167</b>

**Changes in operational risk assets**

	For the year ended 31 December 2015 NIS millions
Opening balance	<b>20,317</b>
Changes	<b>115</b>
Closing balance	<b>20,432</b>

**Leverage ratio (Third Pillar)**

On 28 April 2015, the Supervisor of Banks issued Proper Conduct of Banking Business Directive No. 218 on the "Leverage Ratio".

The directive adopts the Basel Committee instruction from January 2014 to add a simple and non-risk based leverage ratio to act as a supplementary metric of risk-based capital requirements, and to limit the accumulation of leverage in the banking sector.

The leverage ratio is defined as the measurement of equity divided by the measurement of exposure, expressed as a percentage. Equity for purposes of measuring the leverage ratio is the Tier 1 capital as defined in Proper Conduct of Banking Business Directive No. 202, taking into account the transitional arrangements that were set. The total exposure measurement of a banking corporation is the amount of balance-sheet exposures, exposures to derivatives and securities financing transactions, and off-balance sheet items.

Pursuant to the Directive, all banking corporations will be required to have a leverage ratio of not less than 5% on consolidated basis. A banking corporation whose total balance sheet assets on a consolidated basis is 20% or more of total balance sheet assets in the banking system, will have a leverage ratio of not less than 6%. This additional Directive applies to Leumi.

A banking corporation that on the date of publication of the Directive does not meet the minimum leverage ratio applying to it, is required to increase the leverage ratio in fixed quarterly installments until 1 January 2018. A banking corporation meeting the minimum leverage ratio applying to it on the date of publication of the Directive shall not go below the threshold defined.

On the date of publication of the Directive, Leumi met the threshold required. The leverage ratio at 31 December 2015 is 6.27%.



**Table 12 - Leverage ratio on consolidated basis and principal subsidiaries according to Basel (Third Pillar)**

	31 December <b>2015</b> NIS millions
<b>A. Consolidated data</b>	
Tier 1 shareholders' equity	<b>29,001</b>
Total exposures	<b>462,680</b>
<b>Leverage ratio</b>	<b>Percentages</b>
Leverage ratio	<b>6.27%</b>
Minimum leverage ratio required by the Supervisor of Banks	<b>6.00%</b>
<b>B. Significant subsidiary companies</b>	
<b>Arab Israel Bank</b>	
Leverage ratio	<b>8.62%</b>
Minimum leverage ratio required by the Supervisor of Banks	<b>5.00%</b>
<b>Leumi Card Ltd.</b>	
Leverage ratio	<b>11.66%</b>
Minimum leverage ratio required by the Supervisor of Banks	<b>5.00%</b>
<b>Bank Leumi USA<sup>(a)</sup></b>	
Leverage ratio	<b>9.98%</b>

(a) Implemented in accordance with local regulation, under which there are no minimum leveraging ratio requirements.

**Table 13 - Comparison of the assets in the balance sheet with the measurement of exposure for the purpose of the leverage ratio (Third Pillar)**

	31 December <b>2015</b> NIS millions
Total assets in accordance with the consolidated financial statements	<b>416,499</b>
Adjustments in respect of:	
Investments in entities in banking, finance, insurance or commerce that were consolidated for accounting purposes, but for which consolidation is not applicable for	-
Trust assets recognized in the balance sheet pursuant to the Public Reporting Directives, but were not included in the measurement of exposure of the leveraging ratio	-
Derivative financial instruments	<b>(4,266)</b>
Securities financing transactions	-
Off-balance sheet items	<b>48,564</b>
Others	<b>1,883</b>
Exposure for purposes of leveraging ratio	<b>462,680</b>

**Table 14 - Disclosure format for the leverage ratio (Third Pillar)**

	31 December <b>2015</b> NIS millions
<b>Balance sheet exposures</b>	
Balance sheet assets (except for derivatives and securities financing transactions, but including collaterals)	<b>404,044</b>
Amounts in respect of assets deducted for purposes of determining Tier 1 shareholders' equity	<b>(922)</b>
Total exposures	<b>403,122</b>
<b>Exposures in respect of derivatives</b>	
Replacement cost related to all the transactions in respect of derivatives (for example, after reduction of eligible variable cash-collateral)	<b>1,671</b>
Amounts of additions in respect of potential future exposure related to all the transactions in respect of derivatives	<b>5,847</b>
Deductions of assets of debtors in respect of variable cash-collateral given in transactions in derivatives	<b>(533)</b>
Total exposures	<b>6,984</b>
<b>Exposures in respect of securities financing transactions</b>	
Gross assets in respect of securities financing transactions (without recognizing set-offs), after adjustments in respect of transactions dealt with as an accounting sale	<b>1,875</b>
Exposures in respect of transactions as an agent	<b>2,135</b>
Total exposures	<b>4,010</b>
<b>Other off-balance sheet exposures</b>	
Total off-balance sheet exposure at gross notional value	<b>130,384</b>
Of which: conversion coefficient 0%	<b>4,763</b>
conversion coefficient 10%	<b>26,271</b>
conversion coefficient 20%	<b>22,697</b>
conversion coefficient 50%	<b>70,513</b>
conversion coefficient 100%	<b>6,141</b>
(Adjustments in respect of conversion to equivalent credit amounts)	<b>(81,821)</b>
Total off-balance sheet after conversion to credit value	<b>48,564</b>
<b>Capital and total exposures</b>	
Tier 1 shareholders' equity	<b>29,001</b>
Total exposures	<b>462,680</b>
Leveraging ratio	<b>6.27%</b>

## **Risk exposure and its assessment**

### **Risk management in Leumi**

Risk management is an essential condition for complying with the current objectives and long-term goals of the Group. The Group is engaged in a wide range of activities involving taking on financial risks, including credit risks, market and liquidity risks and other non-financial risks, such as operating risks, including technological and cyber risks, legal risks, regulatory risks, goodwill risks and compliance risks.

The main areas of responsibility of the Risk Management Division correspond to those defined in the provisions of Proper Conduct of Banking Management Directive No. 310 dealing with risk management. These include responsibility for the risk management at Bank and Group level, leading 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, leading the process of assessing the fairness of the capital adequacy (ICAAP) in all its various components (stress scenarios, quality review of the risk management and definition of the main gaps, including plans for their closure, calculation of the capital buffers and the capital adequacy required for Leumi's risk profile, the capital planning (in conjunction with the Finance Division), responsibility for authorities in credit and market activities, responsibility for monitoring and control of the main risk limits, development and validation of models, assessment of risks and validation of the borrower's internal rating in specific portfolios in credit according to the thresholds provided, overall responsibility for the fairness of the classifications and allowances in credit and the determining of rates of the collective allowance, supporting key projects and strategies in real time, conducting independent analyses when making strategic decisions and approval processes of new products and creating an overall and up-to-date picture of the risk for real-time decision-making.

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 changes occurring in the business environment, and the requirements of the Bank of Israel, and other relevant regulatory authorities in Israel and abroad.

The working framework used for estimating and managing the risks and as a basis for decision-making includes:

- a. the risk appetite, which defines the boundaries for business activity, both on a routine basis, and under a stress scenario and which defines, inter alia, the establishment of risk policies and restrictions - for each type of risk.
- b. working processes defined for analyzing and managing risk at the single transaction level and at the portfolio level.
- c. periodic reports for evaluating risk, 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, the definition of general plans of action to be carried out to contend with /mitigate the risks.

The assessment of risk at the overall level of the Group 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 various types of statistical models. 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 internal, and sometimes, external, factors.

## **Organizational structure of risk management in the Bank**

Risk management in Leumi is based on three "lines of defense". The first line of defense is the business lines, which are responsible for identifying, assessing, measuring, monitoring, mitigating and reporting on inherent risks in products, activities, process and systems under their responsibility, as well as maintaining a proper control environment in the context of risk management; the second line is the Risk Management Division, which is an independent function, responsible for leading policy and risk limits in conjunction with the business party and the directives of the Board of Directors, for examining the appropriateness of processes and controls, and for challenging the business divisions and supporting functions in important real-time decisions; the third line of defense is the Internal Audit Division, which conducts an independent review and challenges controls, processes and risk management systems in the banking corporation. Audit is carried out retrospectively on the first and second lines. In addition to these three lines of defense, the Board of Directors is involved in determining, supervising and challenging 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, and the management of legal risks and compliance risks is under the authority of the Bank's Chief Legal Counsel and the management of reputational risk is under the responsibility of the Digital Banking Division.

## **Organizational structure of risk management in the Leumi Group:**

Reporting to the Chief Risk Officer are the heads of the sub-divisions for managing credit risks, market risks, operating risks, an Enterprise Risk Management section manager and the Head of the CRM Department, which deals with credit risks at the single transaction level. In each subsidiary in Israel and abroad, a Chief Risk Officer is appointed, who reports administratively to the CEO of the subsidiary, and reports indirectly (Dotted Line) to the Chief Risk Officer of the Group.

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 Senior Risk Management Committee headed by the President and CEO, of which all of the members of the management are members.
- Risk management committees according to various topics headed by the Chief Risk Officer and with the participation of business entities from the various divisions: credit, market, operational and enterprise risk.
- The Compliance Risk Committee headed by the Chief Legal Counsel.

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, with policy documents of the subsidiaries corresponding to the Group policy, reflecting relevant changes as far as is required from the 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 and supervision is exercised by the Board of Directors of each subsidiary.

## **Risk appetite**

The risk appetite of the Group outlines the boundaries for business activity, both in the normal course of business, and under a stress scenario. The risk appetite is adapted to Leumi's strategy and the boundaries of business focus on which it has chosen to actually concentrate and from a forward-looking aspect. The risk appetite relates to the way Leumi conducts itself in identifying, measuring, controlling, managing and mitigating the risks, with this conduct having a direct impact on the Group's residual risk profile. The risk appetite limitations are approved at board level within the framework of the ICAAP process.

The risk appetite document represents a point of attribution to the specific policy documents in relation to each type of risk, and in which additional risk restrictions and risk management directives are set forth.

The declaration of the Group's risk appetite deals with the scope and types of aggregate risk that the Bank wants to bear in order to achieve its business objectives. Various metrics were set, both quantitative and qualitative, based on forward-looking assumptions which reflect the aggregate risk appetite of the Group.

When outlining the risk appetite, the risk capacity is regularly calculated - the maximum level of risk the Group can bear without breaching capital, leverage, liquidity, and liability constraints and other regulatory restrictions, including from the perspective of shareholders and customers. The risk capacity is examined, inter alia, through the implementation of stress scenarios.

Leumi Group has a set of internal stress tests, which is updated regularly. This is with purpose of examining the main risk areas, in light of various developments in the environment in which the Bank operates, such as changes in the business environment, regulatory requirements and so forth. Leumi's set of scenarios includes, among other things - a global systemic scenario, a local systemic scenario, operational scenarios and others.

The effect of the most severe stress tests is examined against Group capital planning in order to check that the Group complies with all regulatory and internal limits set forth under the scenario.

## **Risk management culture in the Bank**

There is a proper organizational risk management culture in the Leumi Group, based on solid risk management, which is the key to effective risk management.

The following are the principles guiding the Bank in assimilating the risk management culture:

- Risk management as one of the strategic targets – Leumi places great importance on risk, sees its priority as a strategic target and emphasizes the development of advance abilities in the field, their assimilation and their implementation in the organization.
- Integrated approach for risk management – management of all the material risks and the interaction between them, search for correlation between different risks, also placing an emphasis both on the micro and macro level of the transaction / project).
- Real-time risk management, in a close interface with the business side and from a forward-looking perspective.
- Analyzing and understanding the risk as an essential pre-condition for activity – focusing on activities in which the organization has at its disposal the required expertise for estimating and managing the risks.
- Risk management will constitute an important part of decision-making – the employees, the Management and the Board of Directors study, understand and are committed to the risk policy principles and make decisions in accordance with these guidelines.
- Differential risk management – the risk management will be more intense on significant risks and less severe with less significant risks.
- A wide and cross-organizational perspective of all of the risks – this via broad processes, like ICAAP (capital adequacy assessment process), transparency of the risk in the work program and execution of holistic stress scenarios.
- Independence and segregation of duties – through the existence of monitoring and control entities independent of the lines of business.
- The ethical code – activity in the Bank will be conducted according to the principles of the code of ethics which reflect its core values.
- Continuous training, both for the sake of professional reinforcement of all of those engaged in risk management in the Group, and in order to assimilate the culture and principles of risk management in the various lines of business
- The existence of proper corporate governance in the organization from the aspect of risk management.
- The existence of an effective framework for the management of risks and controls – the business activity and management of risks and controls are organized effectively so as to minimize conflicts of interests among the employees and organizational units. The information systems and the professional level of the employees are conducive to the complexity of their office and the risk managed by them.
- Risk appetite limitations and policy approved at board level and outline the boundaries for routine business activity.
- Existence of three lines of defense for risk management – the lines of business, independent risk management and the internal audit.
- Drawing conclusions – discussion of events of failure or almost failure, analysis of implications and significance of the findings in the event and formulation of recommendations for improving the working processes and increasing the business effectiveness.
- Efficient and critical communication – which encourages a range of opinions, with a positive and constructive approach.
- Remuneration – the measurement of the performance of those responsible for risk-taking and their remuneration will be made in terms of return vis-à-vis risk.

The Bank has established policy for approving new products, including supporting new products, significant changes in products or in current activity and entry into new markets. The approval process includes an examination of the risks inherent of the new products and their impact on the risk profile, and whether there is the expertise and tools in the Bank required in order to identify, measure, monitor, control and report the risks of the new products.

## **Credit risk**

Credit is the Bank and the Group's principle core activity, taking place in a diversified manner in a number of lines of business. The credit risk is the risk of the Bank for a loss as a result of the possibility that a counterparty will not meet its obligations vis-à-vis the banking corporation, as agreed. This is in reference to credit to the public, derivatives, deposits in banks, investments in bonds, and equity holdings.

### **Organizational structure and responsibility for managing credit risks**

The Bank implements an overall policy for managing credit risk, in accordance with the provisions of Proper Conduct of Banking Business Directive No. 311 and Proper Conduct of Banking Business Directive No. 314, including the responsibility of Management and the Board of Directors. In addition, the Bank takes care to manage risk in accordance with the additional instructions and requirements in the Directives of the Banking Supervision Department while implementing corporate governance that includes three lines of defense".

#### **First line –Lines of business**

Credit risk in the Bank is attributed to a number of main business lines (retail banking, commercial banking, corporate banking and capital market and financial management banking) in accordance with their expertise. These units are responsible for taking the risk, while also routinely analyzing, understanding and monitoring it throughout the life of the transaction. The units operate in a proper risk environment, in the context of which processes for underwriting, managing and operating the credit are defined. The process of approving the credit is carried out in accordance with the Bank's credit policy and in accordance with the established hierarchy of authorities, including the involvement of the CRM Unit (see explanation below).

First-line control activities are an integral part of the risk management process. In the scope of the first line, specialist units operate in each of the corporate divisions, providing a professional solution for aspects of activity and/or control, according to their designation.

It should be noted that, as part of the first line, specialist units operate, providing a solution for unique aspects of the processes of approval and handing credit. Within the Banking Division, credit management centers, subject to the divisional risk manager, operate, providing a solution to the branches of the division, both in credit approvals where they are beyond their authority and from the aspect of monitoring and control.

In addition, the Special Credit Department operates for dealing with customers in difficulties from the commercial and corporate segment.

#### **Second line – Risk Management Division**

The two units which coordinate the handling of credit risks in the Risk Management Division are:

##### **A. Credit Risk Management (CRM) Department**

CRM has overall responsibility for credit risk management at the level of the individual transaction and rendering a profound independent opinion on credit applications submitted by the corporate units, to validate the rating of borrowers (internal risk assessment) and carrying out a periodic review in conjunction with the corporate units with regard to particularly sensitive borrowers, indicating the main risks characterizing the credit and making recommendations for continuing the treatment of the customer, including with regard to the determination of classifications and allowances.

Aside from this, CRM units operate in conjunction with the credit risk department (see paragraph 2) and with the managements of the corporate divisions to develop methodologies and finance "molds" in various segments. The CRM units provide a solution for borrowers with a credit volume of NIS 25 million and above in the Commercial, Corporate and Real Estate Department. In addition, reporting to the CRM, Real Estate operates an "Appraisal Department" whose function is, inter alia, to examine and validate the valuations of real estate assets which are under a lien to the Bank (in excess of the threshold amounts defined) and determine the maximum value of the assets for collateral.

## **B. Credit Risk Section**

While the activity of the CRM Units are focused on analyzing individual borrowers and loans, the Credit Risk Section is responsible for the management and analysis of credit risks at the level of the whole credit portfolio.

The areas of responsibility and activity of the section include leading the formulation of the credit policy and credit risks policy document for approval by management and the Board of Directors, formulating the internal limits at the portfolio level and monitoring compliance with them, presenting an overall picture of the credit portfolio, trends and changes, independently examining the management and control processes in the first-line units, overall responsibility (development/validation) with regard to the models for internal rating of the credit, responsibility for formulating recommendation of letters of authority for approving and updating credit transactions, development of methodologies and conducting stress scenarios, etc.

### **Third line – Internal Audit**

The Internal Audit performs, post facto, an independent review, and challenges the controls, processes and risk management systems in the banking corporation.

Credit risk management is discussed in a number of committees:

The Bank insists on the existence of proper corporate governance in the risk management processes.

- 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 the policy document of the Risk Management Division, including the exposures to the credit risks and the change in the main risk focal points, the position regarding compliance with the limits at Group and Bank level is reported, and the attitude to material changes, if any, in the business environment and/or the regulations are given. In addition, the policy for managing credit risks, including the main internal limitations, are, once a year, 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 plenary session.
- The Credit Committee of Board of Directors – receives and discusses periodic reports in connection with certain segments from the credit portfolio, as well as extremely material specific credit.
- The Senior Risks Committee, headed by the President & CEO, discusses significant topics related to credit risks after they have been debated in the Senior Credit Risks Committee.



- The Senior Credit Risks Management Committee, headed by the Chief Risk Officer – discusses all of the topics connected with the credit policy, internal limitations, main finance methodologies and key procedures' risk monitoring and trends in the credit portfolio, and formulates the recommendations in the topics required for the approval of the Board of Directors.

In addition, the Bank files reports to the Supervisor of Banks including reports on various credit topics, including credit risk by market sector, financial instruments, the structure of the minimum shareholders' equity, large single borrowers and groups of borrowers, credit to finance the acquisition of the means of control, problem debts and supplementary allowance, credit exposures of the overseas units, related persons, etc.

### **The Bank's policy in the credit area**

A credit and credit risks policy document at Group level outlines the framework and supra-principles for the policy documents of the Bank and each of the subsidiaries in the Group in Israel and abroad. In addition, this document includes the limitations in the area of credit which are defined and managed at Group level.

The Bank's credit and credit risk policy document constitutes a principal reflection of the Bank's credit risk strategy, along with the existing procedures for identifying, measuring, monitoring, supervising and controlling the credit risk. The credit risk policy and the existing procedures relate to the credit risk in all of the Bank's activities, both for the single loan, and for the entire credit portfolio.

### **The guiding principles of the Bank's policy in the area of credit**

- Focusing on exposures in activities where the Bank has the expertise required to assess and manage the inherent risks. On entering a new field of activity, the Bank acts in accordance with the "new product" policy which was approved by the Board of Directors.
- Business initiative with varying types of credit with the aim of achieving risk diversification.
- 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 creating 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 increasing of exposure.
- Determining an outline according to market sector, in which categories of the market sectors are defined according to the level of risk in each sector. This outline is routinely updated in

accordance with periodic analyses of the various market sectors and their segments, according to the inherent risks and prospects in each sector. The sectoral outline represents an additional consideration of specific decisions on the provision of credit.

- 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 to increase vigilance and general awareness among relationship 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.
- Determining rules for underwriting include, inter alia:
  - Characteristics required from a borrower for the purpose of approving credit, including: the assessment of repayment capacity; credit rating; business experience; financial data; various conditions on the basis of which the Bank will agree to extend credit (e.g., rate of financing, maximum amount of exposure and acceptable collateral)
  - Hierarchy of credit authorities including also the definition of authorities for exceptional approvals. In addition, there are authority hierarchies for pricing.
  - Directive for determining repayment schedules adapted for the purpose and the nature of the credit, and appropriate to the borrower's repayment capacity, expected source of payments, longevity of the collateral, etc.

### **Credit policy in the subsidiaries**

In each of the Bank's subsidiaries, including the Bank's overseas units, there is a credit policy document, based on the supra-principles in the Group policy document approved by the Board of Directors of the subsidiary. The policy documents of the subsidiaries are also reviewed by the Risk Management Division in Israel, which checks their suitability to Group policy. A summary description of the credit and the main characteristics of the credit portfolio in the subsidiaries are presented periodically to the Board of Directors of the Bank in Israel.

As in Israel, the credit policy of overseas subsidiaries is based on diversification of 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 and expertise. Various levels of credit-granting authorities are set for each subsidiary, and there is a process of internal rating of borrowers. In addition, under a risk manager in each subsidiary, there are credit risk management functions operating that exercise routine independent control and examination of the risk level of the Bank's customers.

### **Conclusion-drawing process**

The Bank has a process for drawing conclusions on credit matters, pursuant to which committees for drawing conclusions have been established in the various divisions. 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 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.

Currently, the relevant sources of concentration for the Bank's credit portfolio are groups of borrowers, single large borrowers, and industry sectors.

The Bank's loan portfolio is diversified between different economic sectors in order to spread diversify the risk inherent in a high concentration in one industry. In industries characterized by a relatively low level of risk, we aim to reach a higher rate of financing than our share in the system.

The Bank's credit policy for the different operating segments and for the various sectors of the economy fluctuates depending on the business environment, the Bank's business focus, the risk appetite of the Bank and the general and specific guidelines of the Bank of Israel

The largest industry in the commercial loan portfolio of the Bank is the construction and real estate sector.

In addition to the industry diversification limit imposed by the Bank of Israel regarding the 20 main economic sectors, the Bank defines, as part of its risk policy, inherent limitations on diversifying the loan portfolio on the basis of economic sectors and sub-sectors, both as a percentage of regulatory capital and as a percentage of credit risk.

### **Activity and risk restrictions in the construction and real estate sector**

The real estate sector 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. 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 department 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 – development of housing construction, building contracting including performance contracting, infrastructure projects, activities in non-housing real estate – rental properties, 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 construction financing is in the "Closed Project" (Construction Loan) form, which is characterized by periodic examination and close monitoring, while relying on and with the assistance of external construction supervisors.

For purposes of dealing with complex transactions for financing projects in infrastructure (power stations, desalination plants, toll roads, BOT (Build Operate Transfer) projects, etc.), the Bank has set up a special unit that examines the transactions and structures the financing package in conjunction with the business side, including possible cooperation of 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 taking an overall perspective of the customers' activity in Israel and abroad. Projects financed overseas are examined in depth, taking into consideration the country's political and economic risk. As a rule – the projects are financed by the relevant overseas unit of the Bank.

**Table 15 - Development of obligations for the construction and real estate sector**

	31 December		Change	
	2015	2014		
	NIS		NIS	Percentage
Balance sheet credit risk	<b>50,631</b>	47,650	2,981	6.3
Guarantees to apartment <sup>(a)</sup>	<b>8,379</b>	7,482	897	12.0
Other off-balance sheet credit risk	<b>29,298</b>	28,367	931	3.3
<b>Total</b>	<b>88,308</b>	83,499	4,809	5.8

(a) Weighted to balance sheet equivalent

Total credit risk in the construction and real estate in Israel increased in 2015 by 4.48%. The credit risk for the construction and real estate in Israel is approximately 22.33% of total credit risk in Israel. On the other hand, according to the calculation rules established by the Bank of Israel for the purpose of determining the degree of concentration by sector, the total obligations in the Bank amount to 18.92% of total indebtedness in the country. In 2015 and 2014 there was no deviation in segment concentration indebtedness.

