BANK LEUMI LE-ISRAEL B.M

Follow-Up |November 2024

Contact persons:

Michal Badinter
Senior Analyst, Primary Rating Assessor
michal.b@midroog.co.il

Amit Federman, CPA
Senior Team Leader, Secondary Rating Assessor
amit.federman@midroog.co.il

Moty Citrin, VP
Head of Financial Institutions, Structured Finance and Additional Services
moty.c@midroog.co.il

BANK LEUMI LE-ISRAEL B.M

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

Midroog reiterates its rating 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 very 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) was reiterated at Aa2.il (hyb), with a stable outlook. This rating is one notch lower compared to the BCA and two notches lower compared to the Bank's 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 reiterates the P-1.il rating for 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 (hereinafter - the "**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 that provides its customers with a range of banking and financial services, alongside a comprehensive value proposition that addresses the broad range of the public's preferences. 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. As in the case of its peer group,[2] the Bank is characterized with a high sectoral credit concentration in relation to the capital absorption buffer and in relation to the BCA, weighing on the Bank's risk profile. In recent years, the Bank's profitability rates are on the rise, in view of exogenous changes such as relatively high base interest rate and inflation environment, on the one hand, and endogenous factors, such as high asset quality and good operational efficiency over time on the other hand. It is noted that as of the first half of 2024, the Bank's profitability was affected - on the one hand - from post-tax capital gains due to the sale of the headquarter buildings in Tel Aviv[3] at the total amount of approx. NIS 0.6 billion, and from an approx. NIS 0.6 billion post-tax loss in respect of impairment in the value of the investment in Valley Bank[4] on the other hand. Accordingly, in 2023 the core return on risk-weighted assets and the return on assets amounted to approx. 3.2% and 1.0%, respectively, and in the first half of 2024 - 3.6% an 1.4%, respectively, and annualized, and they are good in relation to the BCA. The Bank's leveraging level is adequate in relation to the BCA and favorable in relation to the peer group average, as reflected in an equity to asset ratio of approx. 8.0% as of June 30, 2024 (compared to approx. 6.9% on average in the peer group as of that date); it reflects an improvement in the past year (approx. 7.5% as of June 30, 2023). 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. In addition, the liquidity coverage ratio (LCR) is significantly higher than the regulatory threshold (100%), which supports the Bank's business flexibility.

In Midroog's baseline scenario for 2024-2025, we believe that in the short to medium term, in view of the consequences of the "Iron Swords War" (hereinafter - the "**War**") the quality of the banking system's assets might be adversely affected due to the increase in borrowers' risk. Accordingly, the proportion of troubled debts out of the credit portfolio is expected to increase and in our opinion range between 1.8%-2.2% in the forecast years. Furthermore, the Bank's profitability indicators will moderate, to a certain extent, compared to the first half of 2024; however, those profitability indicators shall continue to support further increase in equity and improvement of the financial profile, and the core return on risk-weighted assets and the return on assets are expected to range between 2.6%-3.2%, and 0.9%-1.1%, respectively. In addition, Midroog expects that the capital buffer will continue to increase alongside an increase in the credit portfolio, such that the Tier 1 capital adequacy ratio will be in the range of approx. 11.4%-11.8%. 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 at this stage is expected to support the Bank's stability along the short to medium term. In our opinion, liquidity management will continue to be challenging for both the Bank and the System, due to a high interest

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[1] We assess the probability of support as very high; however, due to the high BCA, this support cannot be equivalent to more than one notch.

[2] Bank HaPoalim Ltd., Bank Mizrahi Tefahot Ltd., Israel Discount Bank Ltd. and First International Bank of Israel Ltd.

[3] For further details, see the Bank's reports posted on the MAYA website in connection with the completion of the transaction for the sale of "Beit Mani" and "Beit Lin".

