Annual Report 2016

The Bank has received the consent of the Supervisor of Banks to the publication of the annual financial report on a consolidated basis only, with condensed statements of the Bank (not consolidated) in Note 35 to the financial statements.
The figures of the Bank alone are available on request from the offices of the Bank at 34 Yehuda Halevi Street, Tel Aviv or on its website: www.bankleumi.co.il.
This is a translation from the Hebrew and has been prepared for convenience only. In the case of any discrepancy, the Hebrew will prevail.

Bank Leumi le-Israel B.M. and its Investee Companies
Annual Report 2016

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Message from the Chairman of the Board of Directors

Leumi finished 2016 with a net profit of NIS 2,791 million; a 9.3% return on equity. The highlight is a Tier 1 capital adequacy apart from the regulatory target, in such a manner in which ratio is 11.15%. The target set by the regulator was challenging, and achieved, if I may say, in an impressive manner. We succeeded in meeting the target thanks to the consistent and determined implementation of policy which the Bank's Management outlined to the Board of Directors.

Last year stood as a sign of many changes in the organization, which derived from two main impetuses: Compliance with regulatory targets and the continuation of the Group's credo – **Leadership of innovative and proactive banking for our customers**.

During the past year, there have been significant changes in the units of the Bank: The **Banking Division** led a comprehensive and innovative reform in its activity platform, including a transition from a structure whose management was according to geographical areas, to a structure based on four designated lines of business, which have been adapted to customers' requirements, Retail, Premium, Private Banking and Small Business. Alongside this, we successfully completed the merger of the Arab Israel Bank within Leumi.

At the beginning of 2016, we established a new division – the **Digital Banking Division**.

This division acts as Leumi's entity responsible for innovation, the development of use of data in areas of activity vis-à-vis all the Group's lines of business, with the aim of creating the most appropriate and advanced products for customers.

Under this framework, we launched in the app stores the "PEPPER PAY" payments app and the "PEPPER banking app (which is currently only open to invitees). This is significant news for the banking system.

I believe that Pepper will act as a lighthouse and the North Star in the banking world, which continues to evolve in the spirit of the digital revolution. Pepper is the face of the future in banking.

We – the Leumi Group – are proud to bear the "digital torch".

The **Corporate-Commercial Division**, the "2020 Commercial" project was launched, in which some of the operational activity was transferred from the commercial branches to performance centers, and other steps were taken to improve the commercial customer's experience. In addition, in 2016, the Commercial Corporate Division took a momentous leap in cooperating with the institutional entities in the economy, in all matters relating to syndication transactions and the sale of debts, for example, the joint underwriting transaction with Harel, the sale of a portion of the mortgage portfolio to Menora, and many more credit sale transactions carried out during the year.

We established the "Leumi Tech Business Center" as the finance home of Israel's hi-tech community which serves the thousands of the Bank's hi-tech customers. The center brings Leumi's hi-tech experts under one roof, integrating unique products and services which have been specifically tailored to the needs of hi-tech companies, with the aim of simplifying the banking processes and providing our hi-tech customers with the highest standard of service.

During the period of the report, the Group completed its handling of the main topics with which the Group dealt in recent years in connection with the U.S. customers affair. The Bank reached an arrangement with the U.S. Securities Authority, the U.S. courts approved the release of the Group from the DPA regulations which were signed by the U.S. Department of Justice, after the Group had complied with its instructions over two years as stipulated in an agreement; the monitor appointed by the DFS completed its work and the Group submitted a program for implementing the recommendations for improving compliance issues; the court ratified arrangements in in the derivative claims and class action, and the Bank finished its decision-making for closing the offices, which main activity focused on international private banking, and the Group is currently operating abroad through only three overseas units, in the United States, , the U.K. and Romania.

And alongside all this, it is important to mention the wide-scale activity of the corporate responsibility which Leumi upholds in a wide range of areas, such as a responsible procurement policy, in the framework of which the Company collaborates with the 'Yasmin' Association and the 'Maale' Organization, with the aim of building a diverse database of social suppliers which will act as the principle of the Israeli economy, and assisting in the embedding of responsible conduct – even among small and mid-size suppliers.

We are proud to be partners in financing the first social debenture in Israel in Tzavta with the public benefit company 'Social Finance Israel' as part of the support program aimed at preventing student dropout, and of course, we continued to deepen the cooperation with the 'Follow Me! – Youth Leading Change' Association, the flagship for the social involvement of the Leumi Group for the Community. In total, in 2016, we invested in the community more than NIS 33 million and thousands of employees volunteered, taking part in a rage of voluntary frameworks throughout the country.

The world economy continues to face significant challenges. The vote of British citizens to separate from the European Union, 'Brexit', has triggered a process which has begun to have an effect on Europe as a whole, in the context of which movements opposed to the idea of a European Union have started to gain power in other countries – with the danger that damage will be caused both on an economic level and politically in the whole of Europe, the economic recovery in the U.S. has continued, albeit with growth and interest rates which will be lower – apparently for the long term – than that which is generally accepted as 'normal' prior to the great economic crisis of 2008-2009. Of course, all eyes are now turned towards the newly elected President of the United States, Donald Trump, and the economic policy he will lead.

Against this backdrop, of slow global growth and zero interest, growth in the Israeli economy in 2016, at a real rate of 4% (2% per capita) is impressive. Nevertheless, part of this rapid growth derives from non-recurring factors, such as the sharp increase in vehicle imports and the investments of Intel in a new facility in Kiryat Gat. Accordingly, a "growth environment" of 3.0%. alongside a very moderate increase in interest rates, is the "new normal" which is expected to characterize the Israeli economy in the coming years.

The Leumi Group will continue, faithful to its perception and way, in action, initiative and constant improvement, with the aim of providing our customers and stakeholders in the Group with the maximum product. All these would not occur were it not for the most important resource at its disposal – the Group's managers and employees. To their credit, the Leumi Group will continue its campaign as the leading banking group in Israel.

David Brodet

Chairman of the Board of Directors

29 March 2017

Report of the Board of Directors and Management

General Review, Goals and Strategy

Description of the Leumi Group's Business Activities

Bank Leumi and its subsidiary companies constitute one of the largest banking groups in Israel, continuing activities that began 115 years ago. The Bank's predecessor, the Anglo Palestine Company, was established in London in 1902 by Otsar Hityashvuth HaYehudim Jewish Colonial Trust Limited, the predecessor of Otsar Hityashvuth HaYehudim B.M.[1]

The Bank is defined as a banking corporation under the Banking (Licensing) Law, 1981, and holds a banking license under that law. As a "bank" and a "banking corporation" the Bank's activities are governed and delineated by a system of laws, orders and regulations, including, *inter alia,* the Banking Ordinance, the Bank of Israel Law, the Banking (Licensing) Law and the Banking (Service to Customer) Law, as well as by directives, rules, instructions and position papers of the Supervisor of Banks.

As a leading banking group in Israel, aiming to achieve adequate levels of long-term profitability, Leumi constantly scrutinizes trends and changes in the business environment in which it operates and formulates a strategy to deal with these changes.

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

1. **Retail Banking** focuses on providing banking services, mainly to households (including mortgages), wealthy customers (Private Banking) and small businesses. Retail Banking is structured to enable personal adaptation to the needs of the customers, by providing an integrative multi-channel customer experience, via the branch channel and direct channels (mobile, Internet, Leumi Call, terminals, information kiosks and ATMs).

