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Midroog

Bank Leumi le-Israel B.M.

Follow-up | October 2022

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Bank Leumi le-Israel B.M.

Baseline Credit Assessment (BCA) of the	**aa1.il**	
Long-term deposits and bonds	**Aaa.il**	**Outlook: Stable**
Subordinated contingent convertible bonds with contractual loss absorption (CoCos)	**Aa2.il(hyb)**	**Outlook: Stable**
Short-term deposits	**P-1.il**	

Midroog leaves its assessment of the Baseline Credit Assessment (BCA) of Bank Leumi le-Israel B.M. (hereinafter - the "Bank") unchanged - aa1.il.

The rating of the Bank's long-term deposits and senior debt remains unchanged Aaa.il with a stable outlook, and they continue to reflect an assumption of high external support from the state, which is equivalent to one rating level[1] (notch) of the BCA.

The rating of the subordinated bonds with loss absorption mechanism (CoCo) by way of write-down or partial write-down (classified as Tier 2 capital) remained at Aa2.il (hyb), with a stable outlook. This rating is one notch lower relative to the BCA and two notches lower relative to the senior debt, reflecting the terms of the instrument, including its contractual subordination and loss absorption mechanisms, and without an external support assumption.

In addition, Midroog sets a P-1.il rating to short-term deposits.

Key considerations for assessing the baseline credit assessment (BCA) and the Bank's ratings

The assessment of the Bank's baseline credit assessment (BCA) is supported by its good positioning in the local banking system, which is based on a strong brand and significant market share, alongside a wide and diversified customer base, that supports the Bank's good income-generation capabilities. The Bank is a universal bank[2] that provides its customers a range of banking and financial services. The Bank has a conservative risk management policy, that supports its risk profile, which is also reflected in positive credit quality metrics relative to the BCA. We believe that the troubled debt rate out of the portfolio is expected to increase but will still be favorable relative to the BCA. In our opinion, during the forecast years, the troubled debt rate will be 2.0%-2.5% of the portfolio. The Bank is characterized with a high sectoral credit concentration in relation to a capital absorption buffer considering the BCA (high compared to other banks), which weighs on the Bank's risk profile. In recent years, the Bank's profitability rates have improved, in view of high asset quality and good operational efficiency over time as a result of the Bank's implementation of its strategic plan. This improvement was also reflected during the first half of 2022; it stemmed, among other things, from the increase in interest income due to the increase in the balance of loans to the public compared with the corresponding period last year, and due to a supporting macro-economic environment in the form of an increase in inflation rates and consequently the frequency of recent interest rate hikes by the Bank of Israel. Thus, in the first half of 2022, the core yield on risk-weighted assets[3], and the return on assets amounted to approx. 2.6% and 1.1%, respectively. In the baseline scenario for 2022-2023, Midroog predicts that the Bank's profitability metrics - the core yield on risk-weighted assets, and the return on assets shall

[1] We assess the probability of support as high on par with other banks in the system; however, due to the high BCA, this support cannot be equivalent to more than one notch.
[2] A Bank, which is engaged in a range of activities, including: retail credit, business credit, raising of deposits, activity in the capital market, consulting, operating and more.
[3] Profit before tax and loan loss expenses to average risk-weighted assets.

range between 2.2%-3.2% and 0.8%-1.2%, respectively. The Bank is characterized with a relatively wide range of common equity Tier 1 capital and overall capital above the regulatory capital requirements (approx. 1.8% and 1.9% on average between 2018 to 2021, respectively), which in our opinion supports the Bank's business flexibility and its growth potential. In the baseline scenario Midroog expects that the capital buffer will remain adequate relative to the BCA, and that the Tier 1 capital adequacy ratio will be 11.3%. It should be noted that in relation to Midroog's stress scenarios, the Bank's capital buffer absorbs unexpected losses in an adequate manner, and supports the Bank's stability along the economic cycle. The Bank's liquidity profile is favorable relative to the BCA; it is supported by a good, wide and diversified sources structure, which is based on a significant rate of stable (retail) deposits, and inventory of liquid assets. At the same time, the liquidity profile may be affected by a relatively high deposits from institutional entities component, which in our opinion is less stable throughout the cycle. The liquidity coverage ratio is significantly higher than the regulatory threshold (100%), which supports the business flexibility.

The rating of the Bank's long-term deposits and senior debt were assigned at one notch above the BCA, which reflects our assessment that it is highly probable that the state will provide support when required. The rating of the subordinated bonds with loss absorption mechanism (CoCo) by way of write-down or partial write-down is one notch lower relative to the BCA and two notches lower relative to the senior debt, reflecting the terms of the instrument, including its contractual subordination and loss absorption mechanisms, and without an external support assumption.