### **Groups of borrowers<sup>1</sup>**

The Bank monitors the credit exposure of groups of borrowers in all their components, for the purposes of regular reporting to the Bank of Israel, for internal monitoring, and for 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 principal 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 a constant flow of information in relation to the applications made for credit which come up for discussion and in relation to the risk of individuals in the group.

Moreover, regarding the small number of the largest 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 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 adequate capital allocation 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.

<sup>1</sup> 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.

As of 1.1.2016, Proper Conduct of Banking Business Directive No. 313 on Single Borrower and Group of Borrowers Limitations came into force. The main update of the Directive is in the transition to Tier 1 shareholders' equity (gradually until 31.12.2018) in respect of which are defined the restriction, namely making the restrictions stricter on granting credit to a single borrower and a group of borrowers.

### **Single Borrower and Group of Borrowers Limitations**

1. As of 31 December 2015, the Group had no credit exposure to a group of borrowers whose indebtedness exceeded 15% of the Bank's capital (as defined in Proper Conduct of Banking Business Directive No. 313).
2. As of 31 December 2015, the Group had no credit exposure to large borrowers, groups of borrowers, and banking groups of borrowers whose indebtedness exceeds 10% of the Bank's capital. The regulatory restriction is 120% of the Bank's capital.

### **Exposure of the Bank to leveraged financing**

Proper Conduct of Banking Business Directive No. 311 provides that a bank's credit policy should relate inter alia to leveraged financing. The Bank operates according to unique principles in the credit policy for this segment. As of 31 December 2015, leveraged financing is defined by the Bank as financing which meets one of the following criteria:

1. Financing the purchase of the means of control or against the means of control held (constitutes an expansion to that required pursuant to Proper Conduct of Banking Business Directive No. 323).
2. Financing classic holding companies with no independent activity, 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 insufficient ability to service a debt compared with norms established by the Bank, a low shareholders' equity to total assets ratio.

As of 31 December 2015, the aggregate of total credit balances (balance sheet and off-balance sheet credit net of credit loss allowances and deductible collateral) to leveraged borrowers, for each of which the balance of credit amounting to 0.5% of the Bank's capital and above stands at NIS 3.2 billion, a decrease of NIS 4.5 billion from the end of last year.

**Table 16 – Aggregate\* credit balances for leveraged borrowers, for each of which the balance of credit amounts to 0.5% of the Bank's capital and above, by sector of the economy:**

Sector of the economy	31 December	
	2015	2014
	NIS millions	
Real estate	1,552	3,044
Industry	466	2,683
Commerce	340	881
Financial services	273	509
Communications	-	254
Transport and warehousing	526	250
Total	3,157	7,621

\* Balance sheet and off-balance sheet credit net after deducting allowances for credit losses and deductible allowances (and including nostro bond holdings and irrevocable obligations to grant credit)

The Directive sets out quantitative limits on the balance of credit for the purchase of the means of control, and the Bank is in compliance therewith.

In addition, the Bank also set an internal quantitative limit relating to leveraged financing, and at the end of 2015 the Bank is in compliance with this limit. In addition, we should note that in Directive 323, there is a definition of credit for the purchase of means of control and quantitative limits were set for this credit.

As at 31.12.15, there are no balances of credit to finance the purchase of means of control in the amounts defined pursuant to Directive 323.

On 1 January 2016, an update came into force of Directive 323 (Restrictions on Financing Capital Transactions), which is an extension to the previous directive, as well as a new Directive 327 (Management of Leveraged Loans). The Bank is prepared to meet the requirement of these Directives.

### **Geographic distribution**

Geographic distribution is defined as one of the potential credit concentration risks in the portfolio (in addition to sectoral distribution and exposure to large borrowers and groups of borrowers). Geographic risk is defined as the risk of economic / political / security deterioration in countries to which the borrower is exposed, which may result in impairment to the borrower's financial position and ability to meet its obligations.

As part of the information used for estimating the internal rating of corporate borrowers, questions relating to geographic exposure are taken into account. These data enable the Bank to make an overview of the entire portfolio of the exposure of the corporate borrowers to the various countries to monitor and manage the risks. As of date, there is no significant concentration in the Bank's credit portfolio in the exposure of the corporate borrowers to any foreign country.

As part of internal risk management, the geographic exposure is determined depending on the location of the sources of cash flow and / or physical assets used in the borrower's current activity.

These data enable the Bank to conduct an examination from the perspective of the entire portfolio's exposure to borrowers in the various countries, for the purpose of monitoring and managing risk.

## **Tools for managing credit risk**

In managing credit risk, use is also made of quantitative models for internal rating of the risk of borrowers and for evaluating and monitoring the risk at portfolio level, with the borrowers' internal rating being a principal layer in the decision-making process and credit pricing and in monitoring its quality in the long term.

Two main tools are used by the Bank in estimating the borrowers' internal rating:

A rating system intended for retail customers, based on the features of the customer's activity over the long term in the account.

A rating system for borrowers, intended for corporate-commercial customers, based on structured expert questionnaires.

The models according to which the rating is done in the abovementioned systems are routinely validated and monitored.

In combination with the rating system, there is a return on equity system which makes it possible to establish the relationship between the risk level and the return on equity, both at the customer level and at the level of the various profit centers. The system facilitates the pricing of transactions in relation to the return required in the various segments.

In addition, in analyzing risk at the total credit portfolio level, the Bank is assisted by an internal model, in order to assess the credit risk at the level of the total credit portfolio and at its various cross-sections.

## **Credit risk mitigation**

### **Policy and processes regarding valuation and management of collaterals:**

As a policy, the main consideration is the capacity of the borrower to repay from his day-to-day activity. In addition, the Bank strives to receive collateral as additional backup, whose purpose is to reduce the loss to the Bank in the event of a business / financial failure of the borrower. The amount of collateral required from a borrower is, inter alia, a consequence of the level of risk in the credit.

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.

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.

Collateral is matched to the kind of credit that it secures, taking into account the maturity, 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 the main collateral (particularly in the area of real estate and equipment) by obtaining up-to-date independent appraisals/valuations.

The common types of collateral which the Bank accepts to secure credit include, inter alia, financial assets, real estate property, motor vehicles, various types of equipment, etc.

Within the Bank, there is a computerized system which can generate information regarding the type of assets used for collateral.

See further details below of credit risk mitigation (disclosure under the Standardized Approach).

### **Activity in Derivative Instruments for the Purpose of Mitigating Credit Risks**

#### **Hedging and/or Risk Mitigation Policy and Strategies and Processes for Monitoring the Continuing Effectiveness of Risk-Mitigating Hedging Activities**

The credit risk in a derivatives transaction 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. Credit risk is measured as the maximum amount of the loss, according to scenarios that the Bank is liable to bear in which the counterparty to the transaction will not comply with the terms of the transaction, after deduction of the enforceable offsetting agreements.

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.

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 weighting and quantification of the borrower's sensitivity to changes in exchange rates and/or commodity prices included in its activity.

Customer activity in transactions in the various types of derivatives is monitored by the Risk Management Sub-Division in the Bank's Capital Markets Division. This unit carries out focused monitoring of activity of customers active in the financial and capital markets, and monitoring of activity carried out by the other customers of the bank. The unit 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 and the work procedures.

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.

In order to mitigate credit risk in derivatives transactions, the Bank enters into CSA agreements (agreements for offsetting and settlement of derivatives) and collateral transfer agreements with some of the customers, mainly in the Capital Market Segment.



## **Loans in arrears and impaired loans**

The Bank implements the provisions of the Public Reporting Directives with regard to impaired debts, credit risk and the credit loss allowance. Treatment of these provisions is organized in individual procedures and directives for the relevant parties, with only certain main aspects in this area related to the classification of debts and the determination of the allowance for credit losses being presented in the sections below.

### **Impaired debt**

Balance sheet debt will be classified as impaired debt in the following situations:

- A customer has a negative debt service from all of the sources which is not of a temporary nature.
- A debt which was individually examined and found to be in arrears of 90 days or more, except if it is well secured and in the processes of collection.
- The business analysis of the current events indicates a low probability that the debt will be paid according to the terms agreed with the customer.
- The debt underwent trouble debt restructuring, and in light of this it will not be repaid according to the original terms of the debt.

Off-balance sheet debt exposure will be classified as impaired, when it is expected that the liability in respect of this debt will be realized and the balance sheet debt that will be created should be classified as impaired.

### **Debt in arrears**

The state of arrears of a debt is determined in relation to the contractual repayment terms. The three possible arrears positions are:

1. Arrears due to non-payment of the loan as required.
2. Overdrawing an approved credit facility and reported in the current account.
3. Low turnover – As long as amounts to cover the debt have not been recorded to the credit of that account within a defined period, even if the debt is within the credit facility.

Principles for classification of debts in accordance with the number of days of arrears:

- A debt which was individually examined and found to be in arrears of 90 days or more, except if it is well secured and in the processes of collection.
- A debt which was examined on a collective basis will be classified in accordance with the following rules:
  - Debt under special mention – a debt in arrears for between 80-89 days
  - Substandard debt – a debt in arrears for between 90-149 days
  - Impaired debt – a debt in arrears for 150 days or more. In this case, the debt will be provided in full and written off.

## **Allowance for credit losses**

The responsibility for the adequacy of the classifications and allowances is imposed on the Risk Management Division.

### **Individual allowance**

An allowance for credit losses is made for a debt which is classified as an impaired debt and individually examined. The allowance is assessed according to the gap between the recorded balance of the debt and the present value of the expected future cash flows to service the debt from the customer's activity and the realization of the collateral and other assets, discounted at the effective interest rate of the debt. The examination as regards the adequacy of the provision is made once a quarter, and pursuant thereto, inter alia, significant changes in amounts or the timing of expected cash flows due to be received in accordance with the current estimates are checked. Regarding obligations whose repayment is based on collateral (collateral-contingent obligations) and there are no other available and reliable sources of repayment, the allowance is determined based on the fair value of the collateral, less costs of disposal and after the operation of safety factors regarding the value of the collateral that will be possible to realize and be reimbursed from it.

The bigger the uncertainty in respect of the cash flows, and the lower the level of confidence with regard to the actual realization of the forecast, use is made of security coefficients which reduce the cash flows, and thus, provide reasonable security that the provision is appropriate.

### **Collective allowance**

The collective allowance reflects an estimate of credit losses based on past losses in respect of debts with similar characteristics, with adjustments made for current risk assessments. This allowance is applied in respect of debts examined individually and found not to be impaired.

The method of determining a credit loss allowance which is estimated on a collective basis is in accordance with the requirements of the Public Reporting Directives, the main points of which are:

- Credit to the public is split according to market sector. Two rates of collective allowance are determined for each market sector: one, in respect of non-problem debts, and the other, higher, in respect of problem debts (those classified with the debt symbol "special mention" or "substandard").  
These rates are determined on the basis of past losses (the average of the net write-off in the current year and in the 4 previous complete calendar years).
- The rate of past losses is added to the "quality adjustment factor" which is an additional factor of the allowance for environmental factors relevant to the prospects of collection of the credit ("quality adjustments") such as industry conditions, economic characteristics and properties of the composition and quality of the loan portfolio.
- The allowance is calculated and made in respect of all the debts, both balance sheet credit and off-balance sheet credit instruments, with the off-balance sheet credit multiplied by a conversion coefficient according to the type of instrument and in accordance with the directives of the Supervisor of Banks.

**Table 17 - Overall risk of credit to the public by economic sector**

31 December 2015										
Overall credit risk <sup>(a)</sup>				Debts <sup>(b)</sup> and off-balance sheet credit risk (excluding derivatives) <sup>(c)</sup>						
								Credit losses <sup>(d)</sup>		
				<sup>1</sup> Of which:				Expenses	Net	Balance of
	Credit						in respect			allowance
Total	performance	Problematic <sup>(e)</sup>	<sup>1</sup> Total	Debts <sup>(b)</sup>	Problematic <sup>(e)</sup>	Impaired	of credit	accounting	for credit	
	rating <sup>(f)</sup>						losses	write-offs	losses	
NIS millions										
<u>In respect of activity of</u>										
<u>borrowers in Israel</u>										
<u>Public-commercial</u>										
Agriculture	2,075	1,951	124	2,070	1,775	123	50	16	(8)	(40)
Mining and quarrying	713	713	-	583	501	-	-	(2)	-	-
Industry	24,498	22,852	1,646	24,066	15,669	1,646	577	1	(60)	(527)
Construction & real-estate - construction <sup>(g)</sup>	47,249	45,433	1,816	47,155	15,688	1,815	639	65	(15)	(348)
estate - real-estate activity	27,556	25,925	1,631	27,485	24,653	1,631	1,053	18	70	(582)
Electricity & water	4,985	4,925	60	4,735	3,162	60	-	(7)	-	(28)
Commerce <sup>(h)</sup>	26,552	25,614	938	26,374	21,531	908	244	(42)	12	(306)
Hotels, accomodation and food services	3,030	2,840	190	3,037	2,666	190	138	4	3	(31)
Transport and storage	6,757	6,420	337	6,638	5,897	337	268	15	15	(39)
Communications & computer services	6,162	5,895	267	5,871	4,128	263	255	(82)	(7)	(81)
Financial services	20,758	20,683	75	14,709	9,570	75	62	(151)	(12)	(267)
Business & other services	7,720	7,628	92	7,701	5,462	92	34	40	30	(92)
Public & community services	7,781	7,755	26	7,742	6,523	26	11	(4)	17	(44)
<b>Total commercial</b>	<b>185,836</b>	<b>178,634</b>	<b>7,202</b>	<b>178,166</b>	<b>117,225</b>	<b>7,166</b>	<b>3,331</b>	<b>(129)</b>	<b>45</b>	<b>(2,385)</b>
Private individuals - housing loans	83,292	82,513	779	83,292	80,633	779	-	14	10	(497)
Private individuals - other	65,815	65,363	452	65,807	36,991	452	63	309	245	(701)
<b>Total public - activity in Israel</b>	<b>334,943</b>	<b>326,510</b>	<b>8,433</b>	<b>327,265</b>	<b>234,849</b>	<b>8,397</b>	<b>3,394</b>	<b>194</b>	<b>300</b>	<b>(3,583)</b>
<b>Banks in Israel</b>	<b>7,048</b>	<b>7,048</b>	<b>-</b>	<b>3,347</b>	<b>2,146</b>	<b>-</b>	<b>-</b>	<b>2</b>	<b>-</b>	<b>(2)</b>
<b>Government of Israel</b>	<b>37,243</b>	<b>37,243</b>	<b>-</b>	<b>262</b>	<b>262</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total activity in Israel</b>	<b>379,234</b>	<b>370,801</b>	<b>8,433</b>	<b>330,874</b>	<b>237,257</b>	<b>8,397</b>	<b>3,394</b>	<b>196</b>	<b>300</b>	<b>(3,585)</b>

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, 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 borrower debt limitations in the sum of NIS 237,258, 36,036, 1,764, 5,081, 99,095 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 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.

(f) Credit risk whose credit rating on the report date corresponds with the credit rating for making new credit in accordance with the Bank's policy.

(g) Including housing loans, extended to certain purchasing groups in the process of construction.

(h) The balance of commercial debts includes the balance of housing loans, amounting to NIS 1,014 million, which were extended to purchasing groups in the process of construction.

31 December 2015										
Overall credit risk <sup>(a)</sup>			Debts <sup>(b)</sup> and off-balance sheet credit risk (excluding derivatives) <sup>(c)</sup>							
						Credit losses <sup>(d)</sup>				
						<sup>1</sup> Of which:				
	Credit performance rating <sup>(f)</sup>	Problematic <sup>(e)</sup>				Expenses in respect of credit losses	Net accounting write-offs	Balance of allowance for credit losses		
Total			<sup>1</sup> Total	Debts <sup>(b)</sup>	Problematic <sup>(e)</sup>	Impaired				
NIS millions										
<u>In respect of activity of</u>										
<u>borrowers abroad</u>										
<u>Public-commercial</u>										
Agriculture	128	126	2	127	72	2	2	2	1	(2)
Mining and quarrying	77	77	-	38	29	-	-	-	-	-
Industry	8,295	7,965	330	7,041	4,638	330	98	(4)	27	(92)
Construction & real-estate <sup>(g)</sup>	13,503	12,866	637	12,973	9,783	637	434	10	79	(230)
Electricity & water	371	371	-	88	56	-	-	-	-	-
Commerce <sup>(h)</sup>	7,818	7,786	32	7,729	5,123	32	31	(2)	85	(79)
Hotels, accomodation and food services	1,577	1,549	28	1,577	1,441	28	24	(1)	-	(10)
Transport and storage	241	155	86	223	198	86	86	(2)	9	(31)
Communications & computer services	2,093	2,093	-	1,782	677	-	-	(1)	-	(1)
Financial services	17,027	16,935	92	2,801	1,619	92	92	45	7	(68)
Business & other services	5,630	5,579	51	5,560	4,613	51	2	(2)	(1)	(16)
Public & community services	516	515	1	504	391	1	1	(39)	14	(19)
<b>Total commercial</b>	<b>57,276</b>	<b>56,017</b>	<b>1,259</b>	<b>40,443</b>	<b>28,640</b>	<b>1,259</b>	<b>770</b>	<b>6</b>	<b>221</b>	<b>(548)</b>
Private individuals - housing loans	1,176	1,126	50	1,176	1,172	50	29	-	2	(16)
Private individuals - other	531	509	22	522	409	22	22	-	8	(6)
<b>Total public - activity abroad</b>	<b>58,983</b>	<b>57,652</b>	<b>1,331</b>	<b>42,141</b>	<b>30,221</b>	<b>1,331</b>	<b>821</b>	<b>6</b>	<b>231</b>	<b>(570)</b>
<b>Banks abroad</b>	<b>22,269</b>	<b>22,269</b>	<b>-</b>	<b>10,119</b>	<b>8,170</b>	<b>-</b>	<b>-</b>	<b>(3)</b>	<b>-</b>	<b>(1)</b>
<b>Governments abroad</b>	<b>11,667</b>	<b>11,667</b>	<b>-</b>	<b>480</b>	<b>191</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total activity abroad</b>	<b>92,919</b>	<b>91,588</b>	<b>1,331</b>	<b>52,740</b>	<b>38,582</b>	<b>1,331</b>	<b>821</b>	<b>3</b>	<b>231</b>	<b>(571)</b>
<b>Total</b>	<b>472,153</b>	<b>462,389</b>	<b>9,764</b>	<b>383,614</b>	<b>275,839</b>	<b>9,728</b>	<b>4,215</b>	<b>199</b>	<b>531</b>	<b>(4,156)</b>

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, 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 borrower debt limitations in the sum of NIS 38,581, 30,120, -, 6,169, 18,049 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 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.

(f) Credit risk whose credit rating on the report date corresponds with the credit rating for making new credit in accordance with the Bank's policy.

(g) Including housing loans, extended to certain purchasing groups in the process of construction.

	31 December 2014 <sup>(i)</sup>									
	Overall credit risk <sup>(a)</sup>			Debts <sup>(b)</sup> and off-balance sheet credit risk (excluding derivatives) <sup>(c)</sup>						
								Credit losses <sup>(d)</sup>		

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, 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 borrower debt limitations in the sum of NIS 229,102, 23,569, 2,000, 8,283, 101,580 million, respectively.

(b) Credit risk to the public, credit to governments, deposits with banks (in 2014 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.

(f) Credit risk whose credit rating on the report date corresponds with the credit rating for making new credit in accordance with the Bank's policy.

(g) In housing loans, extended to certain purchasing groups in the process of construction.

(h) The balance of commercial debts includes the balance of housing loans, amounting to NIS 1,216 million, which were extended to purchasing groups in the process of construction.

(i) Comparative figures have been restated as a result of a Bank of Israel circular from April 2014 regarding the adoption of the directives of the Central Statistical Bureau regarding the consistent classification of the sectors of the economy; 2011 – which replaces the classification established in 1993.

31 December 2014 <sup>(h)</sup>										
Overall credit risk <sup>(a)</sup>			Debts <sup>(b)</sup> and off-balance sheet credit risk (excluding derivatives) <sup>(c)</sup>							
	Credit performance rating <sup>(f)</sup>	Problematic <sup>(e)</sup>	<sup>1</sup> Total	Debts <sup>(b)</sup>	Problematic <sup>(e)</sup>	Impaired	Credit losses <sup>(d)</sup>			
							Expenses in respect of credit losses	Net accounting write-offs	Balance of allowance for credit losses	
Total										
NIS millions										
<u>In respect of activity of borrowers abroad</u>										
<u>Public-commercial</u>										
Agriculture	80	77	3	74	64	3	3	1	-	(2)
Mining and quarrying	4	4	-	4	4	-	-	-	-	-
Industry	9,169	8,703	466	7,906	4,826	466	209	(18)	55	(146)
Construction & real-estate <sup>(g)</sup>	11,901	11,291	610	11,456	8,832	610	563	36	113	(319)
Electricity & water	386	386	-	124	38	-	-	1	1	(1)
Commerce <sup>(h)</sup>	7,858	7,686	172	7,811	5,109	172	165	61	105	(135)
Hotels, accomodation and food services	1,544	1,501	43	1,537	1,364	43	43	3	1	(13)
Transport and storage	351	327	24	210	204	24	24	4	-	(14)
Communications & computer services	1,736	1,734	2	1,415	686	2	2	-	-	(2)
Financial services	17,795	17,698	97	2,949	1,876	97	97	15	1	(56)
Business & other services	4,962	4,896	66	4,469	3,814	66	37	6	18	(12)
Public & community services	708	628	80	585	322	80	70	11	-	(93)
<b>Total commercial</b>	<b>56,494</b>	<b>54,931</b>	<b>1,563</b>	<b>38,540</b>	<b>27,139</b>	<b>1,563</b>	<b>1,213</b>	<b>120</b>	<b>294</b>	<b>(793)</b>
Private individuals - housing loans	1,268	1,214	54	1,268	1,212	54	34	2	3	(18)
Private individuals - other	1,054	1,013	41	1,035	889	41	31	1	25	(14)
<b>Total public - activity abroad</b>	<b>58,816</b>	<b>57,158</b>	<b>1,658</b>	<b>40,843</b>	<b>29,240</b>	<b>1,658</b>	<b>1,278</b>	<b>123</b>	<b>322</b>	<b>(825)</b>
<b>Banks abroad</b>	<b>32,527</b>	<b>32,527</b>	<b>-</b>	<b>19,045</b>	<b>17,555</b>	<b>-</b>	<b>-</b>	<b>3</b>	<b>-</b>	<b>(4)</b>
<b>Governments abroad</b>	<b>5,648</b>	<b>5,648</b>	<b>-</b>	<b>429</b>	<b>234</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total activity abroad</b>	<b>96,991</b>	<b>95,333</b>	<b>1,658</b>	<b>60,317</b>	<b>47,029</b>	<b>1,658</b>	<b>1,278</b>	<b>126</b>	<b>322</b>	<b>(829)</b>
<b>Total</b>	<b>461,525</b>	<b>449,777</b>	<b>11,748</b>	<b>385,273</b>	<b>276,132</b>	<b>11,677</b>	<b>5,166</b>	<b>472</b>	<b>305</b>	<b>(4,486)</b>

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, 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 borrower debt limitations in the sum of NIS 47,030, 23,851, -, 8,625, 17,485 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.

(f) Credit risk whose credit rating on the report date corresponds with the credit rating for making new credit in accordance with the Bank's policy.

(g) In housing loans, extended to certain purchasing groups in the process of construction.

(h) Comparative figures have been restated as a result of a Bank of Israel circular from April 2014 regarding the adoption of the directives of the Central Statistical Bureau regarding the consistent classification of the sectors of the economy; 2011 – which replaces the classification established in 1993.