2 **Corporate and Commercial Banking** concentrates providing services to Israeli and international corporations with various scopes of operations and in a variety of areas of activity. The aim of corporate and commercial banking is to service all types of customers with the range of financial and banking services they require, promoting the involvement of units in the Leumi Group in Israel and abroad, as a means to increase the range of products and services offered to customers.

3. **Capital Market Division** and Financial Management is engaged managing the Bank's nostro and, in addition, operating all of the dealing rooms in the Bank with a view to providing service to customers who are active in the capital and financial markets, including institutional customers. The management of the non-bank investment is done mainly through Leumi Partners.

In addition to the lines of business managed in the Bank, Leumi operates through subsidiaries in Israel and abroad.

Activity of subsidiaries in Israel – mainly includes credit card activity carried out by Leumi Card, and non-bank investment activity, and investment banking carried out by Leumi Partners.

Activity of subsidiaries abroad – carried out by the subsidiaries, Leumi USA, Leumi UK and Leumi Romania, whose main activity is granting credit to corporate commercial customers and small businesses.

Some of the financial services are provided by subsidiary companies that operate in various fields, such as: credit cards, underwriting, etc.

The Leumi Group operates in a competitive market in all its operating segments. Its main competitors are other Israeli banks. However, in certain segments, there are additional competitors whose numbers are constantly growing, such as overseas banks and non-bank competitors, other institutional entities and technology-based solutions (FinTech companies).

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1 Otsar Hityashvuth HaYehudim B.M. was the controlling shareholder of the Bank until the equalization of voting rights in the Bank in 1991. In 1993, most of the shares of the Bank passed to the ownership of the State, under the Bank Shares Arrangement Law (Temporary Provision), 1993. On 3 September 2007, the company ceased to be an interested party in the Bank.

Summary of Financial Position

The consolidated statements of profit and loss data for the years 2012 – 2016 are as follows:

	2016	2015	2014	2013	2012
	(NIS millions)				
Interest income	**9,552**	8,784	10,012	12,134	13,507
Interest expenses	**2,026**	1,666	2,649	4,777	6,099
Net interest income	**7,526**	7,118	7,363	7,357	7,408
Expenses (income) in respect of credit losses	**(125)**	199	472	268	1,236
Net interest income after expenses in respect of credit losses	**7,651**	6,919	6,891	7,089	6,172
Non-interest income					
Non-interest financing income	**1,282**	1,610	795	1,127	444
Commissions	**3,967**	4,092	4,167	4,188	4,199
Other income	**159**	595	179	116	131
Total non-interest income	**5,408**	6,297	5,141	5,431	4,774
Operating and other expenses					
Salaries and related expenses	**5,422**	5,544	5,253	5,070	5,310
Building and equipment maintenance and depreciation	**1,697**	1,678	1,631	1,821	1,819
Amortization of intangible assets and goodwill	**-**	5	58	88	23
Other expenses	**1,461**	1,609	2,429	1,838	1,968
Total operating and other expenses	**8,580**	8,836	9,371	8,817	9,120
Profit before taxes	**4,479**	4,380	2,661	3,703	1,826
Provision for taxes on profit	**1,717**	1,691	1,278	1,380	800
Profit after taxes	**2,762**	2,689	1,383	2,323	1,026
Banking corporation's share in profits (losses) of companies included on equity basis after tax	**66**	177	42	(293)	(67)
Net profit					
Before attributing to non-controlling interests	**2,828**	2,866	1,425	2,030	959
Attributed to non-controlling interests	**(37)**	(31)	(12)	(42)	(37)
Attributed to shareholders of the banking corporation	**2,791**	2,835	1,413	1,988	922
Net profit per share attributed to shareholders in the banking corporation (in NIS):					
Basic net profit per share	**1.85**	1.92	0.96	1.35	0.63
Diluted net profit per share	**1.84**	1.92	0.96	1.35	0.63

Total assets under management of the Group (both balance sheet and off-balance sheet*) amounted to NIS 1,259 billion as at 31 December 2016, compared with NIS 1,214 billion at the end of 2015, an increase of 3.7%.

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

The consolidated balance sheet data as 31 December is as follows:

	2016	2015	2014	2013	2012
	NIS millions				
Assets					
Cash and deposits with banks	**74,757**	60,455	60,615	44,351	54,621
Securities	**77,201**	69,475	52,113	63,735	56,408
Securities borrowed or purchased under agreements to resell	**1,284**	1,764	2,000	1,360	1,435
Credit to the public	**265,450**	265,070	256,468	244,757	245,378
Allowance for credit losses	**(3,537)**	(3,671)	(3,988)	(3,883)	(4,114)
Credit to the public, net	**261,913**	261,399	252,480	240,874	241,264
Credit to governments	**642**	453	528	558	442
Investments in companies included on equity basis	**901**	924	2,216	1,689	2,129
Buildings and equipment	**3,147**	3,095	3,162	3,028	3,705
Intangible assets and goodwill	**17**	18	43	99	189
Assets in respect of derivative instruments	**10,654**	11,250	16,909	13,054	11,438
Other assets	**8,087**	7,666	6,918	6,056	4,714
Total assets	**438,603**	416,499	396,984	374,804	376,345
Liabilities and equity					
Deposits of the public	**346,854**	328,693	303,397	286,003	289,538
Deposits from banks	**3,394**	3,859	4,556	4,310	4,073
Deposits from governments	**900**	750	467	397	451
Securities lent or sold under agreements to repurchase	**539**	938	1,238	624	1,007
Debentures, bonds and subordinated notes	**22,640**	21,308	23,678	25,441	27,525
Liabilities in respect of derivative instruments	**10,677**	11,098	15,650	13,487	12,762
Other liabilities	**21,885**	20,746	21,860	19,395	16,092
Total liabilities	**406,889**	387,392	370,846	349,657	351,448
Non-controlling interests	**367**	340	340	340	307
Equity attributable to shareholders of the banking corporation	**31,347**	28,767	25,798	24,807	24,590
Total equity	**31,714**	29,107	26,138	25,147	24,897
Total liabilities and equity	**438,603**	416,499	396,984	374,804	376,345

The principal financial ratios (in %) are as follows:

	As at 31 December				
	2016	2015	2014	2013	2012
Credit to the public, net, to total balance sheet	**59.7**	62.8	63.6	64.3	64.1
Securities to total balance sheet	**17.6**	16.7	13.1	17.0	15.0
Deposits of the public to total balance sheet	**79.1**	78.9	76.4	76.3	76.9
Deposits of the public to total credit to the public, net	**132.4**	125.7	120.2	118.7	120.0
Total equity to risk assets (a) (e)	**15.21**	13.74	13.90	14.59	14.87
Tier 1 capital to risk assets (e)	**11.15**	9.58	9.09	9.19	8.55
Leverage ratio (f)	**6.77**	6.27	-	-	-
Liquidity coverage ratio (f)	**132**	105	-	-	-
Equity (excluding non-controlling interests) to balance sheet	**7.1**	6.9	6.5	6.6	6.5
Net profit to average equity (excluding non-controlling interests)	**9.3**	10.3	5.5	8.0	3.8
Rate of provision for tax on the profit before taxes	**38.3**	38.6	48.0	37.3	43.8
Expenses (income) in respect of credit losses to credit to the public, net	**(0.05)**	0.08	0.19	0.11	0.51
Of which: expenses in respect of collective allowance to credit to the public, net	**0.24**	0.17	0.22	0.11	0.13
Expenses (income) in respect of credit losses to total risk of credit to the public	**(0.03)**	0.05	0.12	0.07	0.34
Interest income, net to total balance sheet	**1.72**	1.71	1.85	1.96	1.97
Total income to total assets (b)	**2.95**	3.22	3.15	3.41	3.24
Total income to total assets managed by the Group (b) (c)	**1.03**	1.11	1.02	1.10	1.16
Total operating and other expenses to total balance sheet	**1.96**	2.12	2.36	2.35	2.42
Total operating and other expenses to total assets managed by the Group (c)	**0.68**	0.73	0.77	0.76	0.87
Net profit to total average assets (d)	**0.64**	0.69	0.40	0.53	0.26
Interest margin	**1.75**	1.84	1.98	1.87	1.87
Operating and other expenses (excluding early retirement expenses) to total income (b)	**66.3**	65.8	74.6	68.4	72.2
Non-interest income to operating and other expenses (excluding early retirement expenses)	**63.0**	71.3	55.1	62.1	54.3
Non-interest income to total income (b)	**41.8**	46.9	41.1	42.5	39.2

(a) Capital – with the addition of non-controlling interests, net of investments in banking and financial non-consolidated subsidiaries and sundry adjustments.

(b) Total income – net interest income and noninterest income.

(c) Including off balance sheet activity.

(d) Average assets are total income-producing and other balance sheet assets.

(e) Since 2014, the capital liquidity ratio has been computed in accordance with the provisions of Basel III directives. Until 2013 (inclusive), this was computed in accordance with the provisions of the Basel II directives.

(f) Pursuant to the Bank of Israel directives, the leverage ratio and the liquidity coverage ratio were computed from the second quarter of 2015. Accordingly, comparative figures are not presented.
For further information regarding the leverage ratio, see Note 25.B.E and for further information regarding liquidity coverage ratio, see chapter " Exposure to Risk and Methods of Risk Management".

Forward-Looking Information in the Report of the Board of Directors and Management

The Director's Report includes, as mentioned above, in addition to data relating to the past, information that relates to the future, which is defined in the Securities Law, 1968, ("the Law") as "forward-looking information". Forward-looking information relates to a future event or matter, the realization of which is not certain and is not within the exclusive control of the Bank.

Forward-looking information is generally drafted with words or phrases such as "the Bank believes", "the Bank foresees", "the Bank expects", "the Bank intends", "the Bank plans", "the Bank estimates", "the Bank's policy", "the Bank's programs", "the Bank's forecast", "expected", "strategy", "aims", "likely to affect" and additional phrases testifying to the fact that the matter in question is a forecast of the future and not a past fact.

Forward-looking information included in the Directors' Report is based, *inter alia*, on forecasts of the future regarding various matters related to economic developments in Israel and abroad, and especially to the currency markets and the capital markets, to legislation, to directives of regulatory bodies, to the behavior of competitors, to technological developments and to personnel matters.

As a result of the inability to foresee with certainty that these forecasts will be realized, and the fact that in reality events may turn out differently from those forecasted, readers of the Report should relate to information defined as "forward-looking" with caution, since reliance on such information involves risks and uncertainty and the future financial and business results of the Leumi Group are likely to be materially different.

The Bank does not undertake to publish updates of the forward-looking information in these reports.

Principal Risks inherent in the Operations of the Bank

Credit risk is the Bank's risk of a loss as a result of the possibility that a counterparty does not fulfill its obligations vis-à-vis the banking corporation, as agreed. This risk is in accordance with the Group's core business and is reflected in activity with corporate, commercial and retail customers, as well as *nostro* activity. The Bank implements an overall policy for credit risk management, in accordance with the provisions of Proper Conduct of Banking Management Regulation no. 311.

For details of credit risk and its management, see below in the chapter, "Credit Risk".

Market risk - The routine management of market risks is intended to support the achievement of business targets, while estimating the forecast profit against the damage likely to emanate from exposure to these risks. Exposures to market risk are managed dynamically as a part of the system of restrictions established by the Board of Directors and the risk committees at different levels which delineates the impact of market's exposure on the economic value, the accounting profit, capital reserve and liquidity position.

For details of market risk and its management, see below in the chapter, "Market Risk".

In the Bank's activity as a financial intermediary, there are operational risks which also include, *inter alia*, information security and cyber risks, information technology risks, embezzlement and fraud risks, legal risks, compliance and business continuity risks. Operating risk is defined as the risk of a loss as the result of the lack of adequacy or a failure of internal procedures, personnel or systems, or as a result of external events including cyber incidents. The definition of risk does not include strategic risk or reputational risk.

Operational risk management is conducted in accordance with generally accepted ("best practice") standards in all parts of the Group, and whenever the risk environment changes, the Bank updates the tools for managing these risks. In recent years, as a result of the rapid development in technology, in general, and, as a corollary, in banking, and as a result of external changes to the Bank, the information security and cyber risks and the risks of embezzlements and frauds have increased, and the Bank continues to take steps to strengthen the risk management in this area.

For details of operational risk and its management, see below in the chapter, "Operating Risks".

Goals and Business Strategy

Leumi's Vision

"Our vision is to conduct proactive and innovative banking for our customers "

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

Leumi's strategy

In light of the significant trends and changes in the activity environment, Leumi has identified two main courses of action, the combination of which forms the Group's strategic core. On the one hand, adapting traditional banking, placing an emphasis on providing a professional and quality service to all customer segments according to their needs, preferences and rate of adopting digital innovativeness and on the other hand, building "New Banking", based on digital and technological innovation. These two courses of action are dependent on and combined with the necessity to streamline and maximize the utilization of capital for complying with capital adequacy targets.

Adaptation of the "Traditional Banking" model

Leumi has been taking measures to adapt the Bank's activity model for a number of years. As a part of this process, the Bank merged Leumi Mortgage Bank, Leumi Financing and the Arab Israel Bank. In addition, it amalgamated the Corporate Division with the Commercial Division, and, after the balance sheet date, Construction and Real Estate Department and Special Credit Department, which belong to the International Credit and Real Estate Division with the Corporate-Commercial Division. In addition, the Bank merged the Private Banking Department within the Banking Division. The Group has reduced its work-force in the past five years by approximately 2,300 positions and is continuing its implementation of a multi-year plan to merge branches, to adapt of the teller service model, and to replace the branch service model with a multi-channel vision.

In the strategic framework of reducing international private banking activity, Leumi completed the closure of its international offices which were engaged in the field, and currently, its activity abroad is focused mainly on commercial corporate credit and credit to small businesses through subsidiaries in the United States, the United Kingdom and Romania.

These activities are intended to create a smaller, more flexible and nimbler platform, which can cope with the challenges of changes in the activity environment.

Intensification of construction of the "New Banking" model

In order to adapt the Bank's business model to the New Banking Model, Leumi has continued to intensify its activity in the Digital Banking activity and has established its position as the leading digital bank in Israel, inter alia, through continually upgrading the digital services provided in apps and on Leumi's website.

In addition, Leumi recently launched the payments app, "PEPPER PAY", and the banking app "PEPPER" (the latter, open, at this stage. only to invitees), which are initial central milestones in the area of digital banking which will be **managed entirely by mobile**. The new apps will allow users to enjoy a personal, quality and advanced customer experience based on a response to their needs, in a user-friendly, fair and personally-tailored way "any time, any place".