Rating outlook

The stable outlook of the Bank's ratings reflects Midroog's assessment that the Bank will maintain an adequate financial profile in the forecast years, while maintaining the risk metrics in the credit portfolio as well as loss absorption buffers within a range that is adequate for the rating.

Factors that may lead to downgrading the Bank's BCA and ratings:

- Significant damage to the Bank's business positioning
- Significant deterioration in the quality of the credit portfolio
- Erosion of the capital and profitability buffers and their stability over time

Bank Leumi of Israel B.M., key financial data and ratios, in NIS million and percentages:

NIS million	2019	2020	2021	June 30, 2021	June 30, 2022	2018
Loans to the public, gross	285,806	300,631	347,391	320,300	369,811	275,954
Deposits by the public	373,644	447,031	537,269	487,082	532,737	364,714
Total equity capital attributable to the Bank's shareholders	35,406	37,664	41,610	40,848	47,060	35,305
Total assets	468,781	556,035	656,454	597,422	667,680	460,560
Profit before taxes and loan loss expenses	6,014	6,043	8,429	4,331	5,096	5,424
Net income attributable to the Bank's shareholders	3,522	2,102	6,028	3,007	3,601	3,257
(%)						
Exposure to the largest sector relative to common equity Tier 1 [4]	167%	180%	210%	188%	209%	169%
Troubled debts out of loans to the public, gross	2.0%	2.9%	1.9%	2.4%	1.6%	2.4%
Troubled debts to equity and loan loss provision	14.3%	19.9%	13.8%	16.5%	11.7%	17.5%
Loan loss expense (income) to average loans to the public, gross [1]	0.2%	0.9%	(-0.3%)	(-0.2%)	0.05%	0.2%
Net income attributable to the Bank's shareholders to average assets [1]	0.8%	0.4%	1.0%	1.1%	1.1%	0.7%
Profit before tax and loan loss expenses to average risk-weighted assets [1]	1.9%	1.9%	2.4%	2.5%	2.6%	1.7%
Efficiency ratio	56.8%	53.8%	46.8%	46.1%	40.3%	60.6%
Common equity Tier 1 capital adequacy	11.9%	11.9%	11.5%	12.0%	11.3%	11.1%
Total equity to total assets	7.6%	6.8%	6.3%	6.8%	7.0%	7.7%
Less stable financing sources [2] to total assets	15.9%	17.2%	23.3%	19.5%	22.4%	15.2%
Liquid balances [3] to deposits by the public	37%	45%	44%	48%	43%	37%

[1] Calculated on an annual basis (average of the ratio as of beginning of period and the ratio as of the end of the period); [2] deposits from institutional entities (wholesale), bonds and subordinated bonds repayable within one year and bank deposits; [3] cash and bank deposits, Israeli and US government bonds and assets backed by the US government; [4] distribution before loan loss provisions.

Description of the key considerations for assigning the baseline credit assessment (BCA)

A high business profile and diversification of income sources support the Bank's very good income recovery capabilities

The Bank has long been one of the two largest banking groups in the local banking system, with a market share of approx. 26% of total loans to the public, and approx. 29% of the system's total assets as of June 30, 2022. The Bank's business profile is supported by its being a universal bank, that offers a range of banking and financial services, a wide and diversified customer base, alongside an overall value proposition that addresses a wide range of the public's needs. The Bank has a strong brand, an extensive system of branches, and a value proposition that includes a traditional banking model alongside digital banking, as well as other digital financial services. Furthermore, we believe that in view of the changes in the operating environment of the banking sector in recent years, which were accelerated due to the movement restrictions imposed during the Covid-19 pandemic, customers increasingly demand quick, flexible and digital response. We believe that the trend of expansion in digital services in the banking sector in general and in Bank Leumi in particular is set to continue. In addition, in our opinion banks that will not adopt technological innovation and adapt their business model over time might be exposed to a significant exposure in their business positioning in the mid-long term.

The stability of the Bank's revenues, as estimated by Midroog, is reasonable relative to the BCA. On the one hand, this stability is affected from the weight of retail revenues[4] (approx. 59% on average in 2019-2021), which contributes to the Bank's ability to generate the revenues, and on the other hand from the considerable weight of revenues from the corporate-commercial segment (approx. 30% for the said years), which we believe to be less stable. The Bank has a relatively low rate of revenues from fees and commissions, which stood at approx. 24% on average in the past couple of years; this obscures the visibility of operating income, which we believe to be stable throughout the cycle.

The diversification of the Bank's sources of income is based on 3 key pillars[5], compared with 4 pillars in recent years; it stems from a decrease in the rate of total net income from the households and private banking segment, which stands at 14% as of June 30, 2022, considering that in 2021[6] the net revenues mix included approx. 29% of the medium and large businesses segment, approx. 21% of the small and micro businesses segment, approx. 25% of the housing loans segment, and approx. 16% of the households and private banking segment.