[4] Bank Leumi holds approx. 14.2% of the share capital of Valley, which is a holding company, that holds Valley National Bank. In view of a decline in the price of Valley's share since the beginning of 2024, the Bank assessed the need to record impairment with respect of the value of the Valley shares recorded in its books of accounts. Accordingly, in the second quarter of 2024 the Bank recorded approx. NIS 0.6 billion in post-tax impairment in respect of the value of the investment in Valley.

rate environment, which may lead to a change in consumer preferences following investment tracks that serve as an alternative for deposits, which generate an excess return on deposits and have a similar liquidity level. However, Midroog anticipates that the Bank's resource structure and good liquidity will remain so within the forecast range.

The ratings of the Bank's long-term deposits and senior debt were set at one rating level (notch) above the BCA, reflecting our assumption of a very high probability of external support from the state, if necessary. The rating of the Bank's subordinated bonds with contractual loss absorption mechanism (CoCo) through a write-off or partial write-off is one notch lower than the BCA and two notches below the Bank's senior debt, reflecting the instrument's conditions, including the legal contractual subordination and loss-absorption mechanisms and without an assumption of external support.

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.

At the same time, the war that broke out in Israel on October 7, 2023 led to a number of consequences and restrictions, as well as uncertainty as to the expected scope and duration of the War and its effects on the Israeli economy. For more information on this issue, please read the special report on the "Impact of the War on the Credit Repayment Capacity of Issuers Rated by Midroog" (October 2024).[5]

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

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

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

NIS million	30.06.2024	30.06.2023	2023	2022	2021	2020	2019
Loans to the public, gross	440,480	415,047	426,203	389,768	347,391	300,631	285,806
Deposits by the public	581,187	533,977	567,824	557,084	537,269	447,031	373,644
Total equity capital attributable to the Bank's shareholders	58,435	51,771	54,497	49,438	41,610	37,664	35,406
Total assets	734,039	686,857	731,497	699,166	656,454	556,035	468,781
Profit before taxes and loan loss expenses	8,562	7,383	14,284	11,394	8,429	6,043	6,014
Net income attributable to Bank's shareholders	5,054	3,434	7,027	7,709	6,028	2,102	3,522
(%)							
Exposure to the largest sector relative to Common Equity Tier 1 capital [1]	215%	221%	221%	205%	210%	180%	167%
Troubled debts out of loans to the public, gross	1.5%	1.7%	1.8%	1.5%	1.9%	2.9%	2.0%
Troubled debts to equity and loan loss provision	10.0%	12.4%	12.4%	11.0%	13.8%	19.9%	14.3%
Loan loss expense (income) to average loans to the public, gross [2]	0.1%	0.4%	0.6%	0.1%	)-0.3%(	0.9%	0.2%
Profit for average assets [2]	1.4%	1.0%	1.0%	1.1%	1.0%	0.4%	0.8%
Profit before tax and loan loss expenses to average risk-weighted assets [2]	3.6%	3.3%	3.2%	2.8%	2.4%	1.9%	1.9%
Efficiency ratio	28.9%	31.0%	32.6%	37.5%	46.8%	53.8%	56.8%
Common equity Tier 1 capital adequacy	12.0%	11.2%	11.7%	11.5%	11.5%	11.9%	11.9%
Total equity capital attributable to the Bank's shareholders to total assets	8.0%	7.5%	7.5%	7.1%	6.3%	6.8%	7.6%
Less stable financing sources [3] to total assets	22.6%	20.6%	22.7%	22.6%	23.3%	17.2%	15.9%
Liquid balances [4] for deposits by the public	39%	39%	42%	44%	44%	45%	37%

[1] Distribution before loan loss provisions.
[2] Calculated on an annual basis.
[3] Institutional entities' deposits (wholesale), bonds and subordinated bonds with duration of up to one year, and deposits from banks.
[4] Cash and deposits in banks, government bonds of the Israeli government, US treasury notes, and assets backed by the US government.

[5] The report "*Impact of the War on the Credit Repayment Capacity of Issuers Rated by Midroog - Special Report",* is posted on Midroog's website.