Realizing of the Group's strategy is achieved in compliance with the risk appetite approved by the Board of Directors, using advanced processes and tools for the management of various types of risks and the completion of preparations for regulatory requirements.

It should be noted that, in strategic planning, there is a not inconsiderable degree of uncertainty with the realization of long-term strategic trends dependent on several variable factors: the state of the markets in Israel and abroad, the security situation, and the constant effects of regulatory changes, whose scope and focus over several years cannot yet be stated with certainty.

Some of the information in this chapter is "forward looking information". For the meaning of this term, see the chapter, "Forward-Looking Information".

Central trends in the operating environment

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

For information regarding the macro-economic environment in Israel and around the world, see the chapter, "Principal Developments in the Economy".

Increased regulation

The impact of regulation on the banking sector continues to grow stronger. The abundance and complexity of the regulation limits the sources of income, leads to an increase in the expenses required for complying with the provisions of the regulations and requires a constant improvement in the level of service and innovativeness. The regulatory changes are changing the face of banking and are expected to continue to do so in the coming years.

The Bank also contends with the requirements of international regulations, including continuing the implementation of the FATCA, preparation for the implementing the CRS regulations regarding the transfer of information to overseas tax authorities, preparation for the BEPS regulations, whose purpose is to contend with international tax planning of global companies, continuing the "declared money" policy, etc.

The regulations are therefore becoming the subject which is having immediate effect on a host of the Bank's business and strategic decisions, including with regard to the Bank's various areas of activity.

For further information regarding the regulatory environment and the implications of the central initiatives, see chapter "Legislation and Regulations relating to the Banking System".

The consumer environment

Economic, social and technological changes, with an emphasis on the increasing use of mobile phones and the wide sharing of information on social networks and the constant improvement in the customer experience provided by hi-tech companies and retail networks, with an emphasis on convenience and "anywhere, anytime" availability, simplicity, personal customization and fairness and transparency, continue to increase consumer awareness and materially change consumption habits.

Non-bank entities, predominantly innovative "Fintech" companies continue to develop innovative solutions (products), mainly in the retail field, but also in other areas. These solutions place a new benchmark in the customer experience and direct competition vis-à-vis the banks in various areas. More and more banks around the world operate in various ways to cooperate with those Fintech companies.

Competitive environment

Domestic banks

In 2016, the trend of increase in the level of competition in all of the banking sectors of activity continued. The domestic banks continue to focus on households (*inter alia*, through consumer credit and mortgages) and in the small and medium business segments. They are taking steps to enroll new customers and increase the scope of activity, and focus efforts on developing innovative digital services, launching value proposals based on customer clubs, establishing new multi-channel service models and improving their operating efficiency, *inter alia*, by a change in the branch deployment model (branch mergers, etc.).

Non-bank competitors

Loans by institutional entities – In recent years, there has been a clear trend of increasing loans of institutional entities to the business sector, including granting finance to infrastructure projects and to income-generating properties, and supporting the construction of residential projects.

Along with the expansion in consumers' use of advanced technology (particularly mobile phones), the supply and quality of ventures/developments offered by Fintech companies has become greater.

Main Changes in the Past Year

Efficiency

On 1 June 2016, the Board of Directors of the Bank approved the efficiency plan, after receiving approval in principle from the Banking Supervision Department in accordance with the provisions of the Streamlining Provisions published by the Banking Supervision Department in January 2016.

For details regarding the Efficiency Plan, see Note 23M.

Trends, Phenomena, Developments and Material Changes

Principal Developments in the Economy[1]

The gross domestic products grew in 2016 by 4.0% in real terms. This growth rate, the highest in two years, was mainly affected by a relatively rapid increase in private consumption (6.3%) and in investments in fixed assets (11.3%), partly due the impact of non-recurring factors.

The global economy

In January 2017, the International Monetary Fund (IMF) revised its forecast for the development of growth in the world for 2017 and the estimates for economic activity for 2016. According to the Fund's revised estimates, growth in the United States and the Euro Area in 2016 amounted to 1.6% and 1.7%, respectively, similar to the forecasts given in October 2016. The estimate for GDP growth in 2016 also remained at a level of 3.1%. As regards 2017, the forecast for growth in advanced countries was revised slightly downwards, mainly due to the rapid growth which was forecast in the second half of 2016 and the expectation of a budget expansion in the United States.

The State Budget and its Financing

During 2016, the Government's budget deficit amounted to some NIS 25.9 billion, about 2.15% of GDP. This compared with the planned annual deficit of NIS 35 billion (2.9% of GDP). A significant part of the explanation for the relatively low deficit derives from the increase in Government income. In the past year, income from taxes (excluding vat on security imports) increased by NIS 5.9 billion, compared to the original income forecast, on the basis of which the State budget was built. This was against a background of an increase in salary, an increase in imports of motor cars and an intensification of efforts to enforce and collect on the part of the Taxes Authority. The increase in loans to the National Insurance Institute, compared to the forecast, is also a significant factor in the increase in government income.

Foreign trade and capital transactions

Israel’s trade deficit in 2016 amounted to some US$ 13.1 billion, an increase of US$ 5.3 billion, compared with the deficit for 2015. The increase in the trade deficit is due a fall in exports, mainly in the chemical and electronic components sectors), compared with an increase in most imports components, except energy mats

During 2016, direct investments in Israel by foreign residents, via the banking system, amounted to US$ 1.05 billion, while financial investments amounted to US$ 3.3 billion. However, investments by Israeli residents abroad (direct investments through Israeli banks and the financial investments) amounted to US$ 2.7 billion, such that there was a significant gap between the volume of investment inflows into Israel and foreign currency outgoing investments. On the other hand, this gap falls significantly when data for direct investments not reported by the banking system are taken into account, for which data exist only for January-September 2016.

Exchange Rate and Foreign Currency Reserves

The exchange rate of the shekel rose in value against the dollar in 2016 by some 1.5%, against the pound sterling, by 18.3% and against the euro, by 4.8%. Against this background, the real exchange rate of the shekel against the basket of currencies (reflecting Israel's trade with countries around the world) was at its lowest level for the last 15 years.

Foreign currency balances in the Bank of Israel at the end of December 2016 amounted to some US$ 98.4 billion. This compared with US$ 86.1 billion at the end of December 2015.

During 2016, foreign currency purchases by the Bank of Israel, part of a program of purchases to offset the effect of gas production on the exchange rate, totaled US$ 1.8 billion. In total, the Bank of Israel purchased foreign currency amounting to US$ 8.8 billion in this period.

Inflation and Monetary Policy

The Israeli consumer price index fell in 2016 by 2%. This rate is under the lower limit of the Government's target range of the price stability of 1% to 3%. This is the third year in succession in which the index has fallen. Half of the index items fell in the past year and half of them rose, with a noticeable contribution to the increase being the housing component, while the component for transport and communication making a noticeable contribution to the fall in the index.

The "known" consumer price index fell in 2016 by 0.3%.

[1] Data sources: Central Bureau of Statistics' publications, Bank of Israel, Ministry of Finance, Tel Aviv Stock Exchange

There was no change in the Bank of Israel interest rate during 2016 the rate remaining at 0.1%. In the interest notice for March 2017, the Monetary Committee noted that it continues to estimate that the monetary policy will remain expansive for some time and that it considers that the risk of attaining the inflation target remains high. However, it added that the increase in salary and the increase in inflation around the world are expected to support the return of inflation within the target.