The Bank's risk management policy supports its risk profile; however, the sectoral concentration relative to the capital loss-absorption buffer remains relatively high

The Bank's risk management function is comprehensive, and based on a number of underlying risk mitigation principles and controls, that support the outlining of a risk management policy, determining the Bank's risk appetite (in line with its strategy), and monitoring the risks and implementing controls in respect thereof. Credit risks are managed through statistical rating models (consumer credit) and expert assessments (business credit). The Bank is characterized with a high sectoral credit concentration in

[4] Gross income from interest and non-interest finance income from external parties by supervisory operating segments, and including the households and private banking segments (including housing) and small and micro businesses, net of income from financial management.

[5] Operating segment that constitutes more than 15% of total net revenues (interest income and non-interest finance income from external parties), net of revenues from financial management.

[6] By supervisory segments.

relation to a capital loss-absorption buffer considering the BCA, which weighs on the Bank's risk profile. Thus, the Bank's exposure to the largest sector relative to common equity Tier 1 capital is in respect of the construction and real estate sector (as is the case in all other banks), which constitutes approx. 209% of the common equity Tier 1 capital as of June 30, 2022; this rate is relatively high compared to the peer group (approx. 169%), and is rising (approx. 186% on average in 2019-2021). Total exposure to the large borrowers, which constitute more than 5% of the Bank's common equity Tier 1 capital (approx. NIS 2,156 million) increased compared with previous years, and is estimated by Midroog at approx. 21% of the Bank's common equity Tier 1 capital as of December 31, 2021 (approx. 14% on average in 2018-2020)[7].

The Bank assesses the market risks by applying the VaR model, using conservative assumptions and in line with all other banks in the system; in order to complement the risk assessment, the Bank applies a number of stress scenarios (including holistic scenarios) of varying degrees of severity. Midroog is of the opinion that the Bank's market risk appetite is relatively low and is in line with the BCA, as reflected in the VaR exposure limit of 2.8% of the Tier 1 capital with regard of the entire Bank's activity in a one-month investment horizon, in accordance with the data as of December 31, 2021.

The quality of the credit portfolio is favorable relative to the BCA

The Bank is characterized by high quality credit portfolio, which supports its future income recovery capabilities, as reflected in good risk indicators relative to the BCA. Thus, as of June 30, 2022, the troubled debts to credit to the public ratio stood at approx. 1.6% (approx. 2.2% on average in 2019-2021, and 2.4% on average compared to the peer group as of that date). During the first half of 2022, the balance of the provision out of total loans to the public, gross, as of June 30, 2022 stood at approx. 1.3% compared with 1.4% on average in 2019-2021. Thus, as of June 30, 2022, the coverage ratio improved and stood at 170% (compared with 111% on average in 2019-2021). This ratio is high relative to the peer group average as of that date (approx. 147%).

The Bank has high exposure to the real estate and mortgages sectors, which, on aggregate, accounted for approx. 56% of the Bank's total debts[8] as of June 30, 2022 (approx. 54.9% in the peer group as of that date). In our opinion, the Bank's exposure to the local real estate market (excluding mortgages) is characterized by relatively high risk, in view of homogeneous characteristics, and due to high exposure relative to the capital loss-absorption buffer, which constitutes approx. 25.4% of the Bank's total debts (including credit for activity abroad), and is significantly high relative to the peer group (approx. 16.6%). However, we believe that the Bank is characterized with conservative underwriting processes relative to this sector, and these processes were further tightened in view of the increase in risk levels throughout the crisis; this constitutes a moderating factor in term of the Bank's sectoral concentration risk. The exposure to housing loans constitutes approx. 30.6% of total debts as of that date, and is characterized with conservative underwriting processes in the Bank, as reflected in its ability to maintain a high repayment capacity. Accordingly, the average loan to value rate (LTV) in the Bank's housing loans portfolio[9], stood at approx. 48% as of June 30, 2022 (a rate that reflects the value of the pledged asset when the credit facility was extended), and the share of the loans with relatively high leveraging rate (LTV higher than 75%) was low - approx. 0.2% of the portfolio as of that date. These data support low probability of default.

Midroog's baseline scenario regarding the quality of the Bank's credit portfolio is based on several macroeconomic[10] exogenous effects, including: (1) GDP growth of approx. 6.0% and 3.0% in 2022 and 2023, respectively; (2) a stable unemployment rate of 3.1%-3.5%; (3) interest rate hikes leading to interest of around 2.75%-3.5%; (4) a relatively high inflation environment in 2022 (around 4.6%) which will moderate in 2023 around the mid-range of the Bank of Israel's target of approx. 2.5%; (5) continued