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

A high business profile and stable revenues contribute to the high revenue recovery capability; on the other hand, the diversification of revenues is low in relation to the BCA

The Bank has long been one of the two largest banking groups in the local banking system, as reflected in a market share of approx. 29% of the banking system's total assets, approx. 29% of the deposits by the public, and approx. 27% of total loans to the public, as of June 30, 2024. Furthermore, the Bank's business profile is supported by its being a universal bank, which offers a range of banking and financial services, a broad 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. We believe that in view of the changes in the operating environment of the banking sector in recent years, 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. Moreover, we believe that changes in the business environment, and in particular the launch of the Central Credit Register, the Open Banking Reform, the licensing of a new digital bank and other regulatory changes will further intensify the competition in retail banking and will force the Bank to compete against new market players and improve its value proposition to customers against the backdrop of emerging threats.

The stability of the Bank's revenues, as estimated by Midroog, is adequate in relation to BCA. On the one hand, it is affected by the weight of retail revenues[6] (approx. 59% on average in 2021-2023), which contribute to the Bank's ability to generate the revenues and mitigate the volatility of the activity, and on the other hand it is affected by the high weight of revenues in the corporate-commercial segment (approx. 36% for the said years), which we view as less stable. On the other hand, the Bank has a relatively low rate of revenues from fees and commissions, which stood at approx. 15% in the first half of 2024, and reflects a decline compared to previous years (approx. 20% on average in 2021-2023). The increase in finance income beyond the increase in operating income obscures the visibility of operating income, which we believe to be more stable throughout the cycle. As of the first half of 2024, the diversification of the Bank's revenue sources is based on 3 key pillars,[7] as is also reflected in the revenues mix in 2023, comprising approx. 43% from SMEs and institutional entities, approx. 23% from mortgages, and approx. 19% from small and micro businesses.

The Bank's risk management policy supports its risk profile; on the other hand, the credit concentration relative to the capital loss-absorption buffer remains high considering the BCA level

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 relation to a capital loss-absorption buffer considering the BCA, which weighs on the Bank's risk profile. Accordingly, 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. 215% of the common equity Tier 1 capital as of June 30, 2024; this rate is relatively high compared to the peer group as of that date (approx. 164%). Total exposure to the large borrowers, which constitute more than 5% of the Bank's common equity Tier 1 capital (approx. NIS 2,695 million as of December 31, 2023) is adequate relative to the BCA, and is estimated by Midroog at approx. 11%[8] of the Bank's common equity Tier 1 capital as of December 31, 2023. It is noted that the rate calculated above may be biased upwards since the data as per the financial statements relate to a cross-section of the total liability of those borrowers, where this ratio is an estimate calculated by Midroog.

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 supplement 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 in line with the BCA, as reflected in the VaR exposure limit of 5% of the Tier 1 capital with regard to the entire Bank's activity in a one-month investment horizon, in accordance with the data as of December 31, 2023. [9]

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

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

[8] The ratio was calculated as follows: In accordance with Note 30 to the annual financial statements of 2023, Midroog aggregated - based on the proportionate share - the balance sheet liability included within the range of NIS 2,400 million and NIS 2,800 million, and the amount that equals approx. 5% of the Bank's equity as of December 31, 2023 is in the middle, as well as the total balance sheet liability of the upper range.
In order to calculate the ratio, the above liability amount was divided by the common Equity Tier 1 Capital as of December 31, 2023. It is noted that the liability ranges in the said note also refer to the liability in respect of off-balance sheet liability. Therefore, the ratio resulting from Midroog's estimate is biased upwards.

[9] According to the Bank's Risk Management Report for 2023, the restriction for 2024 was revised at the beginning of 2024 in accordance with the Bank's risk appetite framework.