**Table 18 - Credit risk exposure by principal types of credit exposure (Third Pillar)**

	31 December			
	2015		2014 <sup>(b)(c)</sup>	
	Gross credit risk exposure <sup>(d)</sup>	Average gross credit risk exposure <sup>(d)</sup>	Gross credit risk exposure <sup>(d)</sup>	Average gross credit risk exposure <sup>(d)</sup>
	NIS millions		NIS millions	
Type of credit exposure:				
Credit <sup>(e)</sup>	322,511	311,348	314,688	298,174
Bonds <sup>(f)</sup>	56,013	49,471	37,223	41,094
Others <sup>(g)</sup>	17,119	17,101	16,789	16,341
Guarantees and liabilities on account of customers	130,531	133,589	131,819	124,482
Derivatives <sup>(h)</sup>	8,653	10,864	11,054	9,157
Total	534,827	522,373	511,573	489,248

- (a) After deducting accounting write-offs, but before deducting allowances for credit losses on individual and collective basis.
- (b) Data for 31 December 2014 have been restated including changes pursuant to the change in accounting method for accumulating employee rights, and implementation of the directive of the Supervisor of Banks on capitalization of software costs.
- (c) Without the effect of adopting US GAAP on employee rights that came into force from 1 January 2015.
- (d) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities as credit) and after offsetting transactions in derivatives (netting).
- (e) Including credit to the public, credit to the Government, and deposits in central banks, and after deducting liabilities in respect of transactions in derivative instruments subject to CSA agreements.
- (f) Not including the bonds included in the trading portfolio and not including investments in capital of financial corporations.
- (g) Including cash, investments in financial corporations not deducted from capital, advance payments to the tax authorities, shares and other assets without a counterparty such as buildings and equipment.
- (h) Positive fair value of derivatives, including an add-on reflecting the amount of potential future exposure to credit in respect of the balance of nominal value of derivative instruments and after offsetting transactions in derivatives (netting).

**Table 19 - Exposure to foreign countries (Third Pillar)**

31 December 2015						
Balance sheet exposure (a)						
Cross-Border Balance Sheet Exposure				Balance sheet exposure of foreign offices of the banking corporation to local residents		
To governments (c)		To banks	To others	Balance sheet exposure before deducting local liabilities	Deduction for local liabilities	Net balance sheet exposure after deducting local liabilities
NIS millions						
Country						
United States	9,652	2,577	10,748	22,020	11,310	10,710
United Kingdom	39	2,942	3,022	7,015	2,143	4,872
France	552	635	942	-	-	-
Switzerland	-	334	1,194	535	101	434
Germany	-	1,519	1,583	-	-	-
Others	389	4,001	5,218	1,272	651	621
Total exposure to foreign countries	10,632	12,008	22,707	30,842	14,205	16,637
Total exposure to LDC countries	212	943	719	1,180	647	533
Total exposure to GIIPS countries (d)	97	57	408	-	-	-

31 December 2015							
Balance sheet exposure (a)				Off-balance sheet exposure (a) (b)			
Total balance sheet exposure	Balance sheet problem credit risk	which: Balance of impaired debts	Total off-balance sheet exposure	Of which: Off-balance sheet problem credit risk	Sheet Exposure		
					Repayment period		
					Up to one year		
					Over one year		
NIS millions							
Country							
United States	33,687	733	299	6,153	-	6,941	16,036
United Kingdom	10,875	247	229	3,846	-	1,717	4,286
France	2,129	10	8	1,126	-	872	1,257
Switzerland	1,962	-	-	412	-	962	566
Germany	3,102	-	-	259	-	1,882	1,220
Others	10,229	294	282	3,068	-	2,389	7,219
Total exposure to foreign countries	61,984	1,284	818	14,864	-	14,763	30,584
Total exposure to LDC countries	2,407	210	199	2,128	-	521	1,353
Total exposure to GIIPS countries (d)	562	-	-	250	-	222	340

(a) Balance sheet and off-balance sheet risk, problem commercial credit risk and impaired debts are stated before the effect of a credit loss allowance and before the effect of collateral permitted for deduction for the purpose of indebtedness of a borrower and a group of borrowers. Not including off-balance sheet risk components.

(b) Credit risk in off-balance sheet financial derivatives as computed for the purpose of the indebtedness of a borrower.

(c) Including governments, formal institutions and central banks.

(d) Exposure to GIIPS includes the countries: Portugal, Ireland, Italy, Greece and Spain.



31 December 2014							
Balance sheet exposure (a)							
Cross-Border Balance Sheet Exposure				Balance sheet exposure of foreign offices of the banking corporation to local residents			
				Balance sheet exposure before deducting local liabilities	Deduction for local liabilities	Net balance sheet exposure after deducting local liabilities	
To governments (c)	To banks	others					
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	-	-	-	-
Others	781	6,974	5,409	-	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	-	-	-	-

31 December 2014							
Balance sheet exposure (a)				Off-balance sheet exposure (a) (b)			
Sheet Exposure							
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	Repayment period		
					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
Others	13,913	523	486	1,802	-	8,107	5,057
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

(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 includes the countries: Portugal, Ireland, Italy, Greece and Spain.

**Table 20 - Credit risk exposure by counterparty and by main types of credit exposure<sup>(a)</sup> (Third Pillar)**

<b>2015</b>						
	Credit <sup>(e)</sup>	Bonds <sup>(f)</sup>	Others <sup>(g)</sup>	Guarantees and other liabilities	Transactions in derivative financial instruments <sup>(h)</sup>	Total <sup>(d)</sup>
	NIS millions					
Sovereign debts	52,508	38,320	-	321	28	91,177
Debts of public sector entities	3,838	6,509	-	503	45	10,895
Debts of banking corporations	5,691	4,736	-	3,228	2,218	15,873
Debts of securities companies	-	598	-	-	423	1,021
Debts of corporations	87,923	2,459	-	48,611	5,908	144,901
Debts collateralised by commercial real estate	33,354	-	-	37,845	-	71,199
Retail exposures to individuals	42,003	-	-	29,110	29	71,142
Small business loans	16,150	-	-	4,713	2	20,865
Housing mortgages	81,044	-	-	6,200	-	87,244
Securitization	-	3,391	-	-	-	3,391
Other assets	-	-	17,119	-	-	17,119
<b>Total in respect of credit risk</b>	<b>322,511</b>	<b>56,013</b>	<b>17,119</b>	<b>130,531</b>	<b>8,653</b>	<b>534,827</b>

<b>2014<sup>(b)(c)</sup></b>						
	Credit <sup>(e)</sup>	Bonds <sup>(f)</sup>	Others <sup>(g)</sup>	Guarantees and other liabilities	Transactions in derivative financial instruments <sup>(h)</sup>	Total <sup>(d)</sup>
	NIS millions					
Sovereign debts	44,842	20,991	-	860	35	66,728
Debts of public sector entities	4,790	5,393	-	141	48	10,372
Debts of banking corporations	14,293	3,966	-	2,428	3,448	24,135
Debts of securities companies	-	601	-	-	537	1,138
Debts of corporations	90,659	3,424	-	49,019	6,876	149,978
Debts collateralised by commercial real estate	31,449	-	-	36,670	-	68,119
Retail exposures to individuals	38,228	-	-	31,258	102	69,588
Small business loans	15,106	-	-	4,575	8	19,689
Housing mortgages	75,321	-	-	6,868	-	82,189
Securitization	-	2,848	-	-	-	2,848
Other assets	-	-	16,789	-	-	16,789
<b>Total in respect of credit risk</b>	<b>314,688</b>	<b>37,223</b>	<b>16,789</b>	<b>131,819</b>	<b>11,054</b>	<b>511,573</b>

(a) After deducting accounting write-offs, but before deducting allowances for credit losses on individual and collective basis.

(b) Data for 31 December 2014 have been restated including changes pursuant to the change in accounting method for accumulating employee rights, and implementation of the directive of the Supervisor of Banks on capitalization of software costs.

(c) Without the effect of adopting US GAAP on employee rights that came into force from 1 January 2015.

(d) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities as credit) and after offsetting transactions in derivatives (netting).

(e) Including credit to the public, credit to the Government, and deposits in central banks, and after deducting liabilities in respect of transactions in derivative instruments subject to CSA agreements.

(f) Not including the bonds included in the trading portfolio and not including investments in capital of financial corporations.

(g) Including cash, investments in financial corporations not deducted from capital, advance payments to the tax authorities, shares and other assets without a counterparty such as buildings and equipment.

(h) Positive fair value of derivatives, including an add-on reflecting the amount of potential future exposure to credit in respect of the balance of nominal value of derivative instruments and after offsetting transactions in derivatives (netting).

**Table 21 - Distribution of the portfolio by term to maturity and by main types of credit exposure<sup>(a)</sup> (Third Pillar)**

<b>31 December 2015</b>						
	Credit <sup>(e)</sup>	Bonds <sup>(f)</sup>	Others <sup>(g)</sup>	Guarantees and other liabilities	Transactions in derivative financial instruments <sup>(h)</sup>	Total <sup>(d)</sup>
	NIS millions					
Up to 1 year	145,461	30,131	4,600	77,632	4,425	262,249
From 1 to 5 years	80,524	9,220	919	33,373	5,753	129,789
Above 5 years	96,114	16,662	4,508	19,526	5,472	142,282
Non-monetary items	412	-	7,092	-	5,277	12,781
Benefits for offsetting	-	-	-	-	(12,274)	(12,274)
Total	322,511	56,013	17,119	130,531	8,653	534,827

<b>31 December 2014<sup>(b)(c)</sup></b>						
	Credit <sup>(e)</sup>	Bonds <sup>(f)</sup>	Others <sup>(g)</sup>	Guarantees and other liabilities	Transactions in derivative financial instruments <sup>(h)</sup>	Total <sup>(d)</sup>
	NIS millions					
Up to 1 year	155,300	16,492	3,336	79,582	9,060	263,770
From 1 to 5 years	72,122	8,408	809	34,248	5,738	121,325
Above 5 years	86,958	12,323	3,368	17,989	7,111	127,749
Non-monetary items	308	-	9,276	-	5,352	14,936
Benefits for offsetting	-	-	-	-	(16,207)	(16,207)
Total	314,688	37,223	16,789	131,819	11,054	511,573

(a) After deducting accounting write-offs, but before deducting allowances for credit losses on individual and collective basis.

(b) Data for 31 December 2014 have been restated including changes pursuant to the change in accounting method for accumulating employee rights, and implementation of the directive of the Supervisor of Banks on capitalization of software costs.

(c) Without the effect of adopting US GAAP on employee rights that came into force from 1 January 2015.

(d) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities as credit) and after offsetting transactions in derivatives (netting).

(e) Including credit to the public, credit to the Government, and deposits in central banks, and after deducting liabilities in respect of transactions in derivative instruments subject to CSA agreements.

(f) Not including the bonds included in the trading portfolio and not including investments in capital of financial corporations.

(g) Including cash, investments in financial corporations not deducted from capital, advance payments to the tax authorities, shares and other assets without a counterparty such as buildings and equipment.

(h) Positive fair value of derivatives, including an add-on reflecting the amount of potential future exposure to credit in respect of the balance of nominal value of derivative instruments and after offsetting transactions in derivatives (netting).

**Table 22 - Debts<sup>(a)</sup> - Credit quality and arrears**

31 December 2015						
	Problematic <sup>(b)</sup>				Unimpaired debts - additional information	
	Non-problematic	Non-impaired	Impaired <sup>(c)</sup>	Total	In arrears of 90 days or more <sup>(d)</sup>	In arrears of 30 to 89 days <sup>(e)</sup>
NIS millions						
<u>Activity of borrowers in Israel</u>						
<u>Public-commercial</u>						
Construction & real estate - constructi	14,705	420	563	15,688	11	33
Construction & real estate - real estate	23,182	553	918	24,653	6	13
Financial services	9,495	13	62	9,570	2	1
Commercial - other	64,014	1,798	1,502	67,314	42	108
<b>Total commercial</b>	<b>111,396</b>	<b>2,784</b>	<b>3,045</b>	<b>117,225</b>	<b>61</b>	<b>155</b>
Private individuals - housing loans <sup>(f)</sup>	79,852	781	-	80,633	753	481
Private individuals - other	36,546	385	60	36,991	105	187
<b>Total public - activity in Israel</b>	<b>227,794</b>	<b>3,950</b>	<b>3,105</b>	<b>234,849</b>	<b>919</b>	<b>823</b>
<b>Banks in Israel</b>	<b>2,146</b>	<b>-</b>	<b>-</b>	<b>2,146</b>	<b>-</b>	<b>-</b>
<b>Government of Israel</b>	<b>262</b>	<b>-</b>	<b>-</b>	<b>262</b>	<b>-</b>	<b>-</b>
<b>Total activity in Israel</b>	<b>230,202</b>	<b>3,950</b>	<b>3,105</b>	<b>237,257</b>	<b>919</b>	<b>823</b>
<u>Activity of borrowers abroad</u>						
<u>Public-commercial</u>						
Construction & real estate	9,283	66	434	9,783	4	113
Commercial - other	18,159	368	330	18,857	2	128
<b>Total commercial</b>	<b>27,442</b>	<b>434</b>	<b>764</b>	<b>28,640</b>	<b>6</b>	<b>241</b>
Private individuals	1,510	19	52	1,581	17	4
<b>Total public - activity abroad</b>	<b>28,952</b>	<b>453</b>	<b>816</b>	<b>30,221</b>	<b>23</b>	<b>245</b>
<b>Banks abroad</b>	<b>8,170</b>	<b>-</b>	<b>-</b>	<b>8,170</b>	<b>-</b>	<b>-</b>
<b>Governments abroad</b>	<b>191</b>	<b>-</b>	<b>-</b>	<b>191</b>	<b>-</b>	<b>-</b>
<b>Total activity abroad</b>	<b>37,313</b>	<b>453</b>	<b>816</b>	<b>38,582</b>	<b>23</b>	<b>245</b>
<b>Total public</b>	<b>256,746</b>	<b>4,403</b>	<b>3,921</b>	<b>265,070</b>	<b>942</b>	<b>1,068</b>
<b>Total banks</b>	<b>10,316</b>	<b>-</b>	<b>-</b>	<b>10,316</b>	<b>-</b>	<b>-</b>
<b>Total governments</b>	<b>453</b>	<b>-</b>	<b>-</b>	<b>453</b>	<b>-</b>	<b>-</b>
<b>Total</b>	<b>267,515</b>	<b>4,403</b>	<b>3,921</b>	<b>275,839</b>	<b>942</b>	<b>1,068</b>

(a) Credit to the public, credit to governments, deposits in banks 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.

(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 503 million were classified as problem debts that are not impaired.

(f) Including housing loans in the amount of NIS 144 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.

	31 December 2014					
	Problematic <sup>(b)</sup>				additional information	
	Non-	Non-	Impaired <sup>(c)</sup>	Total	In arrears of 90 days or more <sup>(d)</sup>	In arrears of 30 to 89 days <sup>(e)</sup>
	problematic	impaired				
	NIS millions					
<u>Activity of borrowers in Israel</u>						
<u>Public-commercial</u>						
Construction & real estate - constructi	15,292	290	579	16,161	9	31
Construction & real estate - real estate	20,420	518	1,331	22,269	5	12
Financial services	9,953 <sup>(g)</sup>	33	20	10,006	-	12
Commercial - other	65,096	3,074	1,499	69,669	36	81
<b>Total commercial</b>	110,761	3,915	3,429	118,105	50	136
Private individuals - housing loans <sup>(f)</sup>	73,876	775	-	74,651	768	499
Private individuals - other	34,037	335	100	34,472	89	171
<b>Total public - activity in Israel</b>	218,674	5,025	3,529	227,228	907	806
<b>Banks in Israel</b>	1,581	-	-	1,581	-	-
<b>Government of Israel</b>	294	-	-	294	-	-
<b>Total activity in Israel</b>	220,549	5,025	3,529	229,103	907	806
<u>Activity of borrowers abroad</u>						
<u>Public-commercial</u>						
Construction & real estate	8,275	57	500	8,832	4	23
Commercial - other	17,351	259	697	18,307	3	36
<b>Total commercial</b>	25,626	316	1,197	27,139	7	59
Private individuals	2,016	20	65	2,101	27	3
<b>Total public - activity abroad</b>	27,642	336	1,262	29,240	34	62
<b>Banks abroad</b>	17,555	-	-	17,555	-	-
<b>Governments abroad</b>	234	-	-	234	-	-
<b>Total activity abroad</b>	45,431	336	1,262	47,029	34	62
<b>Total public</b>	246,316	5,361	4,791	256,468	941	868
<b>Total banks</b>	19,136	-	-	19,136	-	-
<b>Total governments</b>	528	-	-	528	-	-
<b>Total</b>	265,980	5,361	4,791	276,132	941	868

(a) Credit to the public, credit to governments, deposits in banks 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.

(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 were classified as problem debts that are not impaired.

(f) Including housing loans in the amount of NIS 175 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.

**Table 23 - Changes in the balance of impaired debts**

	<b>31 December 2015</b>
	NIS millions
Balance of impaired debts at the beginning of the year	<b>5,191</b>
Additions to impaired debts during the course of the year	<b>878</b>
Transferred from impaired to non-impaired during the course of the year	<b>(294)</b>
Accounting write-offs	<b>(323)</b>
Collection of debts after accounting write-off in previous years	<b>7</b>
Net accounting write-off	<b>(316)</b>
Other	<b>(1,224)</b>
Balance of impaired debts at the end of the year <sup>1</sup>	<b>4,235</b>
<sup>1</sup> Of which: in respect of off-balance sheet credit instruments	<b>295</b>

**Table 24 - Changes in the allowance for credit losses**

	<b>For the year ended 31 December 2015</b>				
	Allowance for credit losses				
	Credit to the public				
	Commercial	Residential	Other private	Total	Banks and governments
	(NIS millions)				
Balance of allowance for credit losses at beginning of year	<b>3,317</b>	<b>513</b>	<b>652</b>	<b>4,482</b>	<b>4</b>
Expenses (income) in respect of credit losses	<b>(123)</b>	<b>(12)</b>	<b>(614)</b>	<b>(1,302)</b>	<b>-</b>
Accounting write-offs	<b>(676)</b>	<b>-</b>	<b>361</b>	<b>771</b>	<b>-</b>
Collection of debts written off in previous years	<b>410</b>	<b>(12)</b>	<b>(253)</b>	<b>(531)</b>	<b>-</b>
Net accounting write-offs	<b>(266)</b>	<b>(2)</b>	<b>(1)</b>	<b>2</b>	<b>-</b>
Adjustments from translation of financial statements	<b>5</b>	<b>513</b>	<b>707</b>	<b>4,153</b>	<b>3</b>
Balance of allowance for credit losses at end of year <sup>1</sup>	<b>2,933</b>	<b>-</b>	<b>33</b>	<b>482</b>	<b>-</b>
<sup>1</sup> Of which: in respect of off-balance sheet credit instruments	<b>449</b>	<b>410</b>	<b>-</b>	<b>361</b>	<b>771</b>
Unimpaired debts - additional information					
In arrears of 90 days or more <sup>(a)</sup>	<b>67</b>	<b>770</b>	<b>105</b>	<b>942</b>	<b>-</b>

(a) Classified as non-impaired problem loans. Accruing interest income.

	For the year ended 31 December 2014					
	Allowance for credit losses					
	Credit to the public				Banks and governments	Total
	Commercial	Residential	Other private	Total		
	(NIS millions)					
Balance of allowance for credit losses at beginning of year	3,301	498	496	4,295	2	4,297
Expenses (income) in respect of credit losses	90	(10)	(560)	(1,148)	-	(1,148)
Accounting write-offs	(578)	-	364	843	-	843
Collection of debts written off in previous years	479	(10)	(196)	(305)	-	(305)
Net accounting write-offs	(99)	1	(4)	22	-	22
Adjustments from translation of financial statements	25	513	652	4,482	4	4,486
Balance of allowance for credit losses at end of year <sup>1</sup>	3,317	1	47	494	-	494
<sup>1</sup> Of which: in respect of off-balance sheet credit instruments	446	479	-	364	843	-
Unimpaired debts - additional information						
In arrears of 90 days or more <sup>(a)</sup>	57	775	109	941	-	941

(a) Classified as non-impaired problem loans. Accruing interest income.

## Credit risk – Disclosure with regard to portfolios dealt with according to the Standardized Approach

For the purpose of weighting the risk of exposures dealt with using the standardized approach, the Bank uses the credit ratings of three external credit rating companies:

- Standard & Poors Ratings Services
- Moody's Investors Service
- Fitch Ratings

The risk weights for debts which are based the rating of the country, governments, banks, security companies and public sector entities are attributed according to Moody's long-term credit rating.

The risk weights for the debts of rated corporations are attributed according to the long-term credit ratings of the three companies, in the following way:

When the debt has one credit rating, this rating will be used to determine the risk weight of the debt.

When there are two credit ratings given by two different companies, which are mapped by various risk weights, the higher risk weight will be chosen.

When there are three credit ratings, the two best ratings will be considered, and the risk weighting for the lower rating out of these two will be taken as appropriate.

The amount of the balances of the banking corporation before and after credit risk mitigation in each risk weighting and reduction from capital.

### Long-term rating:

Rating by rating agencies			Risk weighting		
Fitch	Moody's	S&P	Corporations	Banks*	Sovereign
AAA to AA	Aaa to Aa3	AAA to AA-	20%	20%	0%
A+ to A-	A1 to A3	A+ to A-	50%	50%	20%
BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	100%	100%	50%
BB+ to BB-	Ba1 to Ba3	BB+ to BB-	100%	100%	100%
B+ to B-	B1 to B3	B+ to B-	150%	100%	100%
CCC+ or lower	Caa1 or lower	CCC+ or lower	150%	150%	150%

\* The risk weighting of banks is determined under a country-rating approach.

### Short-term rating:

Rating by Fitch	Rating by Moody's	Rating by S&P	Risk weighting
F1 + F2	P-1	A-1 + A -1	20%
F2	P-2	A-2	50%
F3	P-3	A-3	100%
Rating lower than F3	NP	All short-term ratings that are lower	150%

### Credit rating under the Standardized Approach:

The tables below show details of credit exposure by risk weighting, distributing the exposure by counterparty, before and after credit risk mitigation in respect of recognized collaterals.



**Table 25 - The amount of exposure before credit loss expenses and before mitigation of credit risk<sup>(b)</sup>  
(Third Pillar):**

	<b>31 December 2015</b>					
	0%	20%	35%	40%	50%	75%
	NIS millions					
Sovereign debts	<b>87,183</b>	<b>3,098</b>	-	-	<b>414</b>	-
Debts of public sector entities	-	<b>6,298</b>	-	-	<b>4,596</b>	-
Debts of banking corporations	<b>1,808</b>	<b>8,312</b>	-	-	<b>5,238</b>	-
Debts of securities companies	-	<b>1,021</b>	-	-	-	-
Debts of corporations	-	<b>1,358</b>	-	-	<b>1,732</b>	-
Debts collateralised by commercial real estate	-	-	-	-	-	-
Retail exposures to individuals	-	-	-	-	-	<b>70,873</b>
Small business loans	-	-	-	-	-	<b>20,616</b>
Housing mortgages	-	-	<b>37,460</b>	-	<b>14,360</b>	<b>33,008</b>
Securitization	-	<b>3,161</b>	-	<b>178</b>	<b>51</b>	-
Other assets	<b>3,131</b>	-	-	-	-	-
<b>Total</b>	<b>92,122</b>	<b>23,248</b>	<b>37,460</b>	<b>178</b>	<b>26,391</b>	<b>124,497</b>

**Table 26 - The amount of exposure after credit loss expenses and before mitigation of credit risk<sup>(b)</sup> (Third Pillar):**

	<b>31 December 2015</b>					
	0%	20%	35%	40%	50%	75%
	NIS millions					
Sovereign debts	<b>87,183</b>	<b>3,098</b>	-	-	<b>414</b>	-
Debts of public sector entities	-	<b>6,298</b>	-	-	<b>4,596</b>	-
Debts of banking corporations	<b>1,808</b>	<b>8,312</b>	-	-	<b>5,238</b>	-
Debts of securities companies	-	<b>1,021</b>	-	-	-	-
Debts of corporations	-	<b>1,357</b>	-	-	<b>1,732</b>	-
Debts collateralised by commercial real estate	-	-	-	-	-	-
Retail exposures to individuals	-	-	-	-	-	<b>70,867</b>
Small business loans	-	-	-	-	-	<b>20,604</b>
Housing mortgages	-	-	<b>37,460</b>	-	<b>14,360</b>	<b>33,007</b>
Securitization	-	<b>3,161</b>	-	<b>178</b>	<b>51</b>	-
Other assets	<b>3,131</b>	-	-	-	-	-
<b>Total</b>	<b>92,122</b>	<b>23,247</b>	<b>37,460</b>	<b>178</b>	<b>26,391</b>	<b>124,478</b>

(a) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivative transactions (Netting).