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[7] The ratio was calculated as follows: In accordance with Note 30 to the annual financial statements, Midroog aggregated the balance sheet liability at the highest tier of the credit liability. For the purpose of calculating the ratio, the above liability amount was divided by the Common Equity Tier 1 capital as of December 31, 2021. It should be noted that the liability ranges in the said note also refer to off-balance sheet credit liability, which was not included in the calculation. Therefore, the ratio calculated in accordance with Midroog's estimate is biased upwards.
[8] Loans to the public, loans to governments, deposits with banks and other debts, excluding bonds and securities borrowed
[9] Out of the total new housing loans portfolio extended by the Bank.
[10] The Bank of Israel, Macroeconomic Forecast of the Research Department, October 2022

competition by the non-bank debt market with regard to the business and consumer portfolio. Under this scenario, Midroog expects that in2022-2023, the Bank's credit portfolio will grow at a rate of 7%-10%. Furthermore, we assume that the Bank will continue focusing on commercial-business credit (medium and large businesses) and housing loans, in accordance with its strategy in recent years. Midroog examines the development of the Bank's credit portfolio quality in the short and medium term also on the basis of a number of key macroeconomic indicators. The troubled debt rate out of the portfolio is expected to increase but will still be favorable relative to the BCA, reaching, in our opinion, 2.0%-2.5% in the forecast years (approx. 2.2% on average in 2019-2021), with the rate of problem debts out of the absorption buffers (equity and loan loss provision) expected to be around 15% in the forecast years (approx. 16% on average in 2019-2021). Furthermore, we assume that the loan loss expenses shall account for 0.3%-0.4% of the credit portfolio in the forecast years. This scenario takes into account a moderation in recovery rates, and an increase in write-offs compared with previous years.

The BCA is supported by continued improvement in the Bank's profitability; expected improvement in profitability during the forecast years, supported by interest rate hikes by the Bank of Israel and relatively high inflation environment

The Bank's profitability indicators have improved during the past few years, due to, among others things, an increase in the Bank's revenues as a result of a growing credit portfolio, certain stability in the financial margin, and the implementation of streamlining steps that supported a decrease in the Bank's operating expenses. The profitability was also supported by the implementation of a number of streamlining plans, and by the transition to digital and direct service channels. Among other things, in 2017-2021, the number of the Bank's branches was reduced by approx. 10%, the occupancy of real estate properties was reduced, and the number of positions[11] was cut by approx. 25%. Furthermore, in 2019, the Bank signed a new collective agreement, that also includes the relocation of HQ units to a single main site. These steps are expected to support further potential efficiencies and the Bank's managerial flexibility in the mid-long term. Thus, the Bank's operating efficiency ratio improved from approx. 63% in 2017 to approx. 47% in 2021, and even reached 40% in the first half of 2022. The improvement in the Bank's profitability indicators was also reflected in the first half of 2022, when net income amounted to approx. NIS 3,601 million, compared with a median income of approx. NIS 3,007 million in the corresponding period last year - a 20% increase. and an annual profit of approx. NIS 6,028 million last year. These stemmed, among other things, from the increase in interest income due to the increase in the balance of loans to the public compared with the corresponding period last year, and due to a supporting macro-economic environment in the form of an increase in inflation rates and consequently the frequency of recent interest rate hikes by the Bank of Israel. The core yield on risk-weighted assets and the return on assets stood at approx. 2.4% and approx.1.0%, respectively, in 2021, and approx. 2.6% and approx. 1.1%, respectively, in the second quarter of 2022.

The key underlying assumptions regarding the Bank's profitability, on which Midroog's baseline scenario for 2022-2023 was based, are as follows: (1) annual credit portfolio growth of approx. 7%-10%, mainly in the housing loans segment alongside intensive competition in the corporate segment; (2) interest rate hikes leading to interest of around 2.75%-3.5%, which will support the financial margin; (3) a relatively high inflation environment in 2022 (around 4.6%), which will moderate in 2023 around the mid-range of the Bank of Israel's target of approx. 2.5%; (4) loan loss expenses rate of 0.3%-0.4%; and (5) continued slow growth in payroll expenses in accordance with the Bank's wage agreements. In this baseline scenario, Midroog predicts that in the forecast years the Bank's profitability metrics shall continue to support further increase in equity and improvement of the financial profile, and the core yield on risk-weighted assets, and the return on assets shall range between 2.2%-3.2% and 0.8%-1.2%, respectively.