Israeli capital market

The shares and convertible securities index fell by some 11.0% during 2016, following an increase of some 6.8% in 2015. The fall in the index occurred in the second half of the year, as the result of price falls on world stock exchanges, while, in the second half of the year, the index remained stable.

Average daily trading volumes of shares and convertible securities fell in the past year by 12.4%, compared with the average for 2015, and amounted to some NIS 1,269 million

The Government bond market was characterized during 2016 by a trend of increasing prices. The index for of index-linked Government bonds rose by 0.7%, while unlinked Government bonds increased by 1.2% (the fixed interest bond indices rose by 1.3%, while the variable interest (*Gilon*) bond index increased slightly by 0.1%). In the fourth quarter of 2016, price falls were posted, against a background of an increase in long-term yields around the world, in the United States, in particular, which impacted the market in Israel.

In the index-linked non-government debenture market (corporate bonds) in 2016, there were moderate price increases of some 4.1%, following price increases of some 0.8% in 2015.

Financial assets held by the public

The value of the portfolio of financial assets amounted to NIS 3,438 billion at the end of December 2016, an increase of 3.6% since the start of the year. The increase occurred against the background of the increase in most of the components of the asset portfolio (except for foreign shares). The weight of shares (in Israel and abroad) in the financial assets portfolio of the Israeli public reached some 22.2% at the end of December 2016, compared with some 22.9% in December 2015.

Developing risks in the activity environment

In the environment of the various risks, we would note that there were no significant changes during the year in the map of risk and threats, although there were changes in the relative strength of the various risks.

From the range of risks to which the banking system is exposed, we would note that the following risks are risks which increased in the recent period:

- Macro-economic risk
- Regulation risk
- Cyber and technology risk
- Conduct risk (Fair conduct with customers)

For further details of these risks, see Chapter in the Report on Risks "Exposure to Risk and Methods of Risk Management"

Material changes in items in the financial statements

Return on capital in 2016 amounted a rate of 9.3%, compared with 10.3% in 2015.

Net profit attributed to shareholders of the banking corporation (hereinafter "net profit") in 2016 amounted to NIS 2,791 million, compared with NIS 2,835 million in the corresponding period last year. The profit for the year was adversely impacted by an increase in tax expenses amounting to NIS 303 million as a result of a decrease in the companies tax rate. On the other hand, the profit was favorably affected by an insurance refund in respect of the arrangement with overseas authorities, a profit from the Visa Europe transaction and a recognition of a tax shield in respect of the liquidation and selling processes of subsidiaries. The effect of these items on the financial results for 2016 is significantly less than the effect of the profits from the sale of Israel Corporation and Mobileye and the sale of buildings on the United States (see below) on the financial results for 2016.

The ratio of Tier 1 shareholders' equity to risk assets materially improved during the period. This ratio stood at 11.16% at 31 December 2016, compared with 9.58% at 31 December 2015. For further details, see Note 25B.

On 29 March 2017, the Board of |Directors of the Bank approved the distribution of a dividend of 20% of the net profit with effect from the first quarter of 2017.

Net interest income increased by NIS 408 million, an increase of 5.7%, compared with to last year. The increase in net interest income in 2016 derives from an increase in the average balance of interest-bearing monetary assets (credit to the public, securities and deposits), which was offset by a moderate decrease in the interest gaps.

Expenses in respect of credit losses fell by NIS 324 million, compared with last year. In 2016, there was income amounting to NIS 125 million, reflecting a rate of income of (0.05%) of the net credit to the public. In the corresponding period last year, there was an expense of NIS 199 million, reflecting a rate of expense of 0.08% of net credit to the public. Most of the difference in relation to the corresponding period last year derives from significant collections made in the Bank's activity vis-à-vis large borrowers.

Noninterest financing income fell by NIS 328 million, compared with last year, the decrease being primarily attributable to the fact that last year the sales of the Israel Corporation (NIS 811 million) and Mobileye (NIS 288 million) and income from dividend in respect of the shares of Kenon Holdings (NIS 134 million) were recorded, while in 2016, income amounting to NIS 378 million deriving from the Visa Europe transaction was recorded. In addition, there was an increase in the reported period in profits from the sales of available-for-sale debentures, compared with the corresponding period last year.

Other income fell by NIS 436 million, compared with last year. The decrease is primarily attributable to income from the sale of buildings in the United States which were recorded in 2015.

Operating expenses fell by NIS 256 million or 2.9%, due to a fall in the level of salary expenses amounting to NIS 122 million (excluding the effect of special bonuses, salary expenses fell by NIS 300 million – see below) and a decrease in other expenses, principally as a result of an insurance refund received in the third quarter of the year in respect of an arrangement with overseas authorities in respect of the U.S. customers affair, amounting to NIS 235 million. On the other hand, other operating expenses increased mainly due to the insurance of sale guarantees made in the first half of the year.

The Group's share in net profits of companies included on equity basis fell by NIS 111 million, compared with the corresponding period last year, mainly against a background of equity profits amounting to NIS 114 million in respect of the Israel Corporation until the date of its sale last year.

The basic net profit per share attributable to the shareholders in the corporation in 2016 was NIS 1.85, compared with NIS 1.92 in 2015.

Principal Developments in Income, Expenses and Other Comprehensive Income[1]

The net profit attributable to the shareholders of the banking corporation (hereinafter "net profit") of Leumi Group in 2016 amounted to NIS 2,791 million, compared with NIS 2,835 million in 2015 – a decrease of 1.6%.

The changes in profit and loss items in 2016 compared with 2015 are as follows:

	For the year ended 31 December			
	2016	**2015**	Change	
	NIS millions		NIS millions	%
Net income interest	**7,526**	7,118	408	5.7
Expenses in respect of credit losses	**(125)**	199	(324)	-
Non-interest income	**5,408**	6,297	(889)	(14.1)
Operating and other expenses	**8,580**	8,836	(256)	(2.9)
Profit before taxes	**4,479**	4,380	99	2.3
Provision for tax	**1,717**	1,691	26	1.5
Profit after taxes	**2,762**	2,689	73	2.7
The Bank's share in profits (losses) of companies included on equity basis	**66**	177	(111)	(62.7)
Net profit attributed to non-controlling interests	**(37)**	(31)	(6)	19.4
Net profit attributed to shareholders in the banking corporation	**2,791**	2,835	(44)	(1.6)
Return on equity	**9.3**	10.3		
Basic profit per share	**1.85**	1.92		

Net interest income

Net interest income of Leumi Group in 2016 amounted to NIS 7,526 million. The increase in net interest income in 2016, compared with last year, was attributable to an increase in the average balance of interest-bearing monetary assets (credit to the public, securities and deposits). The increase in interest income was offset by a moderate decrease in interest margins.

The ratio of net interest income to the average balance of income-bearing assets (net return on income-bearing assets) was 1.94%, compared with 2.00% in the corresponding period in 2015.

Total Interest Margin in 2016 was 1.75%, compared with a margin of 1.98% in 2015.

Data on interest margins divided into segments are as follows:

In the unlinked shekel sector, the interest margin in 2016 was 2.05%, compared with 2.23% in the corresponding period last year. In the foreign currency segment, the interest margin was 1.14%, compared to 1.30% in the corresponding period last year. In the index-linked segment, the interest margin was 0.61%, compared with 0.44% in the corresponding period last year.