(b) Mitigation of credit risk reflects the classification of the final risk weighting from among the various rates.

100%	150%	225%	250%	350%	650%	1250%	Gross credit exposure <sup>(a)</sup>
482	-	-	-	-	-	-	91,177
1	-	-	-	-	-	-	10,895
481	34	-	-	-	-	-	15,873
-	-	-	-	-	-	-	1,021
139,749	2,062	-	-	-	-	-	144,901
70,466	733	-	-	-	-	-	71,199
73	196	-	-	-	-	-	71,142
89	160	-	-	-	-	-	20,865
2,197	219	-	-	-	-	-	87,244
-	-	-	-	-	-	1	3,391
10,355	486	-	3,147	-	-	-	17,119
223,893	3,890	-	3,147	-	-	1	534,827

100%	150%	225%	250%	350%	650%	1250%	Gross credit exposure <sup>(a)</sup>
482	-	-	-	-	-	-	91,177
1	-	-	-	-	-	-	10,895
481	34	-	-	-	-	-	15,873
-	-	-	-	-	-	-	1,021
138,965	1,975	-	-	-	-	-	144,029
70,449	732	-	-	-	-	-	71,181
41	196	-	-	-	-	-	71,104
23	160	-	-	-	-	-	20,787
2,192	219	-	-	-	-	-	87,238
-	-	-	-	-	-	1	3,391
10,355	486	-	3,147	-	-	-	17,119
222,989	3,802	-	3,147	-	-	1	533,815

**Table 27 - The amount of exposure after allowance for credit losses and after mitigation of credit risk<sup>(b)</sup>  
(Third Pillar):**

	31 December 2015					
	0%	20%	35%	40%	50%	75%
	NIS millions					
Sovereign debts	93,594	3,098	-	-	414	-
Debts of public sector entities	988	3,093	-	-	4,524	-
Debts of banking corporations	1,808	5,036	-	-	5,171	-
Debts of securities companies	-	864	-	-	-	-
Debts of corporations	-	1,357	-	-	1,732	-
Debts collateralised by commercial real estate	-	-	-	-	-	-
Retail exposures to individuals	-	-	-	-	-	69,156
Small business loans	-	-	-	-	-	18,381
Housing mortgages	-	-	37,458	-	14,360	32,973
Securitization	-	2,374	-	178	48	-
Other assets	3,131	-	-	-	-	-
<b>Total</b>	<b>99,521</b>	<b>15,822</b>	<b>37,458</b>	<b>178</b>	<b>26,249</b>	<b>120,510</b>

**Table 28 - The amount of exposure before credit loss expenses and before mitigation of credit risk<sup>(b)</sup>  
(Third Pillar):**

	31 December 2014 <sup>(c)(d)</sup>					
	0%	20%	35%	40%	50%	75%
	NIS millions					
Sovereign debts	63,394	2,645	-	-	435	-
Debts of public sector entities	-	4,964	-	-	5,407	-
Debts of banking corporations	633	19,487	-	-	3,223	-
Debts of securities companies	-	1,138	-	-	-	-
Debts of corporations	-	1,039	-	-	1,544	-
Debts collateralised by commercial real estate	-	-	-	-	-	-
Retail exposures to individuals	-	-	-	-	-	69,232
Small business loans	-	-	-	-	-	19,403
Housing mortgages	-	-	38,344	-	10,482	27,891
Securitization	-	2,348	-	238	160	-
Other assets	2,164	-	-	-	-	-
<b>Total</b>	<b>66,191</b>	<b>31,621</b>	<b>38,344</b>	<b>238</b>	<b>21,251</b>	<b>116,526</b>

(a) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivative transactions (Netting).

(b) Mitigation of credit risk reflects the classification of the final risk weighting from among the various rates.

(c) Data as of 31 December 2014 have been restated, including changes due to a change in the accounting method for accrual of employee rights and the implementation of the directives of the Supervisor of Banks concerning the capitalization of software costs.

(d) Excluding the effect of the adoption of US GAAP on employee rights which came into effect on 1 January 2015.

100%	150%	225%	250%	350%	650%	1250%	Gross credit exposure <sup>(a)</sup>
<b>113</b>	-	-	-	-	-	-	<b>97,219</b>
<b>1</b>	-	-	-	-	-	-	<b>8,606</b>
<b>480</b>	<b>4</b>	-	-	-	-	-	<b>12,499</b>
-	-	-	-	-	-	-	<b>864</b>
<b>127,199</b>	<b>1,948</b>	-	-	-	-	-	<b>132,236</b>
<b>69,481</b>	<b>716</b>	-	-	-	-	-	<b>70,197</b>
<b>45</b>	<b>194</b>	-	-	-	-	-	<b>69,395</b>
<b>22</b>	<b>154</b>	-	-	-	-	-	<b>18,557</b>
<b>2,192</b>	<b>219</b>	-	-	-	-	-	<b>87,202</b>
-	-	-	-	-	-	<b>1</b>	<b>2,601</b>
<b>10,355</b>	<b>486</b>	-	<b>3,147</b>	-	-	-	<b>17,119</b>
<b>209,888</b>	<b>3,721</b>	-	<b>3,147</b>	-	-	<b>1</b>	<b>516,495</b>

100%	150%	225%	250%	350%	650%	1250%	Gross credit exposure <sup>(a)</sup>
254	-	-	-	-	-	-	66,728
1	-	-	-	-	-	-	10,372
792	-	-	-	-	-	-	24,135
-	-	-	-	-	-	-	1,138
145,180	2,215	-	-	-	-	-	149,978
67,148	971	-	-	-	-	-	68,119
182	174	-	-	-	-	-	69,588
133	153	-	-	-	-	-	19,689
5,264	208	-	-	-	-	-	82,189
67	-	35	-	-	-	-	2,848
11,202	491	-	2,932	-	-	-	16,789
230,223	4,212	35	2,932	-	-	-	511,573

**Table 29 – The amount of exposure after credit loss expenses and before mitigation of credit risk<sup>(b)</sup> (Third Pillar)**

	31 December 2014 <sup>(c)(d)</sup>					
	0%	20%	35%	40%	50%	75%
	NIS millions					
Sovereign debts	63,394	2,645	-	-	435	-
Debts of public sector entities	-	4,964	-	-	5,407	-
Debts of banking corporations	633	19,487	-	-	3,223	-
Debts of securities companies	-	1,138	-	-	-	-
Debts of corporations	-	1,039	-	-	1,544	-
Debts collateralised by commercial real estate	-	-	-	-	-	-
Retail exposures to individuals	-	-	-	-	-	69,227
Small business loans	-	-	-	-	-	19,394
Housing mortgages	-	-	38,344	-	10,482	27,890
Securitization	-	2,348	-	238	160	-
Other assets	2,164	-	-	-	-	-
Total	66,191	31,621	38,344	238	21,251	116,511

**Table 30 - The amount of exposure after provision for credit losses and after mitigation of credit risk<sup>(b)</sup> (Third Pillar)**

	31 December 2014 <sup>(c)(d)</sup>					
	0%	20%	35%	40%	50%	75%
	NIS millions					
Sovereign debts	68,515	2,645	-	-	435	-
Debts of public sector entities	681	2,760	-	-	4,127	-
Debts of banking corporations	633	17,289	-	-	3,199	-
Debts of securities companies	-	807	-	-	-	-
Debts of corporations	-	920	-	-	1,544	-
Debts collateralised by commercial real estate	-	-	-	-	-	-
Retail exposures to individuals	-	-	-	-	-	67,119
Small business loans	-	-	-	-	-	17,043
Housing mortgages	-	-	38,340	-	10,481	27,833
Securitization	-	2,006	-	238	160	-
Other assets	2,164	-	-	-	-	-
Total	71,993	26,427	38,340	238	19,946	111,995

(a) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivative transactions (Netting).

(b) Mitigation of credit risk reflects the classification of the final risk weighting from among the various rates.

(c) Data as of 31 December 2014 have been restated, including changes due to a change in the accounting method for accrual of employee rights and the implementation of the directives of the Supervisor of Banks concerning the capitalization of software costs.

(d) Excluding the effect of the adoption of US GAAP on employee rights which came into effect on 1 January 2015.

100%	150%	225%	250%	350%	650%	1250%	Gross credit exposure <sup>(a)</sup>
254	-	-	-	-	-	-	66,728
1	-	-	-	-	-	-	10,372
792	-	-	-	-	-	-	24,135
-	-	-	-	-	-	-	1,138
144,024	2,135	-	-	-	-	-	148,742
67,132	970	-	-	-	-	-	68,102
122	172	-	-	-	-	-	69,521
34	153	-	-	-	-	-	19,581
5,264	201	-	-	-	-	-	82,181
67	-	35	-	-	-	-	2,848
11,202	491	-	2,932	-	-	-	16,789
228,892	4,122	35	2,932	-	-	-	510,137

100%	150%	225%	250%	350%	650%	1250%	Gross credit exposure <sup>(a)</sup>
155	-	-	-	-	-	-	71,750
1	-	-	-	-	-	-	7,569
739	-	-	-	-	-	-	21,860
-	-	-	-	-	-	-	807
131,992	2,092	-	-	-	-	-	136,548
65,263	948	-	-	-	-	-	66,211
99	171	-	-	-	-	-	67,389
28	150	-	-	-	-	-	17,221
5,258	201	-	-	-	-	-	82,113
67	-	35	-	-	-	-	2,506
11,202	491	-	2,932	-	-	-	16,789
214,804	4,053	35	2,932	-	-	-	490,763

### **Credit risk mitigation: disclosures under the Standardized Approach**

For the purpose of credit risk mitigation using the standardized approach, the Bank employs the comprehensive approach for dealing with collateral. The main collateral instruments which are recognized as eligible in the Bank according to the standardized approach are:

Shekel deposits, foreign currency deposits, savings plans, government bonds.

Collateral will be recognized as eligible when it complies with the principles provided in Proper Conduct of Banking Business Directive No. 203, including legal certainty, the right to immediate realization in the event of a failure, and validity vis-à-vis a third party.

The Bank uses letters of offset which meet the conditions stipulated in Proper Conduct of Banking Management Directive No. 203 in order to use the net exposure of loans and deposits as a basis for computing capital adequacy.

In addition, the Bank uses a "netting set" arrangement in accordance with Appendix C to Directive No. 203 in derivative transactions, when there are valid bilateral settlement agreements.

In order to mitigate credit risk in derivative transactions, the Bank enters into CSA agreements (offset and settlement in derivative agreements) and collateral transfer agreements with banks and customers

For the purpose of replacing the risk weighting of debts which are backed by a guarantee with the risk weighting of the supplier of the hedging in calculating risk assets under the Standardized Approach, the Bank recognizes mainly the following guarantees as eligible:

State of Israel guarantee, Israeli bank guarantee, Israel Foreign Trade Risks Insurance Corporation (ASHRA) guarantee.

The eligibility of the guarantee is determined according to compliance with the conditions of legal certainty and the operating requirements set forth in the Directive.

**Table 31 - Mitigation of credit risk (Third Pillar)**

	<b>31 December 2015</b>					
	Gross credit exposure before allowance for credit losses <sup>(c)</sup>	Gross credit exposure after allowance for credit losses <sup>(c)</sup>	Total exposure covered by guarantees deducted	Total amounts added	Total exposure covered by eligible financial collateral <sup>(d)</sup>	Net credit exposure <sup>(e)</sup>
	NIS millions					
Sovereign debts	91,177	91,177	(369)	6,411	-	97,219
Debts of public sector entities	10,895	10,895	(3,273)	989	(5)	8,606
Debts of banking corporations	15,873	15,873	(2,870)	391	(895)	12,499
Debts of securities companies	1,021	1,021	-	-	(157)	864
Debts of corporations	144,901	144,029	(404)	-	(11,389)	132,236
Debts collateralised by commercial real estate	71,199	71,181	(60)	-	(924)	70,197
Retail exposures to individuals	71,142	71,104	(4)	-	(1,705)	69,395
Small business loans	20,865	20,787	(17)	-	(2,213)	18,557
Housing mortgages	87,244	87,238	(4)	-	(32)	87,202
Securitization	3,391	3,391	(790)	-	-	2,601
Other assets	17,119	17,119	-	-	-	17,119
<b>Total</b>	<b>534,827</b>	<b>533,815</b>	<b>(7,791)</b>	<b>7,791</b>	<b>(17,320)</b>	<b>516,495</b>
<b>31 December 2014<sup>(a)(b)</sup></b>						
	Gross credit exposure before allowance for credit losses <sup>(c)</sup>	Gross credit exposure after allowance for credit losses <sup>(c)</sup>	Total exposure covered by guarantees deducted	Total amounts added	Total exposure covered by eligible financial collateral <sup>(d)</sup>	Net credit exposure <sup>(e)</sup>
	NIS millions					
Sovereign debts	66,728	66,728	(100)	5,121	1	71,750
Debts of public sector entities	10,372	10,372	(3,480)	682	(5)	7,569
Debts of banking corporations	24,135	24,135	(1,762)	532	(1,045)	21,860
Debts of securities companies	1,138	1,138	-	-	(331)	807
Debts of corporations	149,978	148,742	(489)	-	(11,705)	136,548
Debts collateralised by commercial real estate	68,119	68,102	(147)	-	(1,744)	66,211
Retail exposures to individuals	69,588	69,521	(6)	-	(2,126)	67,389
Small business loans	19,689	19,581	(7)	-	(2,353)	17,221
Housing mortgages	82,189	82,181	(2)	-	(66)	82,113
Securitization	2,848	2,848	(342)	-	-	2,506
Other assets	16,789	16,789	-	-	-	16,789
<b>Total</b>	<b>511,573</b>	<b>510,137</b>	<b>(6,335)</b>	<b>6,335</b>	<b>(19,374)</b>	<b>490,763</b>

(a) Data as of 31 December 2014 have been restated, including changes due to a change in the accounting method for accrual of employee rights and the implementation of the directives of the Supervisor of Banks concerning the capitalization of software costs.

(b) Excluding the effect of the adoption of US GAAP on employee rights which came into effect on 1 January 2015.

(c) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivative transactions (Netting).

(d) After taking safety factors into account.



### General disclosure regarding exposures related to counterparty risk

Credit risk in derivatives is different from credit risk in loans due to the fact that changes in market prices can substantially increase the debt of the counterparty.

Utilization of counterparty facilities takes into account the current value of open transactions with the addition of potential exposure that is defined by the change in the future value of the inventory of transactions until the time when additional collaterals can be provided in the framework of the appraisal policy and collateral management.

In recent years mechanisms have developed for mitigating credit risks in counterparty trading, anchored in international legal agreements (such as ISDA), accompanied by processes for offsetting mutual collaterals between the counterparties to the transaction (CSA agreements). Inter-banking trading activity is performed only with counterparties with whom the Bank has signed such agreements. In addition, there is a trend of contracting with high-activity customers on a similar basis.

In the CSA agreements with banks, a daily accounting is performed, according to market data and exposure. The collateral is in cash, for the amount stated in the currency stipulated in the agreement. Lowering the credit rating has no effect on the collateral requirement and the collateral amount, according to ISDA agreements with banks.

"WRONG WAY" risk became apparent pursuant to the 2008 crisis to which mainly entities investing in credit derivatives (e.g. CDS) were exposed, which correlated to the credit risk of the credit derivative issuer (counterparty risk).

This risk is not substantial in Leumi.

**Table 32 - Balances of credit risk of counterparties in derivatives (Third Pillar)**

	<b>31 December 2015</b>	
	Balance of nominal value	Net credit exposures of derivatives
	NIS millions	
<b>Interest contracts</b>	<b>320,844</b>	<b>8,587</b>
Foreign currency contracts	<b>249,151</b>	<b>7,064</b>
Contracts for shares	<b>100,923</b>	<b>5,169</b>
Commodities and other contracts	<b>687</b>	<b>107</b>
Credit derivative transactions <sup>(a)</sup>	-	-
Offsetting benefits	-	<b>(12,274)</b>
Eligible collateral	-	<b>(3,450)</b>
<b>Total</b>	<b>671,605</b>	<b>5,203</b>

(a) As of the date of report there are no credit risk exposures with regard to hedging sold or purchased.

	31 December 2014	
	Balance of nominal value	Net credit exposures of derivatives
	NIS millions	
<b>Interest contracts</b>	337,888	10,490
Foreign currency contracts	302,874	11,437
Contracts for shares	95,504	5,225
Commodities and other contracts	818	109
Credit derivative transactions <sup>(a)</sup>	-	-
Offsetting benefits	-	(16,207)
Eligible collateral	-	(3,207)
<b>Total</b>	<b>737,084</b>	<b>7,847</b>

(a) As of the date of report there are no credit risk exposures with regard to hedging sold or purchased.

**Securitization**

The Bank has no activity derived from the securitization activity of the Bank.

However, the Bank invests in asset-backed securities through its nostro activity:

Asset-backed securities are characterized by wide dispersion of borrowers and sometimes also in sectoral and inter-sectoral dispersion. In addition, in some instruments devices there is an allocation to layers of different risk levels that allow the Bank flexibility in adapting the investment to the risk appetite.

Investments in various types of asset-backed securities are examined in advance both in terms of expected return and from aspects of the inherent risks.

## Banking Portfolio

**Table 33 - Banking portfolio - investment in asset-backed securities by type of exposure (Third Pillar)**

	31 December 2015		
	Overall balance of exposure <sup>(a)</sup>	Resecuritization exposures to which credit risk mitigation was applied	Resecuritization exposures to which credit risk mitigation was not applied
	NIS millions		
<b>Mortgage-backed securities (MBS):</b>			
<b>Pass-through type securities by means of:</b>			
RMBS-type securities guaranteed by US Government GNMA	11	-	-
RMBS-type securities issued by FNMA and by FHLMC	1,224	-	-
Other securities	790	-	-
Other mortgage-backed securities:	-	-	-
RMBS-type securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	4,940	-	-
Other RMBS-type mortgage-backed securities	232	-	-
Other CMBS-type mortgage-backed securities	271	-	-
<b>Total mortgage-backed securities (MBS)</b>	<b>7,468</b>	<b>-</b>	<b>-</b>
<b>Asset-backed securities (ABS)</b>			
Credit card receivables	92	-	-
Lines of credit for any purpose secured by dwelling	-	-	-
Credit for purchase of vehicle	-	-	-
Other credit to private persons	4	-	-
Credit not to private persons	1	-	-
CLO-type debentures	2,001	-	178
Others	-	-	-
<b>Total asset-backed (ABS)</b>	<b>2,098</b>	<b>-</b>	<b>178</b>
<b>Total asset-backed securities</b>	<b>9,566</b>	<b>-</b>	<b>178</b>

**Table 34 - Banking portfolio - investments in asset-backed securities by risk weighting (Third Pillar)(\*):**

	31 December 2015			
	Accumulated total exposure			Capital requirements in respect of securitization
	Securitization exposures	Resecuritization exposures	Total	
	NIS millions			
20%	3,164	-	3,164	79
40%	-	178	178	9
50%	48	-	48	3
100%	-	-	-	-
225%	-	-	-	-
1250%	1	-	1	2
Total	3,213	178	3,391	93

(\*) Not including FNMA, FHLMC securities whose risk weighting is 20%. Not including GNMA securities whose risk weighting is 0%.

## Trading Portfolio

**Table 35 - Trading portfolio - investment in asset-backed securities by type of exposure (Third Pillar)**

	<b>31 December 2015</b>
	Overall balance of exposure <sup>(a)</sup>
	NIS millions
<b>Mortgage-backed securities (MBS):</b>	
<b>Pass-through type securities by means of:</b>	
RMBS-type securities guaranteed by US Government GNMA	-
RMBS-type securities issued by FNMA and by FHLMC	8
Other securities	-
Other mortgage-backed securities:	-
RMBS-type securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	408
Other RMBS-type mortgage-backed securities	5
Other CMBS-type mortgage-backed securities	88
<b>Total mortgage-backed securities (MBS)</b>	<b>509</b>
<b>Asset-backed securities (ABS)</b>	
Credit card receivables	12
Lines of credit for any purpose secured by dwelling	1
Credit for purchase of vehicle	67
Other credit to private persons	14
Credit not to private persons	-
CLO-type debentures	-
Others	148
<b>Total asset-backed (ABS)</b>	<b>242</b>
<b>Total asset-backed securities</b>	<b>751</b>

(a) As of 31.12.2015, there are no resecuritization positions in the trading portfolio.

**Table 36 - Trading portfolio - investments in asset-backed securities by risk weighting (Third Pillar) (\*):**

	<b>31 December 2015</b>	
	Accumulated total exposure NIS millions	Capital requirements in respect of securitization exposures
20%	<b>162</b>	<b>4</b>
50%	<b>168</b>	<b>11</b>
100%	<b>1</b>	<b>0</b>
350%	<b>2</b>	<b>1</b>
1250%	<b>2</b>	<b>3</b>
<b>Total</b>	<b>335</b>	<b>19</b>

(\*) Not including FNMA, FHLMC securities whose risk weighting is 20%. Not including GNMA securities whose risk weighting is 0%.

## Banking portfolio

### Investment in asset-backed securities by type of exposure (Third Pillar)

	31 December 2014		
	Overall balance of exposure <sup>(a)</sup>	Resecuritization exposures to which credit risk mitigation was applied	Resecuritization exposures to which credit risk mitigation was not applied
	NIS millions		
<b>Mortgage-backed securities (MBS):</b>			
<b>Pass-through type securities by means of:</b>			
RMBS-type securities guaranteed by US Government GNMA	18	-	-
RMBS-type securities issued by FNMA and by FHLMC	1,558	-	-
Other securities	-	-	-
Other mortgage-backed securities:	-	-	-
RMBS-type securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	3,263	-	-
Other RMBS-type mortgage-backed securities	724	-	-
Other CMBS-type mortgage-backed securities	20	-	-
<b>Total mortgage-backed securities (MBS)</b>	<b>5,583</b>	<b>-</b>	<b>-</b>
<b>Asset-backed securities (ABS)</b>			
Credit card receivables	93	-	-
Lines of credit for any purpose secured by dwelling	2	-	2
Credit for purchase of vehicle	-	-	-
Other credit to private persons	4	-	-
Credit not to private persons	1	-	-
CLO-type debentures	2,004	-	338
Others	-	-	-
<b>Total asset-backed (ABS)</b>	<b>2,104</b>	<b>-</b>	<b>340</b>
<b>Total asset-backed securities</b>	<b>7,687</b>	<b>-</b>	<b>340</b>



**Investments in asset-backed securities by risk weighting (Third Pillar) (\*):**

31 December 2014				
	Accumulated total exposure			Capital requirements in respect of securitization exposures
	Securitization exposures	Resecuritization exposures	Total	
	NIS millions			
20%	2,348	-	2,348	59
40%	-	238	238	12
50%	160	-	160	10
100%	-	67	67	8
225%	-	35	35	10
Total	2,508	340	2,848	99

(\*) Not including FNMA, FHLMC securities whose risk weighting is 20%. Not including GNMA securities whose risk weighting is 0%.