[11] Number of positions based on a monthly average in Israel and abroad

The capital loss buffer is adequate relative to the BCA and characterized with a good loss absorption capacity; it is expected that the capital loss buffer will continue to increase during the forecast years

The Bank is characterized with a capital loss buffer that matches the BCA, and which was created over the years by accumulating profits, net of dividend distribution (a policy of up to 50% of net income and share buyback plan), optimization and management of risk-weighted assets and asset mix. The Bank's common equity Tier 1 capital adequacy ratio, which is the primary unexpected loss absorption buffer, is favorable relative to the banking system and stood at 11.25% as of June 30, 2022 (compared with 10.4% on average in the peer group), with the Bank maintaining a relatively wide margin of 105 basis points above the regulatory barrier (common equity Tier 1 capital ratio), and is high relative to the peer group (approx. 80 basis points on average). This margin supports the risk profile and has a positive effect on the Bank's business flexibility and growth potential. As of the end of the second quarter of 2022, the Bank's total capital ratio stood at 14% (approx. 50 basis points above the regulatory requirement). As of June 30, 2022, the Bank's equity to asset ratio stood at approx. 7.0%. We believe that in view of the volatility in the capital market, the comprehensive income of the Bank in particular and of the banking system in general might be affected from the adjustment of available-for-sale securities in accordance with their fair value, and from a change in the actuarial liability in respect of employee benefits.

Midroog assessed a holistic stress scenario with a one-year horizon with respect to the Bank's loss-absorption buffers relative to its risk profile, assuming different PD and LGD rates for key operating segments, losses from the securities portfolio, erosion of the financial margin, and loss of income from fees and commissions alongside increasing the equity through current profits and non-distribution of dividends. At the end of the scenario, the Bank's common equity Tier 1 capital adequacy ratio will be 10.3% - a level that reflects the Bank's ability to absorb unexpected losses well and supports its stability throughout the economic cycle.

In the baseline scenario, Midroog expects that the capital buffer will continue to increase, and that the capital adequacy ratio will be around 11.3%. This ratio will be affected by the following factors: (1)accumulated profits and one-off pre-tax earning of NIS 524 million in respect of the sale of "Beit Mani", which is expected to be recorded in the second half of 2023; (2) distribution of a dividend at the rate of up to 50% of the net income in the forecast period; and (3) increase in risk-weighted assets at a rate similar to the rate of increase in the credit portfolio.

The liquidity profile is favorable relative to the BCA; it is supported by a good sources structure and a significant inventory of liquid assets

The Bank's source structure, like other local banks, mainly relies on a wide deposit base, which remained stable throughout the economic cycle. A substantial component of the Bank's sources structure is a highly diversified and stable (retail) deposits (approx. 28.7% of households and private banking, and 18.1% of small and micro businesses, as of June 30, 2022) which, in Midroog's opinion, correspond to Midroog's assessment of the Bank's risk profile. The Bank has a relatively moderate rate of less stable financing sources[12] out of total assets, as defined by Midroog, which stood at approx. 22.4% (an average of approx. 17.1% in the peer group) as of that date. Furthermore, the Bank is characterized with a favorable loan to the public (gross) to deposits by the public ratio of approx. 69%, compared with an average of approx. 79% in the peer group as of June 30, 2022. The Bank's NSFR ratio, as calculated by Midroog[13], is adequate and sufficiently higher than 100%, which also reflects the Bank's favorable sources structure.

[12] Bank deposits, deposits from institutional entities and bonds and subordinated bonds payable within the 12 next months
[13] Calculated by us based on the definition of the Basel Committee

The Bank's liquidity buffer comprises high inventory of liquid assets[14] to total deposits in relation to the BCA, which stood at approx. 43% as of June 30, 2022, and supports the Bank's good liquidity. This inventory, which includes mainly cash and bank deposits and a securities portfolio, which, constitutes approx. 13% of total assets as of that date, and is characterized by a reasonable (credit) risk level, given a relatively high component of Israeli government bonds (approx. 45%) and US government bonds (approx. 19%). The portfolio constitutes a tool for absorbing excess sources and for the management of the Bank's various market exposures; however, it exposes the Bank to interest risk. The Bank's liquidity management is also supported by a relatively high liquidity coverage ratio (LCR) of approx. 122% as of June 30, 2022, significantly higher than the regulatory threshold (100%) and similar to the peer group (approx. 124% on average as of that date). This ratio also supports the Bank's liquidity ratio and its business flexibility.
Midroog expects that the Bank's sources structure and good liquidity will be maintained over the forecast period, in view of, among other things, its assessment that the local savings culture is not expected to change, and in view of the growth potential of the credit portfolio.

ESG considerations

Environmental considerations - we believe that at this stage the Banking system's exposure to environmental risks is relatively moderate.

Social considerations - in our opinion, the Banking system's is exposed to moderate social risks. However, we see a development in information security, customer privacy and cyber risks; but those risks are partially mitigated by significant investment in technology and by the banking system's extensive experience in handling sensitive customer data. Penalties and reputational damage constitute another social risk. Furthermore, strict labor laws and strong trade unions in the banking system limit the workforce flexibility and increase payroll costs. However, the banks did cut jobs and integrated a cost control that allowed them to mitigate those challenges.