The quality of the credit portfolio is favorable relative to the BCA, but a challenging macroeconomic environment and the consequence of the War may put pressure on the credit portfolio's quality metrics in the forecast range

The Bank is characterized by high quality credit portfolio, which supports its future income recovery capabilities, and the potential of creating the capital loss buffer as reflected in favorable risk indicators relative to the BCA, and a relatively high loss absorption buffer that supports the performance of the credit portfolio. Accordingly, as of June 30, 2024, the ratio of troubled debts to gross loans to the public stood at approx. 1.5%, and is a good rate relative to the rating and the peer group as of that date (approx. 2.1%). In addition, as of that date the rate of non-performing debts in arrears of over 90 days of total gross loans to the public stood at approx. 0.6% (approx. 0.9% in the peer group as of that date), which is similar to the ratio as of June 30, 2023. In addition, as of June 30, 2024 the balance of the provision stood at approx. 1.5% compared to 1.3% on average as of June 30, 2023. Accordingly, the coverage ratio[10] improved and stood at 256% as of June 30, 2024 (approx. 212% as of June 30, 2023), which is significantly higher than the peer group average as of that date (approx. 173%), and reflects a conservative policy as to provisions.

We believe that the Bank has a relatively high exposure to the real estate and mortgages sectors, which, on aggregate, accounted for approx. 59% of the Bank's total debts[11] as of June 30, 2024 compared to 56% in the peer group as of that date. The exposure to the real estate sector (excluding mortgages) is characterized by a relatively high risk, in view of homogeneous characteristics, and due to high exposure relative to the capital loss-absorption buffer, which constitutes approx. 28% of the Bank's total debts and is significantly higher than the peer group average as of that date (approx. 18%). It is noted that this ratio includes credit risk with respect to which insurance was purchased, mainly from foreign insurance companies, and therefore the sectoral exposure is lower than this rate. We believe that the Bank is characterized with conservative underwriting processes relative to this sector; this constitutes a somewhat moderating factor in terms of the Bank's sectoral concentration risk. The exposure to housing loans constitutes approx. 31% 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, which supports a low likelihood of default. Accordingly, the rate of loans advanced in the first half of 2024 where the repayment capacity ratio is lower than 2.5 on the loan approval date was approx. 1.1% of total new loans advanced. The average loan to value rate (LTV) in the Bank's housing loans portfolio,[12] stood at approx. 49% as of June 30, 2024 (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. 0.4% of the portfolio as of that date.

Midroog's baseline scenario regarding the quality of the Bank's credit portfolio is based on several macroeconomic[13] exogenous effects, including: (1) GDP growth of approx. 0.5% in 2024 and approx. 3.8% in 2025; (2) an unemployment rate of 3.2%-3.5%; (3) an interest environment at the rate of 4.5%; (4) an inflation rate of approx. 3.8% in 2024 and approx. 2.8% in 2025; (5) continued competition by the non-bank debt market with regard to the business and consumer portfolio. Under this scenario, Midroog expects that in 2024-2025 the Bank's credit portfolio will grow within a range of approx. 7%-10% per year. In our opinion, this growth will be supported by maintaining significant market shares in commercial-business credit (medium and large businesses) and housing loans, in accordance with the Bank's 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. In view of the effects of the War, we believe that in the short to medium term, it is expected that the quality of the assets of the banking system will be adversely affected due to an increase in the borrowers' risk. Accordingly, the troubled debt rate out of the credit portfolio is expected to increase during the forecast years, and will range, in our opinion at 1.8%-2.2%, with the rate of troubled debts out of the absorption buffers (equity and loan loss provision) expected to stand at approx. 12%. Furthermore, we assume that the loan loss expenses shall range between 0.3% and 0.5% 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 to previous years.