## Trading portfolio

### Investment in asset-backed securities by type of exposure (Third Pillar)

	31 December 2014
	Overall balance of exposure <sup>(a)</sup>
	NIS millions
<b>Mortgage-backed securities (MBS):</b>	
<b>Pass-through type securities by means of:</b>	
RMBS-type securities guaranteed by US Government GNMA	-
RMBS-type securities issued by FNMA and by FHLMC	248
Other securities	-
Other mortgage-backed securities:	-
RMBS-type securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	775
Other RMBS-type mortgage-backed securities	6
Other CMBS-type mortgage-backed securities	111
<b>Total mortgage-backed securities (MBS)</b>	<b>1,140</b>
<b>Asset-backed securities (ABS)</b>	
Credit card receivables	18
Lines of credit for any purpose secured by dwelling	1
Credit for purchase of vehicle	78
Other credit to private persons	16
Credit not to private persons	47
CLO-type debentures	-
Others	138
<b>Total asset-backed (ABS)</b>	<b>298</b>
<b>Total asset-backed securities</b>	<b>1,438</b>

(a) As of 31.12.2014, there are no resecuritization positions in the trading portfolio.

**Investments in asset-backed securities by risk weighting (Third Pillar) (\*):**

	31 December 2014	
	Accumulated total	requirements in
	exposure	respect of
	NIS millions	
20%	224	6
50%	181	11
100%	5	1
350%	3	1
1250%	2	3
Total	415	22

(\*) Not including FNMA, FHLMC securities whose risk weighting is 20%. Not including GNMA securities whose risk weighting is 0%.

## **Market Risk**

Market risk is defined as risk of balance sheet and off-balance sheet positions loss caused by a change in the fair-value of a financial instrument due to change in market conditions (change in price levels in various markets, volatility in interest rates, exchange rates, inflation, share prices and other economic indices). The exposure to market risks is expressed in the financial results, in assets and liabilities fair value, in the shareholders' equity and cash flows.

The market risks to which the Bank is exposed include (see details below) –

- Interest risk, which is the risk for loss as a result of changes in the risk-free interest in various currencies, due to gaps between the dates of interest change or realization of the assets and liabilities in any of the index segments, whichever is earlier. Also a risk can be caused by an imperfect correlation of changes in interest rates in different financial markets or various instruments which resemble in their re-pricing characteristics.
- Base risk expressed as the loss that may occur as a result of changes in price index and exchange rates, due to the difference between assets and liabilities values, including the influence of future transactions, in every index segment.
- Tradable credit risk caused by the volatility of credit margins derived from the repayment capacity of the instrument issuer and from changes in the overall risk of tradable debt instruments.
- Risk of investment in share and funds, caused by a decrease in value of investment in shares or in funds or a decrease in profits/dividends that they transfer to the Group.

## **Organizational structure and responsibility for market risks management**

The Bank implements the directives of the Supervisor of Banks in the subject of market risks and the Group's liquidity, under which fundamental principles of risks management and control have been established, including the responsibility of the management and the Board of Directors, defining control means and tools to measure risks, and control means and supervision of these risks, while applying corporate governance comprising three "lines of defense" –

### **First line of defense – Capital Markets Division**

Responsible for taking the risk while analyzing and understanding it throughout the transaction life span. The Division deals with managing the Bank's Nostro and operating all the Bank's trading rooms for trade and arbitration in currencies, interests, derivatives and securities. In addition, the Division deals with financial management of the Group including developing financial and investment products, and managing the Group's assets and liabilities. Also the Division is responsible for keeping contact with financial institutions abroad, provide service to customers who are active in the capital and money markets, including institutional customers, and manage ongoing control of the above mentioned activities. In addition to the control processes inside the trading rooms, an ongoing control of the activity is performed by the Middle Office in the Risk Management Sub-Division in the Division - in aspects of market risks, operational risks and embezzlement and fraud risks. The investments arm of Leumi – "Leumi Partners" operates alongside the Capital Markets Division as "first line".

### **Second line of defense – the Risk Management Division**

The Division is responsible for examining the market risks and liquidity management from overall perspective and with involvement in assessing the risks in new products and activities, formulating risk policy and risk limitations from overall Nostro portfolio perspective, the real investments of the Bank and the pension portfolio. Develop and challenge the risk assessment in essential activities such as approving products, investments, new transactions, development of methodology and execution of stress scenarios, and so forth.

### **Third line of defense – Internal Audit**

Its role is to examine retroactively, the correctness and efficiency of the first and second line risk management processes and expose weaknesses in the internal controls.

Market risks management is discussed at various committees:

- The Board of Directors' Risks Management Committee – every quarter a discussion regarding the Risk Management Division's risk report is held at the Board of Directors' Risks Management Committee dealing with the exposure to market risks and the change in the risk focuses, reporting the updated status of meeting the limitations at the Group level, and also the damage that may be incurred by the Bank from stress scenarios. Additionally, every highly significant new activity in financial instruments is presented for discussion and approval of the Committee as part of the "new product" procedure. Also, the market risks management policy is presented for discussion and approval of the Committee, and the recommendations of the Board of Directors' Risks Management Committee are submitted for the Board of Directors plenary approval.
- The Asset-Liability and Financial Investments Committee (ALCO) headed by the Deputy CEO is responsible for managing the assets and liabilities and financial investments according to decisions of the Board of Directors and management, emphasizing the balance sheet structure, transition prices, required liquidity and liquidity reserves investments, capital structure and sources-raising policy and meeting the Group's limitations and policy.
- Senior Risks Committee headed by the President and CEO – discusses essential issues connected to market risks after they have been discussed at the Senior Market Risks Committee.
- Senior Market Risks Committee headed by the Chief Risk Officer examines market events and trends which may affect the Bank, and is responsible for discussing and approving the risk policy and limitations – prior to presenting them for discussion and approval of the Board of Directors, to monitor the complying with the said limitations, approve the methodology for measuring exposure to market risks at the Leumi Group.

### **Market Risks Management Policy**

Market risks management policy is an expression of the Group's market risks strategy, this alongside the present procedures for identifying, measuring, follow-up, development and control of market risks. The policy is intended from one hand to support reaching business targets while assessing the risks and opportunities that can emanate from exposure to risks compared with the expected profit that they can generate, and on the other hand, intended to decrease the risk level emanating from the ongoing activity of the Bank, including maintaining high level of liquidity. All this considering the scale of the activity, the restrictions and costs of the hedging activities, the changes in the business environment in Israel and in the world, the directives and requirements of Bank of Israel, and changes occurring in the world in the subject of risk measurement and management methods and their adaptation to the needs of the Bank and the Group.

The policy constitutes an important tool for defining the risk appetite of the Bank in the Nostro area, trading rooms and market exposure in the entire Leumi Group. The policy defines the corporate governance, division of organizational responsibility and the escalation mechanisms. The 2016 investments and market risks management policy includes adjustments to regulation requirements regarding liquidity risk, interest risk and measuring the value at risk (VaR), and also adjustments required for directive of the US Walker Rule, which is part of the Dodd-Frank Act designed to maintain the stability of the US financial system.

As part of the market risks management policy, limits by the Board of Directors have been set for every substantial market risk, of which some are detailed below. Also, limits were determined at the level of the Chief Risk Officer and additional complementing restrictions.

The exposures to market risks are managed regularly at the Group level. The overseas subsidiaries determine market risks management policies in compliance with the Group policies and its approved risk frameworks. Information on the actual exposure status according to the determined frameworks is received from the subsidiaries and taken into account in the overall management of the Group's exposures.

Market risks management is performed in two risk centers – the banking portfolio and the trading portfolio. The definition of the trading portfolio is derived from Basel directives and includes the Bank's tradable securities portfolio and derivatives transactions in the tradable activity. The definition of the banking portfolio includes the transactions which are not included in the trading portfolio.

As of January 1, 2015 the Bank implements the US accounting principles for employee benefits, as set by the Bank of Israel, focused on the change in discounting rate of the pension liabilities. Managing the market risks concerning the commitments to employees is done partially in the framework of the banking portfolio, and its remaining part is done independently and separately as part of the "plan assets" management intended to yield a long term return, in aim to service the liability value. The pension liability is a stream influenced by demographic parameters, inflation, the determining wage for pension, and so forth. The actuarial commitment to employees having a long term average duration is substantially influenced by changes in the discount rate. The effect of these changes on the Bank's capital is high. However, investment in "plan assets" is intended to service part of this liability, and is made by investing in diversified and dispersed assets like shares and debt assets. The investment is subject to regulatory restrictions and restrictions set by the funds.

The market risks management policy includes restrictions on the financial exposures according to the risk appetite. These restrictions are intended to limit the loss that may result from unexpected changes in the various risk factors that exist in the markets such as interest rates, inflation, exchange rates, tradable credit spreads and share prices. The restrictions set at the Group level include all the subsidiaries in Israel and abroad.

### **The Trading Portfolio**

The market risks in the trading portfolio are derived from the activity of the Bank as market maker, broker and positions manager for the Nostro, this for the purpose of generating profits from trade, while giving quick response to market changes.

- The activity in foreign currency and derivatives at Leumi is part of a sophisticated global market, with very high liquidity and trade turnovers. Leumi trades in a very broad range of derivatives of different base assets: currency, interest, index, commodities and securities. The main activity is performed with common and very liquid instruments in the local and global market. Facilities for this activity are allocated from the limits framework set by the Board of Directors for the rate of maximum exposure to market risks, which constitute a low rate relative to the total market exposures of the Bank.
- The foreign currency and derivatives trading room acts as a market maker in currencies, interests, various derivative instruments and Israel Government bonds for granting immediate trade services to customers who are active in those instruments. This activity exposes the Bank to market risks (such as foreign currency risks, options risks and interest risks) hence the activity is managed and monitored according to restrictions which have been approved by the Market Risks Management Committee. Due to the dynamic nature of the activity, these restrictions are monitored regularly by the Middle Room at least once a day. The exposures at the options desk are measured and managed based on accepted sensitivity indices.
- The activity in derivatives is performed with business, commercial, institutional customers (such as insurance companies, provident funds, and funds), and private banking customers and financial institutions. The main activity of the trading rooms with institutional customers in the area of derivatives. The majority of activity is performed with liquid collaterals. The models used for calculating the collateral requirement are identical to the existing policy applied to all the Bank's

customers. However, the collateral requirement for tradable derivatives may be lower relatively to all the customers, because their credit risk is low due to them being subject to regulatory directives and tight supervision, with the narrowest window between the demand for additional collateral and when they are actually received, but it will not be less than the minimum required by the relevant stock exchange in Israel or abroad.

- Initiated activity is performed in the Nostro trading rooms in which initiated exposure to interest rates, foreign currency and tradable credit risks are performed. In the Shekel Nostro the main exposure is to Israel Government bonds and in foreign currency Nostro the main exposure is to foreign countries bonds, banks, companies and asset backed securities. This activity is managed and monitored regularly at least once a week, according to limits part of which was approved by the Board of Directors and part by the Chief Risk Officer. All the limits were validated by the Risk Management Division.

Trading portfolio market risks are identified, monitored and controlled vis-à-vis the limits in an ongoing basis by the Middle Office in frequency of at least once a day.

### **The Banking Portfolio**

The market risks in the banking portfolio derive from the Bank's core business activity (primarily credit, deposits and investments in securities in the available for sale portfolio). The principal portfolio risks are interest risk and base exposures. The main tools for managing the banking portfolio exposures are pricing policy, Nostro available for sale portfolio management, issuing debt instruments and hedging by derivative financial instruments. The hedging policy enables narrowing and/or broadening risks, as necessary, by changing the position of the Bank in accordance with the risk appetite as defined by the Board of Directors.

### **Investment Policy**

Leumi's Nostro activity constitutes a principal tool for managing the assets and liabilities, linkage balance sheets, routing the exposed capital and generation of profits. The management is performed with overall perspective, including reference to the comprehensive risks and opportunities, including the Nostro portfolios, the real holdings and assets and liabilities in the pension portfolio. The management is also subjected to risk appetite restrictions set by the Board of Directors and to capital allocations as required by Basel rules. The principal risks inherent in the investment activity are interest risks, credit, liquidity and base.

In order to maintain stability and high liquidity level, asset management is done by assuming low to moderate risk in the major part of the investment and activities, and assuming higher risk in small part of the investments and activities. As part of this policy a high diversification level is maintained among products, countries, risk types and exposure to counterparties.

Leumi is exposed in the Nostro portfolios to credit and market risks of countries, banks and financial institutions in Israel and abroad. The Bank also limits investment in asset backed instruments (such as MBS, CLO, ABS and others) and also in funds and shares with a high volatility.

The Group's policy of exposure to foreign financial institutions and to countries is part of the market risks and tradable credit risks management policy. This policy defines guidelines, risk limits for credit exposure/counterparty and authorities. The policy directs that the main exposure will be to large banks of systemic importance to their country and to banks of relative high credit quality with stress on portfolio diversification. Risk management of exposure to financial institutions and to countries is carried out by credit committees directed by the Capital Markets Division with the Risk Management Division participating. Follow up of the portfolio quality is done in the Risk Management Division, and risk analyses and scenarios for examining risk focuses are carried out and discussed in the Senior Market Risks Committee and in the Board of Directors Risk Management Committee.

For investment in entities which main business are derivative financial instruments and short sales (Hedge Funds), quantitative limitations for investment size were set according to the risk profile. In addition, extensive due diligence checks are performed, control circles and corporate governance are carried out, based on reporting and measuring mechanisms.

As part of examining the overall risk profile the Bank performs follow up and monitoring of the exposures to market risks and losses that may occur under different scenarios including stress scenarios, this done in order to reflect the overall market risks in a holistic perspective – interest, base, credit margins, shares and funds.

Leumi has defined alert mechanisms following exceptional developments in the exposure status and/or in the markets among them –

- Setting reporting thresholds regarding deviation from quantitative restrictions, reporting manner and providing substitutes to treat the deviation.
- Follow up mechanisms (Watch List) and red flags which follow the market developments, complying with restrictions, change in assets, and so forth. These mechanisms are partly monitored by the business units (first defense line) and partly by the Risks Management Division (as second defense line)

Leumi has detailed contingency plans which include action plans upon realization of pre-set triggers.

Leumi closely monitors the value of securities that are likely to be impacted by market fluctuations or deterioration in the quality of the issuing entity. If it is decided that impairment of a security is of a permanent nature, under the criteria set, a provision is made to profit and loss.

**Table 37 - Capital requirements in respect of market risk (Third Pillar)**

	<b>31 December 2016</b>	
	<b>2015</b>	<b>2014</b>
	NIS millions	
<b>Capital requirements<sup>(a)</sup> in respect of:</b>		
Interest rate risks	<b>546</b>	948
Share price risks	<b>34</b>	169
Exchange rate risk	<b>56</b>	200
Options	<b>15</b>	38
<b>Total capital requirements in respect of market risks</b>	<b>651</b>	1,355

(a) At 12.6% and 12.5% in accordance with the minimum ratio required at 31 December 2015 and 31 December 2014, respectively.

The Market Risks capital requirements are presented in the above table according to the Standardized Approach, which reflects only part of the exposure to market risks.

Regulatory capital adequacy is calculated on –

- Interest risks, options risks and a specific risk in the trading portfolio under which the trade rooms activity, market making and positions management in the Nostro portfolio are performed.
- Currency risks.
- Share risks
- Credit risk in the available for sale Nostro portfolio that is managed in the framework of the banking portfolio and constitutes a principal tool in managing assets and liabilities, the Bank's linkage balance sheets and tracing the exposed capital.



## Market risks to which the Bank is exposed

### Base / Exchange Rate Exposure

According to accounting principles, capital is defined as non linked Shekel source, so that investing the capital in sector which is not the non linked Shekel sector, is defined as base exposure. The exposure to base risks is measured as percentage of the Group's exposed capital.

The capital exposed at the Bank level includes the shareholders' capital and certain reserves, deducted by fixed assets and investments in investees, excluding investments in overseas subsidiaries which are financed by foreign currency sources hence not deducted from the capital. At the Group level the exposed capital includes shareholders' equity and certain reserves, deducted by fixed assets and investments in companies included on equity basis.

The base exposure restrictions approved by the Board of Directors are determined by expected return considerations and risk, and are divided between the trade rooms, ALM and the subsidiaries.

The subsidiaries abroad and in Israel conduct low scale base exposures based on policy anchored by the directors' decisions in coordination with the Bank in Israel.

Changes in exchange rate affect the effective tax rate, since exchange rate differences regarding investments abroad are not taken into account in the base income for calculation of provision for tax, unlike exchange rate differences regarding financing sources thereto. As protection against the tax exposure caused by exchange rate differences regarding investments abroad defined as units which activity currency is identical to the Shekel, the Banks performs hedging transactions.

**Table 38 – Below is the actual economic exposure at Group level, compared with restrictions set by the Board of Directors. The data is presented in terms of percentage of the exposed capital:**

	Actual position	
	31 December	
	2015	2014
	In percentages	
Unlinked	(19.3)	(1.2)
CPI-linked*	19.5	3.9
Foreign currency	(0.2)	(2.7)

\* The exposure does not take into account the effect of index floors on the capital invested in the sector.

During 2015, the average amount of capital invested in the index linked sector was some 20.7%. This amount fluctuated during the year from a surplus of 7.2% to 26.6% of the exposed capital. A relatively low amount of capital was routed to the foreign currency sector, and so the effect of exchange rate changes on the profit is not substantial.

In 2015, the Group complied with all the base exposure limits approved by the Board of Directors.

**Table 39 - Below is the sensitivity to changes in exchange rates of the main foreign currencies as of 31 December, 2015. The measurement refers to the effect of the changes on the Bank's capital and includes the activity in balance sheet and off-balance sheet instruments:**

	Dollar	Euro	Sterling	Swiss Franc	Yen
	NIS millions				
Increase of 5% in exchange rate	19	(7)	6	(3)	(4)
Increase of 10% in exchange rate	59	(11)	13	(7)	(8)
Decrease of 5% in exchange rate	(3)	6	(5)	4	4
Decrease of 10% in exchange rate	-	19	(10)	7	8

The follow up on base exposures is done on a daily basis, they are being discussed weekly in a designated forum, headed by the Head of the Capital Markets Division and in the ALCO committee, and are reported in the President & CEO's report and in the Risk Report.

## Shares

The Bank has defined Group policy for investment in shares including determining limits as to the overall scale of investment and in any single company, the investment mix, and various risk levels for types of real investments.

The main investment in shares is part of management of the real investment portfolio in the Group.

Nostro share investment activity is carried out by investment in indices or funds.

The definition of investment objectives in real investments:

- Achieving surplus return compared with the Nostro's financial investment.
- Maximizing investment value and achieving surplus investment conditions by leveraging Leumi Group's reputation.
- Expanding the dispersal of risks and diversifying the Group's sources of income.
- Flattening the volatility of the Nostro portfolio (timing differences)

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

- Strategic investments which the Bank intends to hold for the long-term.
- Investments for the medium term.
- Investments in growth companies (start-up companies).

## Accounting records

Investments are recorded in the available for sale share portfolio. When the investment is in a company included on equity basis, it is recorded under investments in companies included on equity basis.

**Table 40 - Book balance of investment shares in the banking portfolio (Third Pillar)**

	<b>31 December</b>	
	<b>2015</b>	2014
	Book balance	
	NIS millions	
Quoted shares in the available portfolio	<b>1,050</b>	1,596
Unquoted shares in the available portfolio	<b>1,653</b>	1,584
<b>Total</b>	<b>2,703</b>	3,180

### Interest risk

Interest risk is the risk of loss as a result of changes in credit risk-free interest rates in various currencies, due to the gaps between dates of change in interest rate or the realization of the assets and liabilities in each of the index sectors, whichever is earlier.

The interest exposure policy calls for limiting the rate of influence of possible changes in interest on the potential erosion of the economic value<sup>1</sup> and financial profit for the coming year. The profit exposure to interest is affected by activity in derivatives transactions and securities trading portfolio.

There are built-in interest risks derived from uncertainty in market factors that cannot be hedged but is built-in the banking activity. The risk includes behavioral options inherent in loans and deposits that cannot be hedged (such as early redemption options).

The interest risk is measured and managed based on different behavioral assumptions as to the maturity periods of the assets and liabilities. Based on past experience, the Bank considers part of the current accounts balance as long term liabilities. In addition, there are assumptions regarding early repayment of mortgages. These estimates are of high importance for managing interest risks, also due to the substantial increase in balances in recent years.

Measuring exposure to interest changes is performed for both increase and decrease in interest in each index sector. This measurement is designed to examine the sensitivity of the current assets and liabilities structure to interest changes, therefore the calculation is made without changing the assets and liabilities structure. If the interest rate is clearly negative, the assets and liabilities structure will have to change.

The follow-up on interest exposures is made on a bi-weekly basis, they are discussed once every two weeks in a dedicated forum headed by the Head of the Capital Markets Division and in ALCO Committee and reported in the President & CEO Report and the Risks Report.

<sup>1</sup> The economic value of the capital is defined as the difference between the present value of the assets and liabilities. In calculating the present value, the cash flows of the non-risk credit return curve and the Libor foreign currency cash flows are deducted.

**Table 41 - Summary of exposure to unexpected changes in interest rates at Group level (before tax and in NIS millions)\* the potential change in economic value as a result of a scenario:**

Scenario	As at 31 December 2015		As at 31 December 2014	
	Increase of 1%	Decrease of 1%	Increase of 1%	Decrease of 1%
<b>In Israeli currency</b>				
Banking portfolio	(641)	708	(468)	517
Trading portfolio	(87)	111	(113)	123
<b>In foreign currency</b>				
Banking portfolio	(32)	(74)	23	(84)
Trading portfolio	7	(33)	(108)	108
<b>Potential erosion of the annual profit</b>				
	As at 31 December 2015		As at 31 December 2014	
	Actual			
Total	<b>379</b>		106	

\* The scope of exposure ignores the existence of 0% interest floor on deposits. The more the interest decreases nearing zero, the higher the impairment in the financial margin, since any reduction of interest by the Bank of Israel is expressed only in the reduction of credit interest, and hence in reducing margins and eroding the Bank's profitability.

**Table 42 - Exposure of capital to an immediate increase/decrease in interest rates (before the effect of tax)**

	Israeli currency exposure		Foreign currency exposure	
	As at 31 December 2015			
	To an increase of 1%	To a decrease of 1%	To an increase of 1%	To a decrease of 1%
The exposure of the capital to an immediate increase/decrease in interest*	<b>1,472</b>	<b>(1,895)</b>	<b>(292)</b>	<b>182</b>

\* This measurement includes the exposure to immediate change in interest rate of Nostro portfolios revalued at market value and actuarial commitment to employees. This measurement does not include the effect of the sensitivity of the plan's assets to changes in interest which is estimated as a decrease of some NIS 120 million in a scenario of 1% increase in interest. Also the measurement does not include the influence of the transitional provisions of the Standard on employee rights, according to which the capital adequacy ratio is calculated.

Upon implementation of the standard for employee rights and discounting of the actuarial commitment to employees per market interests, the Bank's sensitivity to changes in interest increased. In order to minimize the capital volatility, Leumi is hedging part of this exposure.

During 2015 the Group complied with all the exposure restrictions set by the Board of Directors.

## Sensitivity of the fair value of assets and liabilities to interest

Below is the effect of potential changes in interest rates on the fair value of the Bank's and its consolidated companies' financial instruments, less non-monetary items, in accordance with accounting principles:

**Table 43 - Net fair value of financial instruments, before the effect of changes in interest rates:**

	31 December 2015					
	Israeli currency		Foreign currency including foreign-currency linked Israeli currency			
	Unlinked	CPI-linked	Dollar	Euro	Others	Total
	NIS millions					
Financial assets	257,444	52,070	64,294	7,598	9,709	391,115
Amounts receivable in respect of derivative and off-balance sheet financial instruments	258,434	7,256	193,030	57,823	24,915	541,458
Financial liabilities <sup>(a)</sup>	211,447	59,362	87,666	13,889	9,199	381,563
Amounts payable in respect of derivative and off-balance sheet financial instruments	283,626	8,796	170,470	52,076	26,125	541,093
Net fair value of financial instruments	20,805	(8,832)	(812)	(544)	(700)	9,917
(a) Includes fair value of actuarial liabilities to employees and does not include the value of plan assets.						