Corporate governance considerations - in our opinion, corporate governance considerations have a material effect on the banking system. These risks constitute a key credit consideration, since corporate governance weaknesses might lead to a deterioration in the Bank's credit repayment capacity, whereas strong corporate governance may have a positive impact on the Bank's credit repayment capacity. The regulatory framework in which the banks operate mitigates the corporate governance risks; this framework outlines internal control functions and tight controls on behalf of the regulator.

[14] Cash and bank deposits. Israeli government and US government bonds, and assets backed by the US government

Structural considerations and external support

Assessing the relative expected loss hierarchy

According to Midroog's methodology, the rating of the Bank's subordinated debt (subordinated bonds) is based on the Bank's BCA, which serves as the underlying factor in rating the Bank's liabilities, and reflects the risk of default and the Bank's ability to service its obligations independently, without assuming external support. Midroog adjusts the rating relative to the BCA to the credit risk of the subordinated debt instrument, according to its specific characteristics – taking into account the extent of the instrument's structural subordination, the loss absorption mechanisms set out in the instrument's terms, and the uncertainty regarding their point of activation (based on the contractual trigger or at the discretion of the Banking Supervision Department). Midroog downgrades the Bank’s BCA by one notch for the rating of the subordinated bonds with loss absorption mechanism (CoCo). The downward notching reflects the legal-contractual subordination of these subordinated bonds relative to the Bank's other liabilities (other than Tier 1 instruments and equity), and the contractual loss absorption mechanism. Given the Bank's BCA (aa1.il), the current capital adequacy level - common equity Tier 1 capital (of approx. 11.3% as of June 30, 2022), the anticipated capital adequacy level (~11.3%), and the favorable liquidity profile relative to the BCA, the uncertainty regarding the probability of reaching the “point of non-viability[15]” is low, and therefore it was not reflected in a further notch downgrade.

External support

The rating of the deposits and senior debt was assigned a one-notch upgrade, due to the high probability of external support from the government, in accordance with Midroog's JDA model. The assumption of the probability of external support is based on the following considerations: The banking system’s high level of importance for the local economy and the payment system, and the need to maintain its stability; the high concentration of the banking and financial system; the relatively high connectivity between the banking system and institutional entities; the local financial system being a key credit provider to the government; some degree of uncertainty regarding the behavior and confidence of the different debtors in relation to bail-ins close to the point of non-viability, in the absence of past experience. Furthermore, the State of Israel has previously proven its willingness to support failing banks, and we do not assume any change in this policy.

About the Bank

Bank Leumi le-Israel B.M. and its subsidiaries constitute one of Israel’s two largest banking groups. The Bank is organized into three main business lines, focused on different market segments, with each business line specializing in the provision of banking and financial services to a specific customer segment: retail banking, corporate and commercial banking, capital markets and financial management.
In addition to the Bank’s business lines, Leumi operates through subsidiaries in Israel and abroad: Activity of Israeli subsidiaries – mainly includes non-financial investment, underwriting and investment banking activities carried out by Leumi Partners Ltd. Activity of the subsidiary abroad - Leumi UK (hereinafter - ”BLUK”), which mainly engages in extending loans to corporate and commercial customers, and small businesses. On September 23, 2021, Bank Leumi Corporation (hereinafter - “BLC”), a US-based corporation (85 percent of which is held by the Bank), which wholly owns BLUSA, entered into a merger agreement with Valley National Bancorp (hereinafter - “Valley Bank”). Upon the completion of the transaction and the execution of the merger procedures, BLC will be merged into Valley and BLUSA will be merged into Valley Bank. The merger transaction was completed

[15] Trigger event for non-viability: 1. Notice of the Banking Supervision Department to the effect that the conversion/write-down of the security is necessary in order to avoid the point of non-viability. 2. Providing external support, without which the Bank will reach the point of non-viability. It should be noted that the Banking Supervision Department has not yet defined the “point of non-viability”

on April 1. The consideration of the transaction was paid to the Bank in Valley shares (90% of the consideration) and the rest - in cash. Upon completion of the transaction, the Bank holds approx. 14.2% of Valley's share capital, and it is not a controlling shareholder; however, as of this report's publication date, it is the largest shareholder in Valley. As a result of the merger, a post-tax profit of approx. NIS 645 million was recorded. NIS 194 million out of the said amount were recorded in the first quarter of 2022, and NIS 451 million were recorded in the second quarter.

The bank is a bank without a control core. The Company's CEO and President is Hanan Friedman, Adv., and the Chairman of the Board of Directors is Dr. Samer Haj Yehia.

The subordinated bonds and bonds rated by Midroog*:

Series	Security No.	Rating	Rating outlook	Final repayment date
Series 1	6040612	P-1.il	-	March 23, 2023
Series 2	6040661	P-1.il	-	May 28, 2023
181	6040505	Aaa.il	Stable	September 5, 2023
Series 3	1189364	P-1.il	-	September 10, 2023
178	6040323	Aaa.il	Stable	March 31, 2024
179	6040372	Aaa.il	Stable	June 30, 2026
184	6040604	Aaa.il	Stable	May 5, 2030
405	6040620	Aa2.il(hyb)	Stable	March 27, 2033

Issued by Bank Leumi le-Israel B.M.