For further information, relating to interest income and expenses, see Appendix 1 – Rates of Income and Expenses and Analysis of Changes in Interest Income and Expenses.

(1) The financial statements are prepared in reported values. The known consumer price index fell by 0.3% in 2016. The shekel appreciated in nominal terms by 1.5% against the U.S. dollar, and appreciated against the euro by 4.8%. The representative rate of exchange of the U.S. dollar on 31 December 2015 was NIS 3.845.
For further details, see Note 1D.

Expenses in respect of credit losses

	For the year ended 31 December			
	2016	**2015**	Change	
	NIS millions		NIS millions	%
Individual income in respect of credit losses	**(757)**	(254)	(503)	-
Collective expense in respect of credit losses	**632**	453	179	39.5
Total expense (income) in respect of credit losses	**(125)**	199	(324)	-
Percentage ratios (in annual terms):				
Individual expense in respect of credit losses to total credit to the public, net	**(0.29)**	(0.09)		
Collective expense in respect of credit losses to total credit to the public, net	**0.24**	0.17		
Total expense (income) in respect of credit losses to total credit to the public, net	**(0.05)**	0.08		

Expenses in respect of credit losses of Leumi Group amounted to NIS 125 million in 2016, compared with NIS 199 million in 2015. In the Bank, expenses in respect of credit losses amounted to NIS 160 million in 2016, compared with NIS 149 million in 2015. Income in 2016 derive from significant collections made during the year.

For further information relating to credit loss expenses, see Chapter "Credit Risk, Disclosure, assessment, classification and rules of credit loss allowance", Note 13 and Note 30.

Noninterest Income

	For the year ended 31 December			
	2016	2015	Change	
	NIS millions		NIS millions	%
Noninterest financial income	**1,282**	1,610	(328)	(20.4)
Commissions	**3,967**	4,092	(125)	(3.1)
Other income	**159**	595	(436)	(73.3)
Total	**5,408**	6,297	(889)	(14.1)

The table below presents details of noninterest financing income:

	For the year ended 31 December			
	2016	2015	Change	
	NIS millions		NIS millions	%
Net income in respect of derivative instruments and exchange rate differences, net	**487**	53	434	+
Profits from sale of available-for-sale debentures, net	**357**	181	176	97.2
Profits from investments in shares including dividends (a)	**510**	1,303	(793)	(60.9)
Net profits (losses) in respect of loans sold	**44**	11	33	+
Realized and unrealized profits from adjustments to fair value of debentures and shares for trading,	**(116)**	62	(178)	-
Total	**1,282**	1,610	(328)	(20.4)

(a) In 2016, includes mainly income from the Visa Europe transaction amounting to NIS 378 million (see below). In 2015, mainly including profit from the sale of shares of the Israel Corporation, Mobileye and Derech Eretz amounting to NIS 811 million, NIS 288 million and NIS 100 million. In addition, in 2015, included a loss from the impairment, before the deduction of a dividend received, in respect of shares of Kenon Holdings amounting to NIS 152 million. All data is before the effect of tax.

(b) Net income in respect of derivative instructions and exchange rate differences, net, including income from interest margins, as well as exchange rate differences some of which were offset in other items in total income.

Visa Europe

On 3 November, 2015, the companies Visa Europe Ltd. and Visa Inc. (NYSE: V), gave notice regarding their engagement in an agreement according to which Visa Inc. will purchase Visa Europe. The Bank was a member in Visa Europe Ltd. and accordingly, is entitled to receive a share of the proceeds in accordance with a formula for allocating the proceeds between the members in Visa Europe.

In June 2016, the regulatory approvals required for completion of the Visa Europe transaction were received and the Bank received the proceeds in cash in respect of the transaction, amounting to 69 million euros (NIS 300 million). In addition, income amounting to NIS 78 million was recorded in respect of the right to future payments in cash and convertible shares.

The following table presents a breakdown of commissions:

	For the year ended 31 December			
	2016	2015	Change	
	NIS millions		NIS millions	%
Account management	**715**	762	(47)	(6.2)
Activity in certain securities and derivative instruments	**592**	675	(83)	(12.3)
Credit cards	**1,023**	963	60	6.2
Dealing with credit	**177**	200	(23)	(11.5)
Commissions for distribution of financial products	**287**	306	(19)	(6.2)
Conversion differences	**327**	325	2	0.6
Commissions from financing transactions	**534**	542	(8)	(1.5)
Other commissions	**312**	319	(7)	(2.2)
Total commissions	**3,967**	4,092	(125)	(3.1)

The decrease derives from a decrease in commissions related to the capital market as a result of the decrease in the scope of activity in securities, as well as the result of a decrease in various commission tariffs. The increase in commissions from credit cards derives mainly from an increase in the scope of activity. In addition, total income from commissions in 2016 was influenced by a decrease in the activity of the office in Switzerland, due to the completion of the sale of the activity to Julius Baer in the first quarter of 2015 and from the sale of the activity of the office in Luxembourg during the first quarter of 2016. The income from commissions constitutes 46% of the operating and other expenses similar to the corresponding period last year.

Details of other income are as follows:

	For the year ended December 31			
	2016	2015	Change	Percentage
	NIS millions		NIS millions	
Profits from severance pay fund	**27**	35	(8)	(22.9)
Other income – sale of buildings and equipment	**132**	560	(428)	(76.4)
Total	**159**	595	(436)	(73.3)

The decrease in other income derives a decrease in income from the sale of buildings which was affected by the timing of the sale of the buildings. The profit in 2015 was significantly affected by the sale of buildings in the subsidiary in the United States which yielded income amounting to NIS 380 million.

Operating and other expenses

	For the year ended December 31			
	2016	2015	Change	Percentage
	NIS millions		NIS millions	%
Salary and related expenses	**5,422**	5,544	(122)	(2.2)
Depreciation and amortization	**663**	660	3	0.5
Maintenance expenses of buildings and equipment	**1,034**	1,023	11	1.1
Other expenses	**1,461**	1,609	(148)	(9.2)
Total operating and other expenses	**8,580**	8,836	(256)	(2.9)

Total operating and other expenses of Leumi Group in 2016 amounted to NIS 8,580 million. The decrease, amounting to 2.9%, derives mainly from a decrease in salary expenses as set forth below and from a decrease in other expenses as a result of an insurance repayment received in respect of the arrangement with overseas authorities.

	For the year ended December 31			
	2016	2015	Change	Percentage
	NIS millions		NIS millions	%
Salary and related expenses	**3,891**	4,131	(146)	(3.5)
Yield bonus	**483**	522	(133)	(25.5)
Pension, severance pay and voluntary retirement expenses net of profits from funds	**955**	976	(21)	(2.2)
Total salary expenses excluding one-time bonuses	**5,329**	5,629	(300)	(5.3)
One-time bonus and effect of collective agreements (a)	**93**	(85)	178	+
Total salary expenses	**5,422**	5,544	(122)	(2.2)

(a) In 2016, includes a signing-on bonus to employees for implementing the efficiency program and, in 2015, includes a bonus on signing the collective agreements.

Salary expenses in 2016, excluding non-recurring bonuses, fell, compared with the corresponding period last year by NIS 300 million. The decrease, amounting to 5.5%, derives from a decrease in the number of positions and a change in the mix of the employees and the closure of the offices in Switzerland and Luxembourg. This decrease was partly offset due to the one-time effects of the salary agreement in 2015 and the signing-on bonus granted in 2016.