	31 December 2014					
	Israeli currency		Foreign currency including foreign-currency linked Israeli currency			
	Unlinked	CPI-linked	Dollar	Euro	Others	Total
	NIS millions					
Financial assets	222,410	55,524	64,967	9,373	12,730	365,004
Amounts receivable in respect of derivative and off-balance sheet financial instruments	322,255	6,776	198,239	56,168	35,421	618,859
Financial liabilities	182,348	50,496	87,313	15,721	9,732	345,610
Amounts payable in respect of derivative and off-balance sheet financial instruments	340,762	9,046	177,771	50,011	38,888	616,478
Net fair value of financial instruments	21,555	2,758	(1,878)	(191)	(469)	21,775

**Table 44 - The effect of potential changes in interest rates on the net fair value<sup>(a)</sup> of financial instruments**

<b>31 December 2015</b>							
Net fair value of financial instruments after effect of changes in interest rates						Change in fair value	
Israeli currency	Foreign currency including foreign-currency linked Israeli currency						
	Unlinked	CPI-linked	Dollar	Euro	Others	Total	Total
NIS millions						NIS millions	In %
Corresponding immediate increase of 1%	<b>19,963</b>	<b>(7,086)</b>	<b>(1,079)</b>	<b>(550)</b>	<b>(692)</b>	<b>639</b>	<b>6.44</b>
Corresponding immediate increase of 0.1%	<b>20,721</b>	<b>(8,657)</b>	<b>(839)</b>	<b>(545)</b>	<b>(699)</b>	<b>64</b>	<b>0.65</b>
Corresponding immediate decrease of 1%	<b>21,643</b>	<b>(11,061)</b>	<b>(675)</b>	<b>(537)</b>	<b>(708)</b>	<b>(1,255)</b>	<b>(12.66)</b>

(a) This measurement includes the exposure to immediate change in interest rate of Nostro portfolios revalued at market value and actuarial commitment to employees. This measurement does not include the effect of the sensitivity of the plan's assets to changes in interest which is estimated as a decrease of some NIS 120 million in a scenario of 1% increase in interest. Also the measurement does not include the influence of the transitional provisions of the Standard on employee rights, according to which the capital adequacy ratio is calculated.

<b>31 December 2014</b>							
Net fair value of financial instruments after effect of changes in interest rates						Change in fair value	
Israeli currency	Foreign currency including foreign-currency linked Israeli currency						
	Unlinked	CPI-linked	Dollar	Euro	Others	Total	Total
NIS millions						NIS millions	In %
Corresponding immediate increase of 1%	20,684	2,635	(2,065)	(207)	(482)	(1,210)	(5.56)
Corresponding immediate increase of 0.1%	21,468	2,746	(1,897)	(193)	(470)	(121)	(0.56)
Corresponding immediate decrease of 1%	22,516	2,911	(1,741)	(173)	(456)	1,282	5.89

## Exposure to interest and complying with restrictions

Below is the status of exposure to interest changes at Group level calculated in accordance with accounting principles. During 2014 the Group met all the interest exposure restrictions as set by the Board of Directors. Detailed data of the interest exposure can be seen below in Appendix D to the Management Review.

**Table 45 - Exposure to interest rates and compliance with limits**

	31 December					
	2015			2014		
	Unlinked	CPI-linked	Foreign currency	Unlinked	CPI-linked	Foreign currency
<b>Average duration in years:</b>						
Average duration of assets <sup>(a)</sup>	<b>1.06</b>	<b>3.26</b>	<b>1.05</b>	1.03	2.96	0.96
Average duration of liabilities <sup>(a)</sup>	<b>0.94</b>	<b>3.03</b>	<b>0.95</b>	0.92	3.00	0.83
Average duration gap in years	<b>0.12</b>	<b>0.23</b>	<b>0.10</b>	0.11	(0.04)	0.13
IRR gap (%)	<b>1.94</b>	<b>1.33</b>	<b>0.82</b>	2.29	1.22	1.16

(a) Includes futures transactions and options, and relying on fair value data of financial instruments.

Calculating the average duration of liabilities in the index sector takes into account an estimate of early redemptions and withdrawals at saving plans exit points, according to the model of estimating early expected redemptions based on savers' behavior. The average duration of total liabilities according to the original saving plans cash flow is longer and reaches 3.07 years, and the internal rate of return gap ("IRR") amounts to 1.07%.

The presentation of the above mentioned data takes into account early redemption of index-linked mortgage loans, according to a statistical model which estimates the expected redemptions based on past behavior of borrowers. The average duration for the end of 2015 according to the original cash flow, which does not take into account early redemptions, is higher reaching 3.65 years, and the IRR gaps amounts to some 1.07%.

Included in the exposure to changes in interest rates, are the current account balances that pursuant to the directives of the Bank of Israel are shown under deposits on demand and up to one month. However, for purposes of interest rate exposure, a certain percentage of the current balances in shekels and in foreign currency are spread over repayment periods of up to ten years, in accordance with a behavioral model whose basic assumptions are updated on a current basis. Taking into account these assumptions, the average duration of the liabilities is higher and reached 1.05 years in unlinked shekels and 1.01 years in foreign currency, and the IRR gap amounts to 1.80% and 0.56% respectively.

**Below are the principal limits on market risks exposures as of 31 December 2015:**

Limit	In NIS millions	Of the exposed capital
Sensitivity of the economic value to corresponding changes of 1% in interest rates		
Total activity of the Bank	1,100	
Banking portfolio	900	
Trading portfolio	450	
Potential erosion in the annual profit from a corresponding change of 1% in interest rates		
Total activity of the Bank	500	
Base exposure		
Unlinked shekels		-/+ 65
CPI-linked shekels		-/+ 50
Foreign currency		-/+ 15
Value at Risk (VaR)		
Banking portfolio	700	
Trading portfolio	250	

**Methodologies and tools for measuring risk**

Market risks are estimated by a variety of tools, complementing each other and compatible with the various exposures of the Bank. The indices used by the Bank for overall management of market risks are used for evaluating the potential monetary damage from overall market and tradable credit exposures or from a specific portfolio having such exposures, under assumptions which take into account the reciprocal relations between the various risk factors which exist in each portfolio and in all of them together.

**Sensitivity analysis and stress scenarios** – The global and local markets are subject to periodic turmoil expressed in exceptional high parameters volatility, deviating from normal historic behavior. Quantitative models like VaR do not provide information on losses that may occur in stress market conditions, or beyond the set level of significance, therefore the risk measurement is performed in a variety of stress market scenarios and same for analysis of sensitivity to change in any of the risk factors. These include all of the risk factors to which the Bank is exposed and constituting part of the decision making process in determining the overall investments strategy and composition of the preferred portfolio under the set risk restrictions. In calculating stress scenarios, expert assumptions are validated as possible against historic and current market data.

**Value at Risk (VaR)**<sup>1</sup> is a statistical model evaluating the expected loss to the Bank, during a certain investment horizon and a predetermined statistical certainty level. The VaR value may grow as a result of increase in the volatility of the risk factors, or as a result of increase in risk level inherent in the banking activity. However the VaR is limited in its ability to forecast stress scenarios and therefore is used mainly for ongoing management, but also will constitute a warning light in market stress scenarios. At the beginning of the third quarter of 2015 the Board of Directors approved transition to measuring the value at risk based on historic simulation, instead of a parametric simulation which was customary until this quarter.

<sup>1</sup> The credit risk inherent in the various assets is not included in calculating the VaR, which constitutes an estimate of the market risks only.



Since the VaR value can increase as a result of volatility in the markets and not necessarily as a result of change in the risk profile, the Bank has set at Board of Directors level warning restrictions ("Attention Limits") on the value at risk with regard to the banking portfolio and the trading portfolio in measurement horizon adjusted to the nature of the activity and composition of the portfolio (a month and 10 days respectively). These restrictions are designed to be a sort of warning sign for the risk level and reaching them will require examining the risk profile and taking decisions regarding reducing the risk or temporarily adjusting the restriction.

Below is the VaR estimate at Group level in NIS millions according to historic simulation:

	Banking portfolio VAR	Trading portfolio VAR
	31 December	31 December
	2015	2015
Actual	376	45

Below is the VaR estimate at Group level in NIS millions according to parametric simulation, before the change in the method of measurement:

	Economic value VAR	Appraised portfolios VAR
	31 December	31 December
	2014	2014
Actual	156	42

In 2015 the Group met all the VaR limits set by the Board of Directors.

**A model for estimating credit risk (tradable) in Nostro foreign currency portfolio** - The model calculates the expected tail loss ("Expected Shortfall") in Nostro foreign currency portfolio in scenarios of different severity levels based on specific characteristics of the portfolio, with considering the probability of failure and change in the issuers' ratings. Measuring the risk in the complete portfolio takes into account dispersion and centralization in the portfolio.

## **Liquidity risk**

Liquidity risk is the risk created due to uncertainty regarding the possibility to raise sources and/or realize assets, unexpectedly and in very short time, without incurring substantial loss.

### **Liquidity coverage ratio (Third Pillar)**

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 coverage ratio in the banking system in Israel. The liquidity coverage 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, in accordance with a combined scenario incorporated in the directive.

As part of the directive, the method of calculation was determined for the liquidity coverage ratio, including defining the characteristics and operational requirements for an "inventory of high-quality liquid assets" (the numerator) and safety factors concerning them, together with the net cash outflow expected in the stress scenario defined in the directive for the next 30 calendar days (the denominator). This cash flow includes, inter alia, withdrawal of deposits of various types according to coefficients set out in the directive, utilization of credit facilities extended by the Bank and so on, less the repayments during the month of credit provided by the Bank under cash inflow coefficients specified in the directive. Accordingly, changes in the scope or composition of liquid assets, changes in the volume of deposits of each type of the deposits defined in the directive, changes in the volume of credit facilities and guarantees against which liquidity has to be maintained and so on, can lead to a change in the liquidity coverage ratio of the Bank.

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.

**Table 46 - Liquidity coverage ratio (Third Pillar)**

	For the three months ended 31 December 2015	
	Total unweighted value (average) <sup>(a)(d)</sup>	Total weighted value (average) <sup>(b)(d)</sup>
	NIS millions	
Total high-quality liquid assets	-	84,279
<b>Cash outflows</b>		
Retail deposits from individuals and small businesses of which:	<b>161,800</b>	11,239
Stable deposits	<b>43,817</b>	2,191
Less stable deposits	<b>62,524</b>	7,384
Deposits for a period in excess of 30 days (Section 84)	<b>55,459</b>	1,664
Unsecured wholesale financing, of which:	<b>126,260</b>	80,797
banking corporations	-	-
Non-operational deposits (all the counterparties)	<b>125,888</b>	80,425
Unsecured debts	<b>372</b>	372
Secured wholesale financing	-	-
Additional liquidity requirements, of which:	<b>85,968</b>	19,413
requirements	<b>13,427</b>	13,427
Cash flows in respect of loss of financing of debt products	-	-
Credit and liquidity facilities lines	<b>72,541</b>	5,986
Other contractual financing obligations	<b>5,444</b>	5,444
Other contingent financing obligations	<b>43,300</b>	1,460
<b>Total cash outflows</b>		118,353
<b>Cash inflows</b>	-	-
Secured loans (for example resale transactions)	<b>1,570</b>	-
Cash inflows from exposures repaid in order	<b>41,981</b>	28,361
Other cash inflows	<b>15,296</b>	9,446
<b>Total cash inflows</b>	<b>58,847</b>	37,807
<b>Total adjusted value<sup>(c)</sup></b>		-
<b>Total high-quality liquid assets</b>		84,279
<b>Total net cash outflows</b>		80,546
<b>Liquidity coverage ratio</b>		105%

- (a) Non-weighted values will be calculated as unpaid balances to be repaid or repayable by the holder within 30 days (for cash inflows and out flows).
- (b) Weighted values will be calculated after the activation of appropriate safety factors or rates of inflow and outflow (for cash inflows and out flows).
- (c) Adjusted values will be calculated after the activation of (1) safety factors or rates of inflow and outflow, and (2) any relevant restrictions (i.e. limits on high-quality liquid assets in Level 2 and Level 2 and a limit on cash inflows).
- (d) Values are calculated based on a weighted average of 72 observations during the fourth quarter.

The policy of liquidity risk management constitutes an integral part of the strategic business management of Leumi Group which has been adjusted to Proper Conduct of Banking Business Directive No. 342 for liquidity risk management and requirements of Directive 221 "Liquidity Coverage Ratio".

Leumi maintains a proper liquidity level by investing the Nostro portfolio in quality and diversified assets in Shekels and foreign currencies which will enable it to meet all liquidity needs in a variety of stress scenarios, and by a policy of raising diversified and stable sources with different period ranges with emphasis on raising deposits from retailers and issuing long term debt.

In recent years, with the decrease in interest level and regulatory changes occurring in Israel and in the world, the availability of foreign residents' deposits as source of finance has been decreased and a substantial trend of shifting retail deposits to the capital market has been developed, while there was an increase in financing by corporations, mainly financial. Despite these trends the Group managed to increase the volume of deposits by the public and within them the volume of retail deposits, thereby maintaining a stable liquidity coverage ratio all through 2015. Against the background of these trends the liquidity management constitutes an ongoing management challenge.

The management of exposure to liquidity risks is examined, controlled and discussed regularly and in a dedicated fashion by the forums and committees at Board of Directors, management and intermediate levels, as described in the annual reports in the Board of Directors' report section dealing in market risks and other financial risks policy. Within this framework an ongoing follow up is conducted on cash flow forecasts, trends in various deposit segments, concentration of depositors and raising costs. The exposure to liquidity risk is managed regularly at Group level and a group monitoring process is being established. The subsidiaries determine liquidity risks management policy and manage the liquidity independently in conformity with the Group policy and subject to the local regulatory directives of each company. Also, credit lines to the subsidiaries, approved by the Board of Directors, have been determined, in case of stress scenarios that will require injecting monies to the subsidiaries, subject to regulatory restrictions for transfer of monies.

The signing by the Bank of CSA agreements (settlement agreements in derivatives and transfer of collaterals) with some of the Capital Market segment customers, facilitates more efficient management of liquidity buffers, mainly in foreign currency.

As of 1 April, 2015 the Bank measures and manages the liquidity risk both by means of an internal model, and by means of the liquidity coverage ratio (LCR).

- An internal model for estimating liquidity risk under various scenarios corresponding to different market conditions that relate to the entire banking system and to Leumi specifically. The scenarios check that the liquid sources available to the Bank in all currencies and separately in foreign currency suffice to answer all liquidity needs for stress scenarios lasting up to one month. The model is based on assessment of quality and portfolio dispersal using adequate safety coefficients examined on history basis according to risk levels, to the scenario story and reliance on the opinion of professional entities. In addition the model evaluates the stability of deposits by the public according to the characteristics of the customers. The restrictions for the internal model were determined at several management levels first of which is the Board of Directors. During the reviewed period the Bank's liquidity ratio was higher than 1 as required by Directive 342.
- Measuring minimal coverage ratio (LCR) is performed according to Directive 221 for all currencies and separately for foreign currency. In the fourth quarter of the year the average consolidated liquidity coverage ratio was 105%, compared with an average ratio of 104% and 106% in the second and third quarters respectively. As aforesaid, the high coverage is supported by holding a dispersed and high quality assets portfolio ("liquidity buffer") invested in Shekels primarily in deposits in Bank of Israel and Israel Government bonds, and in foreign currency primarily in government bonds or their guarantees, and in a variety of stable financing sources, for different period ranges. The classification of assets, deposits, the various facilities and collaterals as well as the use of coefficients is conducted as set by Directive 221.

**Table 47 - Composition of high quality liquid assets at 31.12.2015 at Group level in NIS thousands**

	In Israeli currency	In foreign currency	In Israeli and foreign currency
	Total weighted value	Total weighted value	Total weighted value
Total Level 1 assets	71,723	22,792	94,515
Total Level 2a assets	0	3,020	3,020
Total Level 2b assets	3	88	91
Total high-quality liquid assets	71,726	25,900	97,626

**Table 48 - Composition of high quality liquid assets by average balances in the quarter in NIS thousands**

	In Israeli currency	In foreign currency	In Israeli and foreign currency
	Total weighted value	Total weighted value	Total weighted value
Total Level 1 assets	64,953	15,842	80,625
Total Level 2a assets	0	3,363	3,363
Total Level 2b assets	129	162	291
Total high-quality liquid assets	65,082	19,367	84,279

The management of foreign currency liquidity is affected also by the Shekel-foreign currency derivatives activity which may create inter-currency volatility in liquidity indices, and therefore is monitored and managed tightly.

The models are used as a dynamic management tool, enable daily ongoing supervision and control of liquidity status, and their results are reported to all the relevant management and control entities. Also, a report on exposures is made in the President & CEO's report and in the quarterly Risk Report discussed in management, in the Board of Directors' Risk Management Committee and in the Board of Directors in plenary session.

The Bank has prepared a contingency plan for treating liquidity crisis that includes a warning lights system that can indicate a change in the liquidity position of the Bank. On appearance of a warning sign, a dedicated forum is convened for assessing the situation and examining the need to operate the plan according to the level of severity. The plan includes detailed operational steps dealing amongst others in arrangements for realization of assets, policy of treating customers and reporting systems to the business entities, the Board of Directors and Bank of Israel.

## Financing Risk

The Bank manages over the years an extensive and diversified infrastructure of stable financing sources of different period ranges. The primary financing source of the Bank is deposits of retail customers. In addition the Bank finances its activity by deposits of commercial and business customers and by issuing notes. The management of sources is made regularly and separately for Shekels and foreign currency. Some 32.6% of the deposits are raised in foreign currency, of which some 24.8% through the Bank's offices abroad. The overseas sources are invested by the offices in credit and liquid assets, mainly in low risk bonds. The Bank has a broad range of foreign currency sources from foreign resident customers, local retail, business and financial customers, and also reparations deposits. In recent years despite increased exiting of foreign currency deposits due to implementing regulatory changes in Israel and abroad and declared money policy, the stability of deposits volume in this sector of the Bank has been maintained. The surplus of deposits over credit in foreign currency is invested in liquid assets and short time swap transactions.

As mentioned above, there was a substantial increase in Shekel deposits. Due to low interest the growth trend of customers' current accounts balances continued. In order to maintain a stable and diversified financing sources infrastructure, the Bank markets a variety of long range attractive deposits including exit points.

The concentration of financing sources is managed and monitored by risk management indicators and models. The Bank performs a follow-up on the composition and concentration of sources under several categories: customer size and type, single depositor, deposit life span, characteristic behavior over time. The ongoing managing of the composition of sources includes delineating policy for diversification of sources and financing periods. The centralization of the sources is controlled and managed within the framework of the liquidity risks management in the Bank. Ongoing daily measuring of the liquidity indices, minimal coverage ratio, follow-up on warning lights enable dynamic managing and follow-up on stable and diversified sources, control and supervision of the liquidity status and development of trends.

**Table 49 - Pledged assets by balance sheet items (EDTF)**

<b>31 December</b>			
<b>2015</b>			
Pledged assets related to			
Issue of bonds and notes	Clearinghouse activities and the Risk Fund	CSA agreements	Activity in derivative instruments
NIS millions			
Cash and deposits in banks		450	400
Securities	796	1,003	1,333
Credit to ther public	-	97	3

## **Operational risk**

Operational risk is defined as risk of loss resulting from non-propriety or from failure of internal processes, people and systems, or as a result of external events including cyber events. This risk definition does not include strategic risk and good-will risk.

Operational risks include *inter-alia* information security and cyber, information technology risks, embezzlement and fraud risks, legal risks, compliance risks and business continuity.

## **Organizational structure and responsibility for operational risk management**

### **Risk management function**

Management of operational risks in Leumi Group is founded on three lines of defense, like in the other risks.

#### **First line of defense – business lines**

The business units and Leumi Technologies Division are responsible for taking the operational risks and their management while identifying, measuring, monitoring and mitigating them throughout the life span of the products/activities/processes and systems under their responsibility. The operational risk management process is performed according to the Bank's operational risks policy and according to the stipulated controls setup.

The control activities are an integral part of the risk management process. Within the first line controllers or controller teams (depending on the unit size) and an official responsible for the process were appointed, who are an expert function providing a professional answer to the entire aspect of operational risks.

#### **Second line of defense – Risks Management Division and interfacing units**

The Operational Risks Sub-Division in the Risks Management Division is responsible for challenging and analyzing the operational risks at the Bank and Group level.

The areas of responsibility and activity of the sub-division include: Formulating an operational risk management document for approval by the management and Board of Directors, participating in the formulation of risk restrictions at substantial product/services level and periodic follow up on meeting them, presenting overall picture of the main risks, trends and changes, independent examination of the management and control processes in the first line units, developing methodologies and performing stress scenarios, real time participation in development of substantial projects and products.

In addition, the second line of operational risks framework includes the Legal Counsel Division including the Compliance and Money Laundering Prohibition Department with regard to legal risks and regulatory risks, and the Chief Accountant Function which includes the reporting control (SOX) regarding financial statements reporting.

#### **Third line – internal audit**

The internal audit executes retroactively an independent survey and challenging of the controls, processes and the risk management systems in the banking corporation.

Operational risks management is discussed in certain committees:

- The Board of Directors' Risk Management Committee – once every quarter the Board of Directors' Risk Management Committee holds a discussion regarding the Risk Management Division's Risk Report which includes the exposure to operational risks and change in risk focuses, reporting on the status of complying with the restrictions at Group level, and also the loss that may be incurred by the Bank by stress scenarios. Also, any new substantial activity or product is presented for discussion and approval by the Committee as part of "New Product" procedure. Once a year the operational risk management policy is presented for discussion and approval by the Committee.

The recommendations of the Board of Directors' Risk Management Committee are presented to the Board of Directors plenary for approval.

- The Senior Risks Committee headed by the President & CEO - discusses significant topics related to operational risks after they have been debated in the Senior Credit Risks Committee.
- Senior Operational Risks Management Committee – headed by the Chief Risk Officer is responsible for formulating the framework for the operational risk management in Leumi Group, including approval of policy and risks restrictions prior to their submission for the management's and the Board of Director's approval, the substantial exposures in operational risk and interfacing risks at the Bank and Group level, reviewing the way of risk focuses management and arrangements necessary for mitigation of substantial risks. The Committee dedicates an annual discussion to the subject of embezzlements and subject of business continuity.

### **The Bank's policy in the area of operational risk:**

The Group's operational risks management policy is approved annually in the Board of Directors. The Group's policy constitutes a basis and work framework for risk management, and minimizing losses while considering risk tolerance and maintaining operational stability over time.

The policy adjusts to the nature, size and complexity of every organizational unit in the Group and delineates a process of identification, assessment, measuring, monitoring, reporting and control/mitigation of the substantial risks. As part of the policy, new/ substantial products risk management methodology was determined.

In addition, procedures supporting reporting on loss events and events that did not materialize into loss, were written and implemented, checking the effectiveness of controls and substantial risks designed for examining their completeness and suitability for minimizing operational risks and their implementation.

### **Processes to manage and mitigate operational risk:**

Operational risks survey – once every three years or upon the occurrence of an event which justifies its immediate examination, an operational risks survey is conducted in all the Bank's units. In the framework of the survey a charting of the processes is conducted including their inherent risks, and required controls. In addition, the operational risks are assessed qualitatively and quantitatively. In the quantitative aspect each risk is evaluated by characteristic damage, its frequency and exceptional damage. The main risk focuses are identified and risk mitigation plans are set according to the derived assessments.

The survey is a primary tool in forming the operational risks map at the unit level as well as the Bank's level.

Analyzing stress scenarios which are assessed, monitored and assessment and mitigation plans are set in their respect. Bank Leumi continues to strengthen the business continuity capability under occurrence of cross-organization operational scenarios like war and earth quake. The Bank has a missile and earth quake proof computer room and there is an emergency plan for continuation of the Bank's activity upon occurrence of such scenarios.

Accompanying new products from initiation stage until their launch, in order to guarantee their high quality operation while examining the inherent risks and their effect on the risk profile. In addition, substantial projects are accompanied in the Bank, and business, technological and projects risks mapping and assessment are conducted with recommendations for mitigation plans.