The BCA Matrix

			As of June 30, 2022		Midroog's forecast [1]		
Category	**Parameter**	**Sub-parameter**	**Measurement [1]**	**Score**	**Measurement**	**Score**	**Other considerations**
profile Business	**Business positioning**		-	aaa.il	-	aaa.il	
	Revenue stability	Retail revenues %	67%	aa.il	65%-70%	aa.il	*Rate of income from fees and commissions*
	Revenue diversification	Number of business lines with over 15% of total revenues	3	a.il	3	a.il	
profile - Risk	**Corporate Governance**		-	aa.il	-	aa.il	
	Risk management policy		-	aa.il	-	aa.il	
	Concentration of the credit portfolio	The largest segment to common equity Tier 1 capital	209%	a.il	~209%	a.il	*Real estate sector*
	Concentration of the credit portfolio	Large borrowers to common equity Tier 1 capital	approx. 21%*	a.il	~21%	a.il	
	Market risk appetite	VAR limit to common equity Tier 1 capital	*2.8%	aaa.il	~2.8%	aaa.il	
Financial profile	**Quality of assets**	Troubled debts to loans to the public, gross	1.6%	aaa.il	2.5%-2.0%	aaa.il	
		Troubled debts to equity and loan loss provision	11.7%	aaa.il	~15%	aaa.il	Coverage ratio
	Profitability	Net income to average assets	1.1%	aaa.il	1.2%-0.8%	aaa.il	
		Profit before tax and loan loss expenses to average risk-weighted assets.	2.6%	aaa.il	3.2%-2.2%	aaa.il	
		Efficiency ratio	40.3%	aaa.il	~40%	aaa.il	
	Capital adequacy	Common equity Tier 1 capital to risk-weighted assets	11.3%	aa.il	~11.3%	aa.il	
		Equity to total assets	7.0%	a.il	6.8%-6.7%	a.il	
	Financing and liquidity	Less stable financing to total assets	22.4%	aa.il	~22.4%	aa.il	
		Liquid assets to deposits The public	43%	aaa.il	~43%	aaa.il	
Derivative baseline credit assessment						**aa1.il**	
Actual baseline credit assessment						**aa1.il**	

[1] The metrics presented in the table are after Midroog's adjustments and are not necessarily identical to those presented by the Company. Midroog's forecast includes Midroog's assessments with regard to the issuer in accordance with Midroog's baseline scenario, rather than the issuer's assessments.

* In accordance with December 31, 2021, data

Rating of the Bank's debts

	Baseline credit assessment (BCA)	**Support from owners and/or related parties**	**Adjusted BCA**	**Subordination and loss absorption mechanism**	**State support**	**Final rating**
Deposits and bonds	aa1.il	0	aa1.il	0	+1	Aaa.il
Subordinated bonds with contractual loss absorption mechanism (Tier 2 capital)	aa1.il	0	aa1.il	-1	0	Aa2.il(hyb)

Related reports

Bank Leumi le-Israel B.M. - related reports

Banks' Rating - Methodology Report, September 2019

Guidelines for assessing environmental, social and corporate governance risks as part of credit ratings - methodology report, February 2022

Affiliations and holdings table

Midroog's rating scales and definitions

The reports are published on Midroog's website www.midroog.co.il

General information

Date of the rating report:	October 20, 2022
Date of previous rating update:	September 8, 2022
Publication date of initial rating:	February 18, 2007
Rating initiated by:	Bank Leumi le-Israel Ltd.
Rating paid for by:	Bank Leumi le-Israel Ltd.

Information from the issuer

Midroog's rating is based, among other things, on information received from authorized parties at the Issuer.

Baseline Credit Assessment (BCA)