For further information, see Note 23L.

Salary and related expenses account for 63% of total operating expenses similar to last year.

Operating and other expenses (excluding salary)

Operating and other expenses, excluding salary, amounted to NIS 3,158 million in 2016, compared with NIS 3,292 million in 2015, a decrease of 4.1%, mainly due to a decrease in other expenses as a result of an insurance refund amounting to NIS 235 million received in respect of an arrangement in overseas authorities. This decrease was mainly offset by an increase in insurance expenses as a result of the insurance of Sales Law guarantees which were effected for the first time this year.

For further information, see Notes 6 and 7.

Operating expenses constitute 66% of total income, similar to last year.

Tax expenses

Provision for taxes on profit of Leumi Group for 2016 amounted to NIS 1,717 million, compared with NIS 1,691 million in 2015. The rate of the provision in 2016 was some 38.3% of the pre-tax profit, compared with 38.6% in 2015, a decrease of some 0.3 percentage points.

The provision for tax for the year compared with the corresponding period last year was affected mainly by the recording of a tax expense amounting to NIS 303 million due to the decrease in the balance of net deferred taxes as a result of a fall in the tax rate from 26.5% to 24% in 2017 and to 23% as of 1 January 2018 and thereafter, and from a decrease in net exempt and preferred income compared to 2015. On the other hand, the effect of NIS 195 million due to the liquidation and sale proceedings of subsidiaries reduced the tax effect.

Profits of companies included on equity basis

Profits of companies included on equity basis amounted to a profit of NIS 66 million in 2016, compared with a profit of NIS 177 million in 2015.

The decrease derives from sale of shares in the Israel Corporation in the first quarter of 2015 and from the classification of the investment in the Israel Corporation from 31 March 2015 in the available-for-sale securities portfolio according to the market value of the investment as at 31 March 2015. In the second quarter of 2016, the Bank sold the balance of the shares held in the Israel Corporation.

For further information, see Chapter, Securities.

Profits of companies included on equity basis in 2016 include mainly profits from companies included on equity basis of the subsidiary, Leumi Partners.

For further information, see chapter "Companies included on equity basis".

Investments and expenses of the Bank in respect of the Technological Data Department in 2016

Expenses recorded in the statement of the profit and loss amounted to NIS 1,548 million (NIS 1,503 million in 2015), of which NIS 555 million was recorded in salary and related expenses (NIS 450 million in 2015) and NIS 582 million (NIS 593 million in 2015 in depreciation expenses) and NIS 411 million in other expenses (NIS 460 million in 2015).

Costs in respect of the Technological Data Department not recorded in statement of profit and loss but recorded as assets in the financial statements in 2016 amounted to NIS 695 million, compared with NIS 682 million in 2015.

The balance of assets in the balance sheet in respect of the Technological Data Department as of 31 December 2016 amounted to NIS 1,616 million, compared with NIS 1,651 million as of 31 December 2015.

The following table presents a statement of comprehensive income:

	For the year ended 31 December 2016						
	Other comprehensive income before attribution to non-controlling interests						
	Adjustments for presentation of securities available for sale at fair value	Translation adjustments (a), net after effect of hedges (b)	Banking corporation's share in other comprehensive income of investee companies dealt with under the equity method	Adjustments in respect of employee benefits	Total	Other comprehensive income attributed to non-controlling interests	Other comprehensive income attributed to shareholders of the Bank
	NIS millions						
Balance at 1 January 2014	179	(314)	100	(1,020)	(1,055)	(4)	(1,051)
Net changes during the year	215	249	(78)	(884)	(498)	-	(498)
Balance at 31 December 2014	394	(65)	22	(1,904)	(1,553)	(4)	(1,549)
Net changes during the year	(327)	(2)	16	414	101	-	101
Balance at 31 December 2015	**67**	**(67)**	**38**	**(1,490)**	**(1,452)**	**(4)**	**(1,448)**
Net changes during the year (c)	**(153)**	**(12)**	**(20)**	**(679)**	**(864)**	**-**	**(864)**
Balance at 31 December 2016	**(86)**	**(79)**	**18**	**(2,169)**	**(2,316)**	**(4)**	**(2,312)**

(a) Adjustments from the translation of financial statements of foreign activities which, from the nature of their activity differs from the functional currency of the banking corporation, including adjustments in respect of companies included on equity basis.

(b) Net profits (losses) in respect of net hedging of investment in foreign currency.

(c) The change in the year amounts to a total of NIS 864 million, mainly due an increase in adjustments in respect of employee benefits against the background of the efficiency program in 2016.

Structure and Development of Assets and Liabilities, Capital and Capital Adequacy

Total Assets of the Leumi Group on 31 December 2016 amounted to NIS 438.6 billion, compared with NIS 416.5 billion at the end of 2015, an increase of 5.3%. The Bank's total assets on 31 December 2016 amounted to NIS 413.0 billion, compared with NIS 387.8 billion at the end of 2015, an increase of 6.5%.

Out of the Group's total assets, the value of assets denominated in or linked to foreign currency was some NIS 89.8 billion, some 20.5% of total assets. In 2016, the shekel depreciated against the U.S. dollar by 1.5% and against the euro by 4.8%. The change in the exchange rates of the shekel against foreign currencies contributed to a decrease of 0.6% in the Group's total balance sheet, so that canceling the effect of the appreciation of the shekel, the total balance sheet increased to NIS 441.3 billion.

Total assets under the Group's management – The total balance sheet as well as customers' securities portfolios, and provident funds and supplementary training funds in relation to which operational management and deposit management services are provided – amounted to NIS 1,259 billion, compared with NIS 1,214 billion at the end of 2015, an increase of 3.7% (about US$ 328 billion and US$ 311 billion, respectively).

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

	Consolidated			
	31 December			
	2016	2015	Change	
	NIS millions		NIS millions	%
Total assets	**438,603**	416,499	22,104	5.3
Cash and deposits with banks	**74,757**	60,455	14,302	23.7
Securities	**77,201**	69,475	7,726	11.1
Credit to the public, net	**261,913**	261,399	514	0.2
Buildings and equipment	**3,147**	3,095	52	1.7
Deposits of the public	**346,854**	328,693	18,161	5.5
Deposits from banks	**3,394**	3,859	(465)	(12.0)
Debentures, notes and subordinated notes	**22,640**	21,308	1,332	6.3
Equity attributed to the shareholders of the banking corporation	**31,347**	28,767	2,580	9.1

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

	Consolidated			
	31 December			
	2016	2015	Change	
	NIS millions		NIS millions	%
Documentary credits, net	**1,418**	1,755	(337)	(19.2)
Guarantees securing credit, net	**5,730**	6,058	(328)	(5.4)
Guarantess to apartment purchasers, net	**19,538**	19,292	246	1.3
Other guarantees and liabilities, net	**15,623**	16,903	(1,280)	(7.6)
Derivative instruments (a)	**644,454**	616,885	27,569	4.5
Options of all types	**91,986**	111,125	(19,139)	(17.2)

(a) Including "forward" transactions, financial exchange transactions, futures, swaps and credit derivatives

For further information, see Note 28A and 28B

3. **The following table sets out the development of balances of customers' off-balance sheet financial assets with the Leumi Group:**

	31 December 2016	31 December 2015	Change	
	NIS millions		NIS millions	%
Securities portfolios (a)	**610,082**	593,665	16,417	2.8
Assets in respect of which operating services are provided: (a)(b)(c)				
Mutual funds	**47,636**	59,451	(11,815)	(19.9)
Provident and pension funds	**78,189**	71,221	6,968	9.8
Supplementary training funds	**84,774**	73,569	11,205	15.2

(a) Including a change in market value of securities and the value of securities of mutual and provident funds held in custody, in respect of which operational management and custodial services are provided.