The Bank's profitability is good relative to the BCA, in view of relatively high base interest rates and inflation environment compared to the past several years; however, profitability is expected to moderate to a certain extent in the forecast range due to the effects of the War

The Bank's profitability indicators have improved during the past few years, due to, among other things, an increase in the Bank's revenues as a result of a growing credit portfolio, relatively high base interest and inflation environment in the past few years, and the implementation of streamlining steps and transitioning to providing services through digital, direct channels, that supported a decrease in the Bank's operating expenses. Thus, as of the first half of 2024, the Bank's operating efficiency ratio stood at approx. 29% (approx. 43% on average in the peer group during that period), which is favorable relative to the BCA and reflects a significant and consistent improvement over the past few years; in 2023, this ratio stood at approx. 33%, with an average of approx. 46% in 2020-2022. As of the first half of 2024, the Bank's profitability was affected by capital gain from the sale of the headquarter buildings in Tel Aviv amounting to approx. NIS 0.6 billion after tax, and by a loss of approx. NIS 0.6 billion, after tax, in respect of impairment of the investment in Valley Bank. Accordingly, in 2023 the core return on risk-weighted assets and the return on assets amounted to approx. 3.2% and 1.0%, respectively, and in the first half of 2024 - 3.6% an 1.4%, respectively, and

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[10] The balance of the provision for total non-accrual debts and debts in arrears over 90 days in arrears.

[11] Loans to the public.

[12]Out of the total new housing loans portfolio extended by the Bank.

[13] [Macroeconomic Forecast of the Research Department, Bank of Israel, October 2024.]

annualized, and they are good in relation to the BCA.

The key assumptions regarding the Bank's profitability, on which Midroog's baseline scenario for 2023-2024 was based, are as follows: (1) annual credit portfolio growth of approx. 7%-10%; (2) interest rate environment of 4.5%; (3) inflation rate of approx. 2.8%-3.8%; (4) loan loss expenses rate of 0.3%-0.5% in respect of the credit portfolio; (5) continued slow growth in payroll expenses in accordance with the Bank's wage agreements. In this scenario, Midroog predicts that in the forecast years the Bank's profitability indicators will moderate, to a certain extent, compared to the first half of 2024; however, those profitability indicators shall remain at a level similar to 2023 and will continue to support further increase in equity and improvement of the financial profile, and the core return on risk-weighted assets is expected to range between 2.6%-3.2%, and approx. 0.9%-1.1%, respectively.

The capital buffer is adequate relative to the BCA and is characterized by a good loss-absorption capacity

The Bank is characterized with a capital loss buffer that is adequate in relation to the BCA, and which was created over the years by accumulating profits, net of dividend distribution, optimization and management of risk-weighted assets and asset mix. As of June 30, 2024, the Bank's Common Equity Tier 1 Capital ratio stood at approx. 12.0%, which is an improvement compared to 11.2% as of June 30, 2023, with the Bank maintaining an adequate margin of approx. 181 basis points above the regulatory barrier (Common Equity Tier 1 Capital ratio), which is high compared to the average in the peer group (approx. 154 basis points). This margin supports the risk profile and has a positive effect on the Bank's business flexibility and growth potential.

The Bank's leveraging level is adequate in relation to the BCA and favorable in relation to the peer group average, as reflected in an equity to asset ratio of approx. 8.0% as of June 30, 2024 (compared to approx. 6.9% on average in the peer group as of that date); it reflects an improvement in the past year (approx. 7.5% as of June 30, 2023). 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 ratio will stand at 10.7% - a level that reflects, in our opinion, the Bank's ability to absorb unexpected losses well, which is expected to support its stability in the short to medium term.

In the baseline scenario, Midroog expects that the capital buffer will continue to increase, alongside an increase in the credit portfolio, such that the core Common Equity Tier 1 Capital adequacy ratio will be between approx. 11.4%-11.8%. This ratio will be affected by the following factors: (1) accumulated profits; (2) distribution of a dividend at the rate of up to 50% of the net income in the forecast period; (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 that of other local banks, mainly relies on a broad retail deposit base, which was stable throughout the economic cycle. A substantial component of the Bank's sources structure is a highly diversified and stable (retail) deposits (approx. 30% of households and private banking, and approx. 17% of small and micro businesses, as of June 30, 2024) which, in Midroog's opinion, are in line with the Bank's risk profile. The Bank has a reasonable rate of less stable[14] financing sources out of total assets, as defined by us, which stood at approx. 22.9% as of that date. The Bank has a good ratio between loans to the public and deposits by the public, which stood at approx. 76% as of June 30, 2024 (approx. 79% on average in the peer group as of that date), compared to approx. 78% as of June 30, 2023. Furthermore, as of June 30, 2024, the Bank's NSFR ratio stood at approx. 118%, which is adequate and sufficiently higher than 100%, and supports the Bank's financing profile.