Since the operational risks are cross organization and activities, the Bank operates to establish a solid operational risks management culture including reporting on events and performing conclusions drawing, among the Group's employees and managers. As part of this, assimilation and instruction



activities are performed through dedicated training sessions for managers and employees, integrating the subject in a variety of banking courses and building a dedicated portal for managing operational risk.

### **Tools for risk management**

The methods and tools for managing operational risks in Leumi are examined and updated regularly while leveraging professional knowhow from Israel and the world and following regulatory directives of Bank of Israel and additional controlling entities.

For purpose of supporting the risk management process, a dedicated operational risk management system was implemented in the Bank supporting the documentation of the risks, controls and mitigation plans. The system also enables collecting and analyzing loss events and events which did not realize into loss. The collected data supports the decision making process regarding substantial risks management and prioritization of the mitigation actions.

### **Insurances**

For purpose of mitigating possible damages upon realization of the risk, Leumi Group has an insurance setup which covers a variety of operational risks. The insurances are according to the risks management policy with scale and coverage limits which suit the Group's activity.

The insurances setup includes:

1. Banking insurance including coverage against damages emanating from employees embezzlements, negligence which causes a substantial damage, relying on forged documents, fraud, and so forth.
2. Computer crimes insurance by intrusion and/or hacking into the Bank's data systems
3. Professional liability insurance which insures the Bank's liability resulting from acts or omissions of any of the Group's employees within the financial services provided by the Bank or its subsidiaries.
4. Directors and office-holders insurance
5. Cyber insurance

In addition, Leumi Group purchases property insurances, and other liabilities and insurances according to the risk management policy that prevails on date of making the insurance.

### **Major risk areas in operational risks**

#### **Information security and cyber risks**

A cyber risk is defined as damage to a substantial property of the Bank by an attack through the cyber space, including information exposure (leak), information availability (lockout), reliability and completeness of the information (disruption).

Cyber risks are not new and they accompany the Bank's activity in the last years, however we are witnessing a constant increase in the volume and intensity of the threats globally and in Israel especially. These threats are the result of increase of the attack space – many "external links", smart phones, outsourcing, and new technologies – all of which exist in the Bank since it is an innovative and advanced bank.

The main risks of technological innovation refer to increasing the risk level of cyber attacks for exposing information of Bank's customers and impairment of the availability of services.

The protection of the sensitive information is executed in several levels: In information systems and mainly in data banks, in managing the permissions and providing access to systems in conformity to sensitive information definitions and employees in sensitive positions, diligent protection of information by physical security aspects and assimilation of the subject and raising the awareness among all the employees.

Bank Leumi operates regularly to the identification and charting of the sensitive information details in the business processes and their support systems in order to determine and prioritize the Bank's most sensitive information which requires enhanced protection.

### **Technology risk**

In recent years significant changes occurred in the banking and operational environment, emanating *inter alia* from new demands of customers regarding their activity and introducing advanced and innovative technologies. These technological environments relate *inter alia* to providing services in digital channels, the new digital banking, and use of mobile, cloud services, FinTech, and so forth.

In order to provide the aforementioned services, The Bank needs suitable technological infrastructures.

The business activity of Leumi depends to a large extent on information systems. The availability of the systems, reliability of the data and protection of their confidentiality is crucial to proper business conduct and maintaining customers' privacy. The risk level to Leumi increases with the advancement of technology. As part of the striving for advancement and excellence, new technologies are integrated in the core banking conduct, as well as in Leumi's end systems and with our customers.

As mentioned above, technology risks have a business aspect of providing response to the organization needs in order for its adaptation to the business and consumer environment which changes and develops from aspects of maintaining its updating and innovation and also from operational aspects.

In order to manage the aforesaid risks, a policy document is written and assimilated in the Bank defining the principles of technology risks management which includes the organizational form, areas of activity and the responsibility of the different entities in the Bank and work processes required for information technology risk management.

### **Embezzlement and fraud**

Embezzlement and fraud risks are managed in all units of the first line of defense, both in their day-to-day activity and in focused monitoring activities.

As part of the routine operations, controls are applied in these working processes, including, *inter alia*, segregation of duties, management of authorizations, administrative directives, automated blocks in the system, recording of conversations and voice identification system. In addition, designated monitoring centers operate in the first line of defense to prevent and detect fraudulent activity, which monitor and examine irregularities committed by the Bank's employees and outside factors.

Recently, a new concept was formulated to manage the risks of embezzlement and frauds, placing an emphasis *inter alia*, on the human factor. The concept includes structured activity to prevent, detect and deal with attempts to steal, disrupt information and monies, carried out by inside and outside factors.

As part of the concept, areas of responsibility of the three lines of defense were defined:

First line of defense – Exercising control over the day-to-day activity of the units and the operation of the various monitoring centers.

Second line of defense – Responsible for devising methodology and work-processes for the management of these risks, identifying and analyzing trends, detecting and revealing risk focal points, challenging activities of the first line and reporting on the risk profile.

Third line of defense – The Internal Audit Division considers these risks within the routine audit carried out in the units of the Bank.

### **Business continuity risks**

Business continuity risk – A risk of damage to physical infrastructures following a severe event, which may prevent the Bank from fulfilling its business obligations. Business continuity risks are risks that create substantial operational disruption – a disruption of severe effect on the regular business activity, harming a large area and it's combined economically public. Substantial operational disruption includes destroying or severe hit of the physical infrastructure and facilities, loss or inaccessibility of personnel and limited accessibility to the hit area. Such disruption may happen as a result of natural disasters (such as an earth quake), or external factors (war, terror attack, vandalism).

The Bank's business continuity policy defines the procedures and officers who at emergency are responsible for backing up the systems and their rehabilitation in pre-determined rehabilitation time frames. The Bank is also prepared for the continuation of making business decisions in emergencies. The working framework for managing business continuity includes: a business continuity plan, analysis of business consequences, recovery and risk identifying strategies, and practice drill methodology.

Bank of Israel directives require the banks to take actions for guaranteeing business continuity at emergencies. The Bank's computer system is based on two computer centers and an additional backup site.

The Bank prepares itself for recuperating from disaster event and continuity of its business activity. The activity is comprises of three pillars:

- Technological infrastructures
- Business activity plans, policy and procedures, and performing practice drills according to a three-year plan while extending the contents and nature of the exercises performed at the Bank for purpose of improving the Bank's level of readiness and enabling drawing conclusions for identifying and minimizing of gaps.
- Execution of exercises

### **Regulation and compliance risks**

#### **a. Compliance, prohibition of money laundering and terror financing**

For effective management of the subject, a compliance and enforcement department was established at Leumi headed by the Chief Compliance Officer. The Chief Compliance Officer is responsible for complying with the obligations according to the legislative provisions on prohibition of money laundering and terror financing.

The Chief Compliance Officer is also in charge of enforcement in the area of securities law and as Responsible Officer in the FATCA area, as will be described below.

The Compliance Department activity is conducted by a professional team with profound knowledge and understanding in the compliance realm, and based on work processes, control and automated systems.

In 2015, an organizational structural change was made and the compliance function was subordinated to the Chief Legal Counsel.

The complexity and development of the banking activity requires the Bank to strictly comply with all duties applied to the banking corporation, relations with its customers, by virtue of primary legislation, bylaws, orders, permits and Bank of Israel's directives.

The Proper Conduct of Banking Business Directive No. 308 "Compliance and Compliance Function in Banking Corporations" entered into effect on 1 January, 2016. The new regulation extends the compliance responsibility areas formally and at the Group level. The regulation extends the definition of compliance regulations beyond consumer regulations and stipulates that "compliance risk" is derived from laws, by-laws, directives, regulation, internal procedures, behavior rules and authority positions. The regulation stipulates that it is required to assess the effectiveness of the compliance risk management, and find means for its measuring, while, as aforesaid, the compliance risk is derived from the overall legislation relevant to the Bank's activity.

The new directive stipulates that the compliance function will be responsible to at least the compliance risk derived from the core regulations (such as: Bank's fairness towards its customers, money laundering and financing of terror, customer counseling, conflict of interests, privacy protection, taxation aspects relevant to products or to services to customers and so forth). Whereas the risk derived from the rest of the regulations applied to the banking corporation can be managed by other functions from the second defense line.

As part of this framework the Group policy document has been updated and was approved by the Board of Directors on 30 December, 2015. An organizational structure supporting the compliance risk management was formalized as part of the policy document, confirming with the regulation. Also, corporate governance was set out to include the management's and Board of Directors' responsibility from compliance perspectives. A new methodology for risk assessment by regulatory directives was stipulated (compliance directives as defined by the new directive).

As part of adapting the Compliance Department work to the new directive a multi-year risk oriented work plan was set, which includes allocating time for tasks and activities.

The Department is in ongoing contact with the subsidiaries in Israel and abroad for purpose of following up the implementation of the compliance subject including money laundering prohibition, terror financing prohibition, treating US customers and other foreign residents.

Based on trends developing globally, the Bank handles the issue of "declared money" for customers' tax purposes according to risk based policy which was approved by the Board of Directors. In this context policy and work processes were determined, the purpose of which is to avoid as much as possible receiving moneys which are undeclared by customers to the relevant tax authorities in their country of origin.

## **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 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 officers and employees committing violations, and breaches of 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 these areas.

In 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 it had reviewed the main enforcement procedures.

### **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.

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 2015, 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**

The Legal Counsel who is a member of the Bank's management and the Head of the Legal Counsel Division is responsible for leading legal risks management.

#### **Areas of legal risks and their treatment**

Legal risks derive from five main areas:

- Legislation risks – risks derived from Bank's activity if it does not confirm with primary or secondary legislation directives, Bank of Israel directives or directives of other authorities
- Contractual risks – risks derived from activity of the Bank facing customers, vendors and other entities with whom the Bank contracts by various agreements, if not backed by an agreement resolving the full rights of the Bank, or that the agreement is not fully enforceable.
- Ruling risks – risks derived from the Bank's activity if it does not comply with precedent ruling
- Risks derived from legal proceedings conducted against the Bank
- Risks derived from changes in enforcement policy

## **The treatment of legal risks**

The Group implements a legal risks management plan aimed at tracing, preventing, managing and minimizing the legal risks. The plan includes policy documents and interface between the Legal Counsel Division and the Bank's units, and also internal procedures applied in the Legal Counsel Division intended to ensure that the legal counseling provided in the Bank is professional and updated. The policy document has been updated over the years, including in 2015.

Regarding the Bank's subsidiaries in Israel and abroad, a general legal risks management policy was set as part of designated policy documents. Every subsidiary and office prepared a legal risks management internal procedure which suits its activity and the Group's policy in this subject. The said internal procedures prepared by the subsidiaries, were approved by the Legal Counsel Division and by the subsidiaries Board of Directors. According to the policy documents the subsidiaries are required to refer certain subjects for appropriate legal counseling. In addition, the companies send the Chief Legal Counsel semiannual reports by the end of the second and fourth quarter of every year, and also immediate reports, as required by the policy documents.

The reports are sent pursuant to a uniform format prepared in the Legal Counsel Division.

In 2015, the legal risks management policy document in overseas offices was updated and direct communication channels were set with the offices' legal counsels. In 2015 the legal risks management policy document in the subsidiaries in Israel was updated as well.

### **In the framework of the legal risks management plan, emphasis was put on:**

- Preventing and minimizing legal risks.
- Tracing and treatment of substantial legal risks focuses.
- Preparing agreements, directives and appropriate procedures.
- Checking legislation provisions (including ruling) and authorities' directives, and examining their effect on the Bank's work.
- Drawing conclusions in various subjects and implementing the conclusions in legal documents customary in the Bank, and also providing the relevant units in the Bank with an opinion on the subject.

For implementation of the legal risks management plan, there are functions and committees operating in the Legal Counsel Division headed by the Chief Legal Counsel, whose task is to regularly trace legislation and new rulings affecting the Bank's work, examine them and coordinate the treatment of their impact. New regulatory directives (primary legislation, secondary legislation, and authorities' directives) are traced and treated if necessary, already in the relevant law or regulation proposal stage.

Activity of the above mentioned functions and committees is organized by internal work procedures of the Legal Counsel Division. Amongst others, the procedures determine the information flow interface between each of the foregoing functions and the Division's management and the legal risks team operating in the Division.

## **General**

There is a general exposure that cannot be estimated or quantified, which is derived, *inter alia*, from the complexity of the services provided by the Bank and the consolidated companies to their customers. The complexity of these services holds, *inter alia*, a potential for claims, interpretational and others, relating to a long list of commercial and regulatory conditions. It is impossible to predict all sorts of claims that will be raised in this area and the exposure derived from these and other claims with regard to the Bank's and consolidated companies' services, that are raised, *inter alia*, by the discussion mechanism set in the Class Action Law.

Also, exposure exists due to regulatory changes and directives of the Supervisor of Banks. Relations with customers are, partially, relations which last many years, during which changes in policy, regulation, law trends, including court ruling may happen. The Bank and the consolidated companies operate by complex automated systems, which in light of the said changes, must be adjusted regularly. All these create an enhanced operational and legal exposure.

Also there is a general exposure derived from complaints against the Bank and consolidated companies which are submitted from time to time to the Supervisor of Banks, which under certain circumstances may lead to taking of legal proceedings against the Bank. Presently, it is not possible to estimate if exposure regarding those complaints exists and it is not possible to estimate if broad ruling by the Supervisor of Banks will be provided regarding complaints as mentioned above and/or if class or other actions will be filed as a result of such processes, and also it is not possible to estimate the potential exposure to complaints as mentioned above. Therefore provision for said exposure was not made.

### **Evolving risks (EDTF)**

From all the risks described in the Report on Risks, it should be noted that the following are risks that intensified lately with growth in the business complexity, increase in technological capabilities and strengthening of regulation:

#### **Strengthening of regulation requirements, primarily capital requirements**

that affect the business model, profitability and the Group's capital adequacy requirements. The risk is derived from directives of different regulators that can cause a change in the business environment of the Group.

In recent years demands from banks worldwide and in Israel became very strict, under the background of drawing conclusions from the financial crisis. The primary changes as has been expressed in Basel 3 directives, mainly treated a substantial strengthening of capital and liquidity requirements of the banks in Israel and worldwide. The effect of these requirements are substantial – on profitability as well as on the business model. Leumi is preparing to reach the required capital targets as required by the regulator.

In addition, there are additional potential regulations in the background, for example the "Shtrum Committee" interim report, credit data law proposal, international Basel 4 drafts and so forth. The Bank follows closely the drafts, studies them and prepares accordingly.

#### **Macro-economic risk**

the risk of the Group's income and capital deriving from a global low interest environment, low economic growth levels compared with the past, China and the emerging markets, Euro zone's stability, geopolitical instability of countries in the world and in the Middle east particularly. The Bank examines the risk level to the macroeconomic environment under systemic stress scenarios and follows the developments in the market in order to adjust its activity as required.

#### **Information security and cyber risks and technological risks**

See details in Operational Risks.

## **Other risks**

### **Reputational risk**

The risk that publicity or public disclosure of a transaction or customer related practice, as well as business results and events connected to the Group, will negatively affect the public trust in the Group or cause a decrease in customers base or will result in high legal expenses or a decrease in income. The Group's goodwill risk is managed by diligent compliance with directives of the different regulators, maintaining high control levels and organized work procedures of the management and Board of Directors that guarantee their ability to follow-up the ongoing activity. Leumi has a behavioral code of ethics towards employees, vendors and the environment. Leumi Group is diligent in providing high quality products and services. The attitude towards employees and customers is reflected by a minimal number of complaints. In addition, there are detailed contingency plans to cope with goodwill events. Good will risk may influence the Bank whether to assume certain transactions while preferring to protect the Bank's goodwill over short range income. The Bank has functions that deal with spokes persons, investors' relations and government relations which task is to identify and minimize the image risks

### **Models risks**

The risk caused if there is damage to the forecasting capability of models on which the Bank relies for its business activity or if they are not complete and not maintaining updating and flexibility to external events (such as a change in market conditions or new regulatory directives). The Bank has a models and functions validation policy that periodically examines the forecasting capability of the models which support the business activity. The primary models are discussed in the relevant committees.

### **Competition risk**

The Group operates in a very competitive environment from both the banking system in Israel and from various financial entities such as insurance companies, banks abroad and so forth. This competition may hurt market share and Group's income in the various business lines. The Group defines courses of action to cope with this competition.



## Remuneration

Below is the Bank's disclosure pursuant to the disclosure requirements under Basel's Third Pillar regarding remuneration, as stipulated in the Supervisor of Banks' Public Reporting Directives.

For additional details, see also the description of the remuneration policy and bonus program in Note 23 to the Bank's 2015 Financial Statements. For details about remuneration granted to interested parties and senior office holders in the Group, see the chapter on Senior Office Holders Salaries in the Bank's Board of Directors Report for 2015.

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### Qualitative Disclosure

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#### a. Information referring to entities supervising remuneration

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Name, composition and authority of the primary entity which supervises the remuneration subject	<p>The Board of Directors Remuneration Committee is the primary entity which supervises the remuneration subject in the Bank.</p> <p>Main tasks of the Remuneration Committee: The Committee discusses, approves and recommends to the Board of Directors on remuneration policy at the Bank and remuneration procedures; The Committee discusses periodically the updating and implementation of the policy; The Committee discusses and evaluates the effectiveness of the remuneration policy mechanisms, including examining if the remuneration mechanisms meet the supervisory requirements; The Committee discusses, approves and recommends to the Board of Directors on the employment and retirement conditions of office holders in the Bank, as defined in the Companies Law and Directive 301A; of key office holders, as defined in Directive 301A, and principles of employment and retirement conditions of the Bank's employees.</p>
Details of external consultants who received a request for providing consultation, the entity from whom they received the request, and in what areas of remuneration processes.	<p>Cognom Economic Consulting accompanies the professional economic side of the Remuneration Committee, this pursuant to the Remuneration Committee's decision approved by the Bank's Board of Directors, and the Meitar Law Offices gives advice in the legal area. From time to time, the Remuneration Committee requests an opinion from other external experts on specific issues that arise.</p>
Description of the application of the Bank's remuneration policy.	<p>The Bank's Remuneration policy comprises three policy documents: Remuneration policy applied to the Bank's office holders; Remuneration policy applied to the Bank's key employees (who are not office holders) and remuneration policy applied to all the rest of the Bank's employees.</p> <p>The office holders in the Bank are those set out in the list of office holders that are not directors in the Directors' Report.</p> <p>A key employee who is not an office holder (as defined in Directive 301A) is a member of the Bank's "100 Forum". This is approximately 100 of the most senior officers of the Bank, apart from office holders.</p> <p>The remuneration policy is a group policy, whereas the Bank conducts ongoing follow-up and supervision of the means of implementing the said policy by corporations controlled by the Bank in Israel and abroad. The remuneration policy of the Bank constitutes guidelines</p>

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	<p>(but not binding) for the subsidiaries.</p> <p>The Bank's office holders remuneration policy is for the years 2014-2016</p>
Description of types of employees considered as senior office holders and other key employees, including the number of employees in each group.	<p>The group of senior office holders in the Bank comprises the fifteen (15) directors serving in the Bank (including the Chairman of the Board), the President &amp; CEO of the Bank and thirteen (13) members of management (including the Chief Internal Auditor) and three (3) office holders who are not members of the management. As of 31 December 2014, the group of senior office holders included the President &amp; CEO, 12 members of management, and 3 office holders who are not members of management.</p> <p>The group of other key employees in the Bank comprises holders of personal management contracts in the Bank, numbering 102 key employees who are not senior office holders. As of 31 December 2014, the group of key employees numbered 96 employees.</p>
<b>b. Information referring to planning and structure of the remuneration processes</b>	
Review of the main characteristics and the remuneration policy objectives.	<p>The remuneration policy is based on provisions of amendment 20 to the Companies Law regarding service and employment terms of office holders, and as stipulated in regulation A301 of the Proper Conduct of Banking Management Regulations regarding remuneration policy in a banking corporation, and it was determined on the basis of overall organizational considerations including the salaries of employee groups in the bank and the desired salary gaps between them as well as the salary and remuneration levels customary in the Israeli banking system.</p> <p>The remuneration policy applies to the entire Bank's employees and on all types of remuneration and, <i>inter alia</i>, it relates to the salary component, the related terms, the retirement terms and to the annual bonus component.</p> <p>The remuneration policy is designed to reward all the employees in the Bank, including the key employees and office holders according to the Bank's performance and profitability over time, and according to the Bank's objectives and the long term strategy of Leumi Group, and according to the actual contribution of the office holders to achieve these performance and objectives. In addition, the remuneration policy is designed to secure the existence of proper balance between the fixed remuneration component and the variable remuneration component, and structure of incentives promoting sound and effective risk management which does not encourage assuming risks beyond the Bank's risk appetite and enables maintaining a sound capital base, and also add and retain quality key employees in competitive environment in the Bank for long run.</p>
Review of changes made during the reported year in the remuneration policy of the Bank.	<p>The Bank's remuneration policy confirming with Regulation A301 was first approved in 2014, and was not changed after its approval.</p> <p>The Bank intends to submit for approval by the Bank's authorized entities, a remuneration policy for the years 2017 and thereafter, confirming with regulation A301 to the Proper Conduct of Banking Management Regulations, including amendments made to said regulation during the reported year.</p>

<p>Discussion about the way the Bank ensures that employees dealing with risks and compliance are rewarded independent of the business they supervise.</p>	<p>As determined in the remuneration policy, the ratio between fixed remuneration and variable remuneration for key employees in the Bank who belong to risk management, control and audit functions, tend to be in favor of the fixed remuneration, compared with this ratio for key employees in the business functions. In this concern, the variable remuneration in a calendar year for any of the key employees who belong to risk management, control and audit functions in the Bank separately, will not exceed 75% of the fixed remuneration of same employee in same calendar year. The remuneration policy guarantees that office holders and employees who work in risk management, audit and control will not have conflict of interests due to the remuneration policy because of the activities that they monitor.</p> <p>Pursuant to the abovementioned, key employees in the Bank being part of risk management, audit and control functions are entitled to "basic variable bonus" (as defined in the remuneration policy) of lower rate than the basic variable bonus given to other key employees. However, key Bank employees being part of risk management, audit and control functions, as aforesaid, are entitled in addition to a fixed annual bonus not conditional to performance.</p>
<p><b>c. Description of ways in which present and future risks are considered in the remuneration process</b></p>	
<p>Review of primary risks that the Bank considers when applying remuneration indices</p>	<p>The Bank's remuneration policy ensures that the remuneration arrangements of key employees will be consistent with the Bank's risk management framework, while establishing incentive structure which maintains a proper balance between the fixed remuneration component to the variable remuneration component and promotes established and effective risk management that does not encourage assuming risks beyond the Bank's risk appetite and enables maintaining strong capital base. The remuneration policy takes into consideration the Bank's main risks, and includes provisions regarding "claw back" which allows for restitution of bonuses paid in the event that it appears after the fact that risks have been taken in contradiction to the decisions of the bank that caused significant damage to the bank. .</p>
<p>Review of the nature and type of primary indices used for taking these risks into consideration, including hard to measure risks and discussing the ways in which these indices affect the remuneration</p>	<p>The Bank's remuneration policy determines various mechanisms ensuring that the various risks related to the Bank's activity will be considered for purpose of determining the key employees' remuneration. Below are the primary indices and mechanisms:</p> <ul style="list-style-type: none"> <li>• The remuneration policy determines that the maximal ratio between the variable remuneration that can be paid to key employees in the Bank and the fixed remuneration component paid to each of them will not exceed 100% (less exceptions stipulated in regulation A301).</li> <li>• Accumulated preconditions for entitlement of key employees to variable annual bonus are as follows: Bank's compliance with the capital adequacy ratio required by the Supervisor of Banks in the remuneration year; Minimum 7.5% return on equity gain in the bonus year; and entitlement of all Bank's employees to an annual bonus regarding the remuneration year.</li> </ul> <p>Pursuant to the remuneration policy directives, the key Bank</p>

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employees including office holders, were not entitled to variable annual bonus for 2014 since the Bank did not meet the precondition of gaining the minimum return on equity in that year.