aaa.il	**Issuers or issues rated aaa.il have, in Midroog's judgment, the highest internal or stand-alone (independent) financial strength relative to other local issuers, absent of any possible external support from an affiliate company or the state.**
aa.il	**Issuers or issues rated aa.il have, in Midroog's judgment, very high internal or stand-alone (independent) financial strength relative to other local issuers, absent of any possible external support from an affiliate company or the state.**
a.il	**Issuers or issues rated a.il have, in Midroog's judgment, high internal or stand-alone (independent) financial strength relative to other local issuers, absent of any possible external support from an affiliate company or the state.**
baa.il	**Issuers or issues rated baa.il have, in Midroog's judgment, moderate internal or stand-alone (independent) financial strength relative to other local issuers, absent of any possible external support from an affiliate company or the state, and could involve certain speculative characteristics.**
ba.il	**Issuers or issues rated ba.il have, in Midroog's judgment, weak internal or stand-alone (independent) financial strength relative to other local issuers, absent of any possible external support from an affiliate company or the state, and involve certain speculative characteristics.**
b.il	**Issuers or issues rated b.il have, in Midroog's judgment, very weak internal or stand-alone (independent) financial strength relative to other local issuers, absent of any possible external support from an affiliate company or the state, and involve certain speculative characteristics.**
caa.il	**Issuers or issues rated caa.il have, in Midroog's judgment, excessively weak internal or stand-alone (independent) financial strength relative to other local issuers, absent of any possible external support from an affiliate company or the state, and involve very significant speculative characteristics.**
ca.il	**Issuers or issues rated ca.il have, in Midroog's judgment, extremely weak internal or stand-alone (independent) financial strength, absent of any possible external support from an affiliate or the state, and are very near insolvency, with some prospect of recovery of principal and interest.**
c.il	**Issuer or issues rated c.il have, in Midroog's judgment, the weakest internal or stand-alone (independent) financial strength, absent of any possible external support from an affiliate company or the state, and are usually insolvent with little prospect of recovery of principal and interest.**

Note: Midroog uses numeric modifiers 1, 2 and 3 in each rating category from aa.il to caa.il. The modifier '1' indicates that the obligation ranks in the higher end of its rating category, which is denoted by letters. The modifier '2' indicates that it ranks in the middle of its rating category and the modifier '3' indicates that the obligation ranks in the lower end of that category, denoted by letters.

Unlike previous publications until now, Midroog does not publish a rating outlook for Baseline Credit Assessment (BSA) in order to differentiate the BCA from the credit rating.

Local Long-Term Rating Scale

Aaa.il	**Issuers or issues rated Aaa.il have, in Midroog's judgment, the highest creditworthiness relative to other local issuers.**
Aa.il	**Issuers or issues rated Aa.il have, in Midroog's judgment, very high creditworthiness relative to other local issuers.**
A.il	**Issuers or issues rated A.il have, in Midroog's judgment, high creditworthiness relative to other local issuers.**
Baa.il	**Issuers or issues rated Baa.il have, in Midroog's judgment, moderate creditworthiness relative to other local issuers, and could involve certain speculative characteristics.**
Ba.il	**Issuers or issues rated Ba.il have, in Midroog's judgment, weak creditworthiness relative to other local issuers, and they involve certain speculative characteristics.**
B.il	**Issuers or issues rated B.il have, in Midroog's judgment, very weak creditworthiness relative to other local issuers, and they involve certain speculative characteristics.**
Caa.il	**Issuers or issues rated Ba.il have, in Midroog's judgment, excessively weak creditworthiness relative to other local issuers, and they involve certain speculative characteristics.**
Ca.il	**Issuers or issues rated Ca.il have, in Midroog's judgment, extremely weak creditworthiness compared to other local issuers, and are very near insolvency, with some prospect of recovery of principal and interest.**
C.il	**Issuers or issues rated C.il have, in Midroog's judgment, the weakest creditworthiness, and are usually insolvent with little prospect of recovery of principal and interest.**

Note: Midroog uses numeric modifiers 1, 2, and 3 for each rating category from Aa.il to Caa.il. The modifier '1' indicates that the obligation ranks in the higher end of its rating category, which is denoted by letters. The modifier '2' indicates that it ranks in the middle of its rating category and the modifier '3' indicates that the obligation ranks in the lower end of that category, denoted by letters.

Local Short-Term Rating Scale

P-1.il	**Issuers rated Prime-1.il, in Midroog’s judgment, have very good ability to repay short-term obligations relative to other local issuers.**
P-2.il	**Issuers rated Prime-2.il, in Midroog’s judgment, have good ability to repay short-term obligations relative to other local issuers.**
P-3.il	**Issuers rated Prime-3.il, in Midroog’s judgment, have moderate ability to repay short-term obligations relative to other local issuers.**
NP.il	**Issuers rated Not Prime.il do not belong to any of the Prime categories.**

Link between the Long-Term and Short-Term Rating Scales

The following table presents the long-term ratings consistent with short-term ratings, when such long-term ratings exist[16]

Short-term rating_____Long-term rating_____

Aaa.il	
Aa1.il	
Aa2.il	
Aa3.il	**Prime-1.il**
A1.il	
A2.il	
A3.il	
Baa1.il	**Prime-2.il**
Baa2.il	
Baa3.il	**Prime-3.il**
Ba1.il, Ba2.il, Ba3.il	
B1.il, B2.il, B3.il	
Caa1.il, Caa2.il, Caa3.il	**NotPrime**
Ca.il C.il	

[16] Short-term structured financing ratings are normally based on the short-term rating of the entity providing liquidity to the transaction or on the estimated cash flow to repay the rated liability.

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