The Bank's liquidity buffer comprises a favorable inventory of liquid assets[15] to total deposits relative to the BCA, which stood at approx. 39% as of June 30, 2024, and supports the Bank's good liquidity. This inventory includes mainly cash and bank deposits and a securities portfolio. This portfolio constitutes approx. 18% 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. 51%) and foreign government bonds (approx. 17%, mostly US treasury bills). 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 rate risk. The Bank's liquidity management is also supported by a relatively high liquidity coverage ratio (LCR) of approx. 130% as of June 30, 2024, which is significantly higher than the regulatory threshold (100%) but relatively low compared to the average in the peer group (approx. 142% as of that date). This ratio supports the Bank's liquidity ratio and its business flexibility. In our opinion, liquidity management will continue to be challenging for both the Bank and the System, due to a high interest rate environment, which may lead to a change in consumer preferences following investment tracks that serve as an alternative for deposits, which generate an excess return on deposits and have a similar liquidity level. However, Midroog anticipates that the Bank's resource structure and good liquidity will remain so within the forecast range.

[14] The Bank has a policy in place for distribution of up to 50% of the net income.
[15] Bank deposits, deposits from institutional entities, bonds and subordinated bonds payable within the next 12 months.
[15] Cash and bank deposits, Israeli government and US government bonds, and assets backed by the US government.

Other considerations

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 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 investments 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 employees by way of early retirement plans, and integrated 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.

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 one-notch downgrade 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. 12.0% as of June 30, 2024), and the anticipated capital adequacy level in the baseline scenario in our opinion (11.4%-11.8%), and the favorable liquidity profile relative to the BCA, the uncertainty regarding the probability of reaching the "point of non-viability"[16] 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 (BLC), a US-incorporated corporation (85% of which is held by the Bank), which wholly owns BLUSA, entered into a merger agreement with Valley National Bankcorp. Following the completion of the transaction and execution of the merger procedures, BLC was merged into Valley and BLUSA was merged into Valley Bank. Upon completion of the transaction on April 1, 2022, Bank Leumi holds approx. 14.2% of Valley's share capital, but the Bank

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[17] 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".

is not a controlling shareholder; however, as of this report's publication date, it is the largest shareholder. The Bank does not have a controlling core. The Bank's President and CEO is Hanan Friedman, Adv., and the Chairman of the Board of Directors is Dr. Shmuel Ben Zvi.

The subordinated bonds and bonds rated by Midroog:

Series	Security No.	Rating	Rating outlook	Final repayment date
Leumi Bonds (Series	6040372	Aaa.il	Stable	30.06.2026
Leumi Bonds (Series	6040604	Aaa.il	Stable	05.05.2030
Leumi Subordinated	6040620	Aa2.il(hyb)	Stable	27.03.2033