In accordance with the remuneration policy, in respect of 2015 office holders and key office holders are entitled to a variable bonus, provided the Bank has achieved a return on equity exceeding the minimum required and met regulatory capital adequacy targets.

However, in light of the signing of the special collective agreement on 17 February 2016, its provisions were also applied to holders of personal contracts (office holders and key office holders) and, therefore, the annual bonus in respect of 2015 will be paid through shares blocked for two years that the Bank will issue, whose value, at market price, is based on the amount of the grant that will be approved for each employee. Accordingly, part of the annual bonus in respect of 2015, which was to be paid in cash (except for the half that is deferred and paid through the PSU mechanism, as described in paragraph e. below), will be paid through shares blocked for two years to be issued by the Bank, and whose value, at market price, is based on the amount equal to the amount that was to be paid as a cash bonus.

- The amount of variable base annual bonus (as defined in the remuneration policy) for each of the key employees was determined based on return on equity rate, whereas an 11% return may entitle to maximal annual bonus. The mechanism of determining the base annual bonus reflects the risk management.
- The annual bonus amount is determined, *inter alia*, by adjusting the base variable annual bonus of each key employee to a measurable score of same key employee, determined, *inter alia*, by the relevant performance measuring sheet for each of the key employees (with excluding the Bank's overall return on equity in the bonus year, as far as this data is included in the relevant employee's performance measuring sheet). It should be noted that the performance measuring sheet is used for evaluating the performance of the Bank and its different units, and it combines quantitative measuring of several subjects, as applicable, including: capital adequacy, efficiency ratio, credit portfolio quality, improvement of the Bank's risk management, and compliance with laws.
- The annual bonus amount is determined also by personal assessment score (some of which does not exceed 20% of the total variable annual bonus of each key employee) which considers, *inter alia*, compliance with law and regulation, compliance with Bank's procedures and no substantial deviation from policy set by the Board of Directors and the President & CEO including meeting the Bank's risk appetite, as well as audit reports issued regarding areas under the key employee's responsibility.
- The remuneration policy includes mechanisms that enable considering all the risks existing in the Bank, including: (1) The authority of the Board of Directors and/or an authorized function

	<p>in the Bank (according to the key employee's rank) to revoke the bonuses regarding a certain year and/or lower the bonuses for any reason; (2) The Bank's authority to dismiss a key employee in certain relevant cases without severance pay and without entitlement for bonuses.</p> <ul style="list-style-type: none"> <li>• According to regulation A301, variable bonus exceeding 1/6 of the fixed bonus is deferred and spread over 3 years (and granted to office holders as performance dependent restricted share units (PSU)), whereas the entitlement to receive the deferred portion of the bonus is subject to conditions for achieving minimum return on equity and Bank's compliance with all the capital adequacy ratios required by the Supervisor of Banks. The mechanism of three years deferral of bonus and paying the deferred parts subject to fulfillment of the aforesaid conditions, enable adjusting the variable remuneration to realization of risks related to the Bank's activity in the years consequent to the variable bonus year. So does the aforesaid deferred variable bonus to office holders by capital instrument, creating a link between the remuneration and the Bank's share value over years.</li> <li>• As stipulated in regulation A301 which was amended during the reporting year, a key employee may be requested, in the relevant cases, to refund variable remuneration paid to him. Pursuant to this new regulation, variable remunerations will be refundable for period of five (5) to seven (7) years from date of grant, considering the seniority of the key employee. This regulation applies to variable remuneration to key Bank employees, and implemented as aforesaid, subject to the interim regulations set with its regard.</li> <li>• According to the remuneration policy and as stipulated in regulation A301, remuneration to key Bank employees regarding employment termination beyond what is stipulated in the employment terms of all the Bank's employees ("variable retirement terms"), consider the actual performance over time and employment termination reason, and classified accordingly as variable remuneration. As aforesaid, payment of variable retirement terms is subject to arrangements of payments deferral for period after the employee has left, and also to using mechanisms adjusting to retroactive performance, in order to ensure that they don't encourage assuming extra risks, as specified in the remuneration policy.</li> </ul>
<p>Discussion about change in nature and type of these indices during the past year and the reasons for change, as well as the effect of the changes on remuneration.</p>	<p>The indices and mechanisms described hereinabove have not been changed in the report year.</p> <p>It should be noted that according to the remuneration policy, at the beginning of every year the Board of Directors approves the performance measuring sheet. Performance measuring sheet is a sheet of marks used to assess the performance of the Bank and its different units, including performance indices as detailed below. At the beginning of every year the Board of Directors discusses and approves, after receiving the Remuneration Committee's approval and recommendations, the parameters and weights of that year's performance measuring sheet based on the Bank's work plan.</p> <p>As stipulated in regulation A301 which was amended during the</p>

reporting year, a key employee may be requested, in the relevant cases, to return variable remuneration paid to him. Pursuant to this new regulation, variable remunerations will be returnable for period of five (5) to seven (7) years from date of grant, considering the seniority of the key employee. This regulation applies to variable remuneration to key Bank employees, and implemented as aforesaid, subject to the interim regulations set with its regard.

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**D. Description of ways in which the Bank links performance during a performance measurement period to remuneration levels**

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Review of primary performance indices for the Bank, for the upper level of the business lines and personal performance indices.

The primary performance indices of the Bank considered and affecting the annual variable remuneration of key Bank employees include, *inter alia*, the Bank's return on investment (the return on investment concerning net income to Bank's shareholders according to the annual financial statements for the relevant year); Capital adequacy ratios as required from the Bank by the Supervisor of Banks; The relevant performance measuring sheet for each of the key Bank employees combining, as aforesaid, quantitative measuring of various subjects including financial indices as well as non quantitative indices (such as return on equity, capital adequacy, efficiency ratio, credit portfolio quality, credit concentration, compliance with the Bank's risk appetite, improvement in the Bank's risks management and compliance with laws, regulatory directives and Bank's procedures).

It should be noted that the measurable score of the Chairman of the Board of Directors and the President & CEO is determined by measuring the overall various Bank's performances (excluding the overall Bank's return on equity in the reporting year).

The key employees are also measured by indices of contribution to the strategic planning of the Bank; Implementation, execution and promotion of strategic objectives and plans predefined for each the key employee; Initiation, leading and promotion of special Bank's projects and processes predefined for each the key employee, in the business, structural or ethical area; Compliance with law and regulation, compliance with Bank's procedures, and no significant deviation from the policy set by the Board of Directors and the President & CEO including compliance with the Bank's risk appetite; Audit reports issued regarding the key employee's area of responsibility.

Discussion about the way personal remuneration amounts relate to the Bank's performance as a whole and to personal performance.

- The scale of the annual bonus to key employees is determined on the basis of weighting the following parameters, all or part of them, according to the key employee's position and according to meeting predetermined conditions for entitlement to annual bonus.
  - The Bank's return on equity in the relevant year;
  - Comparing the actual Bank's return on equity in the bonus year, to weighted return on equity (by shareholder's equity) in the four major banks in Israel in the same year.
  - Bank's performance measuring sheet in case of determining the measurable score of the chairman of the Board of Directors and the President & CEO, and in case of the other key employees -
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	<p>performance measuring sheet of the division which the key employee is in charge of or the division/unit to which he belongs, as applicable.</p> <p>As aforesaid, the performance measuring sheet is used for assessing the Bank's and its units' performance, combining quantitative measuring of various subjects including financial and other indices. At the beginning of every year, the Board of Directors discusses and approves, after receiving in advance the approval and recommendations of the remuneration committee, the parameters and weights of the performance measuring sheet for same year, based on the Bank's work plan.</p> <ul style="list-style-type: none"> <li>• Quality personal assessment score, based on quality criteria regarding the key employees bonus year, used for quality assessment of the key employees contribution to the Bank in the measured year, as specified hereinabove.</li> <li>• Additionally, the Board of Directors discusses and approves, every year in advance, criteria and special events according and subject to as stipulated in clause 13 (a)(2) to regulation A301, that upon their fulfillment, the total maximum remuneration for a certain key employee may exceed 100% of the fixed remuneration of same year.</li> </ul>
<p>Discussion about means usually used by the Bank to adjust the remuneration in case the performance indices will be weak (including criteria for determining weak performance indices).</p>	<ul style="list-style-type: none"> <li>• The key employees' entitlement to annual bonus are conditional to meeting three cumulative prerequisites: (a) Entitlement of all the Bank's employees to an annual bonus regarding the bonus year; (b) Reaching a minimum of 7.5% return on equity in the bonus year; and (c) Compliance of the Bank with the capital adequacy ratio required by the Supervisor of Banks directives in the bonus year.</li> <li>• The influence of weak performance indices on the result of the Bank and its various units will be reflected in the amount of the annual bonus, as far as the key employees are entitled to annual bonus. This way, weak performance indices may affect the amount of base variable bonus (derived from the return on equity of the Bank in the bonus year), and the amount of final variable bonus (after adjustments), effected by score measurement sheet (at Bank's level, Division's level or level of unit at the Bank, as relevant and according to the position and level of the relevant key employee in the Bank) and from determining the personal quality score.</li> <li>• The Board of Directors was authorized to lower the amount of annual variable bonus to seniors in the Bank considering, <i>inter alia</i>, the Bank's data in the bonus year and/or years previous to the bonus year, relating to the Bank's significant profits which the Board of Directors regarded as not derived from regular activity same as substantial losses in those years.</li> <li>• Part of the annual bonus is spread over three years, and the key employees will be entitled to receive part of this annual bonus subject to the Bank meeting the following conditions: (a) The return on equity rate in the calendar year preceding the deferred part payment date, was not less than 5%; (b) In the previous year the Bank complied with all the capital adequacy ratios required</li> </ul>

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by the Supervisor of Banks.

Regarding the part of the deferred annual variable bonus to the Bank's office holders – this part will be granted (provided it will be granted) to office holders by performance dependent restricted share units (PSU). Granting part of the annual deferred variable bonus by capital remuneration (PSU units) reflects the high importance as seen by the Bank, to motivating the office holders while bringing their interests closer to the Bank shareholders' interests.

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**E. Description of ways by which the Bank adjusts the remuneration in order to consider performance for a longer range**

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Discussion about the Bank's policy regarding postponement and maturing of variable remuneration, and if the deferred variable remuneration is different for different employees or for different employee groups, description of factors determining said part and their relative importance.

- Payment of annual bonus regarding a certain year is postponed and spread over three years when the annual bonus regarding the measured year has exceeded 1/6 of the fixed remuneration of the key employee for that year. Payment and spreading the annual variable bonus is made as follows: (a) 50% of the annual payment is paid in cash close to reporting of the Bank's monetary results in the bonus year; (b) The remaining 50% of the annual variable bonus ("remaining annual bonus") are granted to office holders by performance dependent restricted share units (PSU) allocated close to reporting the banking system' monetary results for the bonus year for each of the office holders entitled to said bonus. The PSU units mature into Bank's common share of NIS 1 par value in three equal portions (conditional to the Bank complying with the conditions set in the remuneration policy for receipt of the remaining annual bonus – complying with the minimum return on equity rate and complying with capital adequacy ratio required by the Supervisor of Banks – regarding each of the spread years) close to reporting the banking system' monetary results for each of the three years pursuant to the bonus year, whereas the share derived from maturity of the first portion out of the three will be restricted for a period of one additional year.
- The remaining annual bonus to key employees who are not office holders in the Bank, is spread linearly over three years and paid in each of the spread years in cash, conditional to the Bank complying with the conditions set in the remuneration policy for receiving the rest of the annual bonus in each of the spread years as mentioned above.
- According to the remuneration policy and according to what is stipulated in regulation A301, remuneration to key Bank employees with regard to termination of employment beyond what is stipulated in the employment terms for all the Bank's employees ("variable retirement terms"), the actual performance over time and the reason for the termination of the employment are considered, and classified accordingly as variable remuneration. As aforesaid, payment of variable retirement terms is conditional to deferral arrangements for after the key employee has left, and also to using adjustment mechanisms for retroactive performance, in order to ensure that they do not encourage assuming over risks, as specified in the remuneration policy.

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Discussion about the Bank's

Besides the aforementioned with regard to postponing and spreading

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policy and criteria for adjusting deferred remuneration before maturity and also after maturity by remuneration refund arrangement (clawback)	<p>the annual variable bonus over years, the remuneration policy determines, that the key employee will refund to the Bank amounts paid to him according to the remuneration policy if paid to him based on data which appeared to be erroneous, and restated in the financial statements of the Bank, this by manner and way determined by the Board of Directors' Remuneration Committee.</p> <p>Also, as stipulated in Directive A301 which was amended during the reporting year, a key employee may be requested, in the relevant cases, to refund variable remuneration paid to him. Pursuant to this new regulation, variable remunerations will be refundable for a period of five (5) to seven (7) years from the date of grant, considering the seniority of the key employee. This regulation applies to variable remuneration to key Bank employees, and implemented as aforesaid, subject to the interim regulations set with its regard.</p>
<b>F. Description of different variable form of remuneration used by the Bank and the considerations of using different forms, as aforesaid</b>	
Discussion about relation considered appropriate between maximum variable remuneration and the fixed remuneration, determined by the Bank pursuant to Section 13 of Directive 301A	<p>As stipulated in the remuneration policy, the variable remuneration in a calendar year for each of the Bank's key employees who are not part of the risk management, control and audit function, separately, will not exceed 100% of the fixed remuneration of same key employee in same calendar year, and the variable remuneration in a calendar year for each of the key employees who are part of the risk management, control and audit function, separately, will not exceed 75% of the fixed remuneration of same key employee in same calendar year.</p> <p>The remuneration policy also determines that the fixed monthly salary and/or other fixed remuneration components, given to key employees who are part of the risk management, control and audit function, will be determined by standards which consider the importance and sensitivity of the tasks assigned to these key employees. These key employees will be rewarded appropriately, in order that the Bank will be able to employ trained and appropriately experienced key employees that will reflect their position and task. In this regard, the remuneration policy adds and stresses, that the variable remuneration to fixed remuneration ratio for key employees will incline more to the favor of fixed remuneration, compared with this ratio for key employees who are not part of the risk management, control and audit functions.</p>
In exceptional situations in which the Bank determined that the maximum variable remuneration may reach more than 100% of the fixed remuneration – specifying the determined ratios, the reasons for determining said ratios, the affected employees, their position and effect on the Bank.	<p>Pursuant to the remuneration policy and according to what is stipulated in Section 13 (a) (2) of Proper Conduct of Banking Business Directive No. 301A, in exceptional and unusual situations the Remuneration Committee and after it the Board of Directors (and when required by the Companies Law, the General Meetings approval will be received also, as applicable), is authorized to approve an additional amount of variable bonus regarding a certain year to any of the Bank's office holders, all subject to the following conditions: (a) The additional variable bonus will be granted for an exceptional event that does not repeat every year, such as a onetime project, significant structural change and/or an extraordinary transaction by scope and by nature, provided that the extraordinary transaction event was pre-defined by the Board of Directors at the beginning of the relevant year, for a certain office holder; (b) The total maximum variable</p>

	<p>remuneration for office holder in same year will not exceed 200% of the fixed remuneration; and (c) Detailed reasons for the decision will be provided.</p> <p>In the reporting year, the Bank's authorized organizations discussed and approved criteria and special events pursuant to as stipulated in Section 13 (a) (2) of Directive 301A that upon their fulfillment, certain office holders in the Bank may be entitled to the aforesaid special bonus regarding the year 2015. <b>It should be noted that any of the criteria and events as aforesaid, are extraordinary</b> in all the three following aspects: (1) They are not repeated every year; (2) They do not apply to a broad group of office holders; and (3) They relate to exceptional events in the Bank's life, for example onetime projects or significant structural changes.</p>
Review of the different various forms of the variable remuneration (for example cash, share, share based instruments and other forms).	<p>As mentioned above, in case the annual variable bonus regarding the measured year exceeds 1/6 of the fixed office holder's remuneration in the Bank for that year, fifty (50%) of the annual variable bonus is deferred and granted to him as performance dependent restricted share units (PSU) allocated close to the reporting on the banking system's financial results for the bonus year.</p> <p>The PSU units will mature into Bank's common share each of NIS 1 par value in three equal portions (subject to the following conditions), close to the reporting on the banking system's financial results for each of the three years pursuant to the bonus year, whereas the share derived from the maturing of the first portion out of the three will be restricted for a period of another year.</p> <p>The quantity of the PSU units allotted to each office holder as mentioned above is determined by dividing the balance amount of same office holder's annual bonus, by the average price (per daily closing rates) of one Bank's share in the period beginning on 1 January of the following year and ending on the date of publication of the Bank's annual financial statements regarding the bonus year, provided that the average price will not be lower than NIS 10.</p> <p>The maturity of PSU units into shares is conditional to the fulfillment of the following two cumulative conditions: (a) The return on equity rate for the calendar year preceding the maturity date of the relevant PSU portion ("the previous calendar year") will be no less than 5%; and (b) The Bank will comply in the previous year with all the capital adequacy ratios required by the Supervisor of Banks according to the financial statements.</p> <p>The allotment of PSU units and their conversion into shares of the Bank is made in capital gain track according to cause 102 of Income Tax Ordinance.</p>
Discussion about the use of various forms of variable remuneration, and also if the mix of the various forms of variable remuneration is different between different employees or between different employee groups, describing	<p>As aforesaid, the granting of the remaining annual bonus to key employees who are not office holders in the Bank, is spread linearly over three years and paid in cash (and not by PSU units or another form of capital remuneration) in each of the spread years, conditional to the Bank's complying with the conditions for receiving the remaining annual bonus in each of the spread years.</p>

the factors that determine the mix and their relative importance.

### Quantitative disclosure

Number of meetings held during the reporting year by the primary entity supervising the remuneration subject and the remuneration paid to its members regarding the reporting year.	<p>The Board of Directors Remuneration Committee held 15 meetings during 2015.</p> <p>The total remuneration paid to the Remuneration Committee members for Remuneration Committee meetings during 2015 was NIS 438,661.</p>
Number of employees that received variable remuneration during the reporting year	<p>Office Holders:</p> <p>During the reporting year no variable annual bonus was paid to any of the Bank's office holders (in respect of 2014)</p> <p>Key employees who are not Office Holders:</p> <p>During the reporting year no variable annual bonus was paid to any of the Bank's key employees (in respect of 2014)</p>
Number and total secured bonuses granted during the reporting year.	<p>Office Holders:</p> <p>During the reporting year, variable remuneration in form of a secured bonus to the Bank's office holders was not granted to any of the Bank's office holders, except for payment regarding a signing-on bonus, as described below.</p> <p>6 office holders were granted a fixed annual bonus totaling about NIS 0.78 million, constituting part of the fixed remuneration of the above mentioned office holders.</p> <p>Key employees who are not office holders:</p> <p>During the reporting year, a variable remuneration in form of a secured bonus to key employees (who are not office holders) was not granted.</p> <p>29 key employees (who are not office holders) were granted a fixed annual bonus totaling about NIS 11 million, constituting part of the fixed remuneration of the above mentioned key employees.</p>
Number and total of signing-on bonuses granted during the reporting year	<p>Office holders:</p> <p>During the reporting year, one office holder in the Bank was granted a payment of a signing-on bonus totaling some NIS 0.76 million. This signing-on bonus was given with regard to the first employment year of the above mentioned office holder.</p> <p>Key employees who are not office holders:</p> <p>During the reporting year signing-on bonuses were not granted to key employees who are not office holders.</p>
Number and total severance pay paid during the reporting year.	<p>Office holders:</p> <p>During the reporting year severance pay was paid to one office holder totaling some NIS 0.6 million.</p> <p>The aforesaid does not include other office holders who chose to</p>

	<p>receive a non-contributory pension and/or interim pension from the Bank pursuant to that stipulated in the personal employment contract between them and the Bank.</p> <p>Key employees who are not office holders:</p> <p>During the reporting year severance pays were paid to 2 key employees (who are not office holders) totaling some NIS 4.6 million.</p> <p>The aforesaid does not include other key employees who chose to receive a non-contributory pension and/or interim pension from the Bank pursuant to that stipulated in the personal employment contract between them and the Bank.</p>
Total (outstanding) balance of deferred remuneration with separate disclosure as to cash, shares, share-based instruments and other forms.	<p>Office holders:</p> <p>The deferred annual remuneration outstanding to office holders during 2015 is 420,760 Performance Share Units constituting a deferred and conditional right to receive ordinary shares of the Bank of NIS 1 par value each, and 54,276 Restricted Share Units constituting a deferred and conditional right to receive ordinary shares of the Bank of NIS 1 par value each.</p> <p>Key employees who are not office holders:</p> <p>During 2015 there was no outstanding deferred remuneration.</p>
Total deferred remuneration paid during the reporting year.	<p>The annual deferred remuneration granted to office holders during 2015 is 219,290 Performance Share Units constituting a deferred and conditional right to receive ordinary shares of the Bank of NIS 1 par value each, and 27,138 Restricted Share Units constituting a deferred and conditional right to receive ordinary shares of the Bank of NIS 1 par value each.</p> <p>Also paid during the reporting year, a onetime amount of NIS 347 thousand to an office holder in the Bank instead of her entitlement to a portion of the annual deferred variable bonus in respect of 2013 which was not yet paid yet as of that date. For further details see the Immediate Report of the Bank dated 7 July 2015 (Reference: 2015-01-067953).</p> <p>Key employees who are not office holders:</p> <p>During the reporting year no deferred remuneration was paid to key employees who are not office holders.</p> <p>Regarding former office holders in Arab Israel Bank that were absorbed by the Bank on 1.1.16, there is outstanding deferred remuneration in 2015 to be paid in the years 2016-2018 in a total amount of NIS 405 thousand.</p>
Further details of the remuneration amount regarding the reporting year, with distinction between fixed and variable, deferred and not deferred, various forms that were been used (cash, shares, share-based instruments and other forms).	See table

Total unpaid remaining deferred remuneration and retained remuneration, exposed to retroactive adjustments, explicit and/or implicit.	<p>Office holders:</p> <p>420,760 Performance Share Units constituting a deferred and conditional right to receive ordinary shares of the Bank of NIS 1 par value each, and 54,276 Restricted Share Units constituting a deferred and conditional right to receive ordinary shares of the Bank of NIS 1 par value each, and 237,969 blocked shares of the Bank.</p> <p>Key employees who are not office holders:</p> <p>Not relevant</p>
Total deductions during the reporting year due to explicit adjustments only	Not relevant
Total deductions during the reporting year due to implicit adjustments only	Not relevant

**Table 50 - Remuneration of Senior Office Holders<sup>(1)(2)(3)</sup>**

Total value of remuneration for the reporting year in respect of 2015	Not deferred	Deferred
NIS million		
Fixed remuneration		
• Cash-based	26.0 (26.1 in 2014)	-
• Shares and share-based instruments	-	-
• Others	-	-
Variable remuneration		
• Cash-based	-	-
• Shares and share-based instruments		24.9 (0 in 2014)
• Others	-	-

<sup>1</sup> Not including directors, except for the Chairman of the Board of Directors.

<sup>2</sup> Regarding the signing-on bonus granted during the reporting year, see as detailed in the above quantitative section.

<sup>3</sup> In April 2015, the payment arrangement was cancelled for long-service bonuses and vacations for office holders, against payment of about half of the provision recorded in respect of this liability in the books of the bank. The total payment amounted to about NIS 2 million and is not included in the above quantitative section.

**Table 51 - Remuneration of other key employees (\*)**

Total value of remuneration for the reporting year in respect of 2015	Not deferred	Deferred
NIS million		
Fixed remuneration		
• Cash-based	87.7 (89.0 in 2014)	-
• Shares and share-based instruments	-	-
• Others	-	-
Variable remuneration		
• Cash-based	-	-
• Shares and share-based instruments		46.6 (0 in 2014)
• Others	-	-

(\*) In May 2015, the payment arrangement was cancelled for long-service bonuses and vacations for key employees, against payment of about half of the provision recorded in respect of this liability in the books of the bank. The total payment amounted to about NIS 18.0 million and is not included in the above quantitative section.