Internal Baseline Credit (BCA) Assessment Matrix

			As of 30.06.2024		The rating outlook [1]		
Category	**Parameter**	**Sub-parameter**	**Measurement [1]**	**Score**	**Measurement**	**Score**	**Other considerations**
Business profile	**Business positioning**		-	aaa.il	-	aaa.il	
	Revenue stability	Retail revenues %	79%	aa.il	~79%	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	
Risk profile	**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	215%	a.il	~215%	a.il	*Construction and real estate segment*
	Concentration of the credit portfolio	The largest borrowers to Common Equity Tier 1 capital	Approx. 11%*	aa.il	>5%	aaa.il	
	Market risk appetite	VAR limit to Common Equity Tier 1 capital	*5%	aa.il	7.5%-5.0%	aa.il	
Financial profile	**Assets quality**	Troubled debts out of loans to the public	1.5%	aaa.il	2.2%-1.8%	aaa.il	
		Troubled debts to equity and loan loss provision	10.0%	aaa.il	~12%	aaa.il	*Coverage ratio*
	Profitability	Net income to average assets	1.4%	aaa.il	1.1%-0.9%	aa.il	
		Profit before tax and loan loss expenses to average risk-weighted assets	3.6%	aaa.il	3.2%-2.6%	aaa.il	
		Efficiency ratio	29.0%	aaa.il	~33%	aaa.il	
	Capital adequacy	Common Equity Tier 1 capital to risk-weighted assets	12.0%	aa.il	11.8%-11.4%	aa.il	
		Equity to total assets	8.0%	aa.il	7.8%-7.6%	aa.il	
	Financing and liquidity	Less stable financing to total assets	22.9%	aa.il	~22.9%	aa.il	
		Liquid assets to deposits by the public	39%	aaa.il	~39%	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.

** Midroog's estimate according to December 31, 2023 data.*

Rating of the Bank's debts

	Internal Baseline Credit (BCA) Assessment	Support from owners and/or related parties	BCA מותאם	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
Impact of the "Iron Swords War" on the Credit Repayment Capacity of Issuers Rated by Midroog" - special report October 2024
Promoting the Competition in the Banking System - special report, February 2023
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:	06.11.2024
Date of previous rating update:	31.10.2023
Publication date of initial rating	18.02.2007
Rating initiated by:	Bank Leumi le-Israel B.M.
Rating paid for by:	Bank Leumi le-Israel B.M.

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 aaa.il standalone (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 aa.il standalone (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 standalone a.il (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 baa.il standalone (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 standalone ba.il (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 b.il standalone (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 caa.il standalone (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 ca.il standalone (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 c.il standalone (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 variable '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 Long-Term Rating Scale

Aaa.il	**Issuers or issues rated Aaa.il have, in Midroog's judgment, the highest credit repayment capacity relative to other local issuers.**
Aa.il	**Issuers or issues rated Aa.il have, in Midroog's judgment, very high credit repayment capacity relative to other local issuers.**
A.il	**Issuers or issues rated A.il have, in Midroog's judgment, high credit rating capacity relative to other local issuers.**
Baa.il	**Issuers or issues rated Baa.il have, in Midroog's judgment, medium credit repayment capacity 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 credit repayment capacity 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 credit repayment capacity relative to other local issuers, and they involve certain significant speculative characteristics.**
Caa.il	**Issuers or issues rated Ba.il have, in Midroog's judgment, excessively weak credit repayment capacity relative to other local issuers, and they involve certain very significant speculative characteristics.**
Ca.il	**Issuers or issues rated Ca.il have, in Midroog's judgment, extremely weak credit repayment capacity 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 credit repayment capacity, 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 variable '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[18]

Long term rating	Short-term rating
Aaa.il Aa1.il Aa2.il Aa3.il A1.il A2.il A3.il	Prime-1.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 Ca.il C.il	NotPrime

[18]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.

[18] The ratio was calculated as follows: In accordance with Note 30 to the annual financial statements of 2023, Midroog aggregated - based on the proportionate share - the balance sheet liability included within the range of NIS 2,400 million and NIS 2,800 million, and the amount that equals approx. 5% of the Bank's equity as of December 31, 2023 is in the middle, as well as the total balance sheet liability of the upper range. In order to calculate the ratio, the above liability amount was divided by the common Equity Tier 1 Capital as of December 31, 2023. It is noted that the liability ranges in the said note also refer to the liability in respect of off-balance sheet liability. Therefore, the ratio resulting from Midroog's estimate is biased upwards.