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

(c) Assets of customers in relation to which the Group provides operational management services, including balances of the funds of customers who receive counseling at Leumi.

Credit to the public, net

Credit to the public in the Leumi Group at the end of 2016 amounted to NIS 261.9 billion, similar to last year. Credit to the public constitutes 59.7% of total assets, compared with 62.8% at the end of 2015.

The change of the exchange rate of the shekel against all foreign currencies contributed to a decrease of 0.6% in total credit to the public. Excluding the effect of the appreciation, there was an increase of 0.8% in total credit to the public, so that excluding the effect of the appreciation of the shekel, total credit was NIS 263.4 billion.

As well as granting credit to the public, the Group invests in the securities of companies, amounting to NIS 13,488 million at the end of 2016, compared with NIS 14,095 million at the end of 2015. These investments also involve credit risk.

Total credit to the public by the Group in Israel amounted to some NIS 238.3 billion at the end of 2016, compared to NIS 238.1 billion at the end of 2015.

Credit to the public in unlinked shekels, at 31 December 2016, represents 68.6% of total credit, while at 31 December 2015, it represented 66.1 of total credit. Against the increase in the weight of the unlinked credit, there was a decrease, mainly in index-linked credit which, at 31 December 2016, represented 16.9% of total credit, compared with 18.8% at 31 December 2015.

The following table sets out the development of credit to the public, before the allowance for credit losses, by principal operating segment:

	31 December 2016	31 December 2015	Change	
	NIS millions	NIS millions	NIS millions	%
Individuals - housing loans	**79,131**	81,805	(2,674)	(3.3)
Individuals - other	**38,557**	37,986	571	1.5
Construction and real estate	**48,994**	49,912	(918)	(1.8)
Commercial	**27,344**	26,548	796	3.0
Industry	**18,554**	20,251	(1,697)	(8.4)
Other	**52,870**	48,568	4,302	8.9
Total	**265,450**	265,070	380	0.1

For further details on the development of credit and credit risks according to market sector, see chapter "Credit risk".

Problem debts

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

	31 December 2016			31 December 2015		
	Balance sheet	Off-balance sheet	Total	Balance sheet	Off-balance sheet	Total
	NIS millions			NIS millions		
Impaired debts	**2,942**	**176**	**3,118**	3,037	150	3,187
Substandard debts	**1,013**	**74**	**1,087**	1,172	220	1,392
Special mention debts	**2,233**	**1,190**	**3,423**	2,498	851	3,349
Total	**6,188**	**1,440**	**7,628**	6,707	1,221	7,928

Problem credit risk:

	31 December 2016	31 December 2015
	NIS millions	
Commercial problem credit risk	**7,984**	8,461
Retail problem credit risk	**1,427**	1,303
Total	**9,411**	9,764
Allowance for credit losses	**1,783**	1,836
Problem credit after allowance for credit losses	**7,628**	7,928

For additional information on problem credit, see chapter "Credit Risk"

Securities

Policy for managing investments in securities (*Nostro*)

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

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

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

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

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

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

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

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

The Group’s investments in securities as at 31 December 2016 amounted to NIS 77.2 billion, compared with NIS 69.5 billion in 2015, an increase of 11.1%.

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

The classification of a security purchased by the Bank for the available-for-sale securities portfolio or for the trading securities portfolio is done at the date of purchase and is carried out in accordance with the Bank's intention for the use of the securities. Securities that are purchased for the purposes of trading (or with the aim of hedging other components of the trading portfolio), for the purposes of market-making or within the framework of the dealing room, are classified to the trading portfolio, while securities purchased as part of managing the Bank's assets and liabilities are classified in the available-for-sale portfolio.

Securities for trading are presented in the balance sheet at fair value, and the difference between fair value and adjusted cost is charged to the statement of profit and loss. Available-for-sale securities are presented in the balance sheet at fair value, with the difference between fair value and adjusted cost presented as a separate item in shareholders' equity in other overall profit, called "adjustments for presentation of available-for-sale securities at fair value" less the related tax. Whenever the impairment is of a non-temporary nature, the difference is charged to the statement of profit and loss.

Method of calculating fair value

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

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

The following table sets out the classification of the securities item in the consolidated balance sheet:

	31 December 2016			31 December 2015		
	Securities available for sale	Trading securities	Total	Securities available for sale	Trading securities	Total
	NIS millions					
Government of Israel	**35,409**	**5,091**	**40,500**	28,553	6,664	35,217
Foreign governments	**11,929**	**2,458**	**14,387**	8,128	3,058	11,186
Financial institutions in Israel	**23**	**159**	**182**	35	238	273
Foreign financial institutions.	**7,460**	**104**	**7,564**	6,262	148	6,410
Asset-backed (ABS) or mortgage-backed (MBS)	**9,749**	**280**	**10,029**	9,566	751	10,317
Others in Israel	**296**	**132**	**428**	586	152	738
Others abroad	**1,882**	**286**	**2,168**	1,694	320	2,014
Shares and mutual funds	**1,942**	**1**	**1,943**	2,703	617	3,320
Total securities	**68,690**	**8,511**	**77,201**	57,527	11,948	69,475

(a) Includes unrealized profits (losses) from adjustments to fair value of losses amounting to NIS (92) million which were recorded in other comprehensive income (31 December 2015 – NIS 294 million)

(b) Includes unrealized profits (losses) from adjustments to fair value amounting to profits of NIS 9 million which were recorded in profit and loss (31 December 2015 –losses of NIS 100 million)

As at 31 December 2016, 89.0% of the Group's *nostro* portfolio was classified as available-for-sale securities and 11.0% as the trading portfolio 2.5% of the value of the securities represents investments in shares of companies that are not presented on equity basis, but according to cost or to the market value of the shares traded on the stock exchange.

For details in the value of securities according to the method of measurement, see Note 33A.

Available-for-sale portfolio

1. In 2016, there was a decrease in other comprehensive income in respect of available-for-sale securities amounting to NIS 281 million (before the effect of tax). The decrease derives from securities which were sold and classified to profit and loss amounting to NIS 851 million (before tax) which was offset by an increase as a result of a rise in value amounting to NIS 570 million. This compared with an increase in other comprehensive income in respect of available securities amounting to NIS 355 million (before tax) in 2015, compared with 2014, which derived from the sale of securities amounting to NIS 792 million which partly offset by a decrease in value amounting to NIS 369 million (before tax).

2. In addition, NIS 357million was recorded to profit and loss, in respect of net profits from the sale of available-for-sale debentures, compared with profits of NIS 181 in 2015.

The accumulated net balance of adjustments to fair value of securities held in the available-for-sale portfolio, as at 31 December 2016, amounted to a negative amount of NIS 86 million (after the effect of tax) compared with a positive balance of NIS 67 million at the end of 2015. These amounts represent net profits which had not been realized at the dates of the financial statements.

For details regarding adjustment to fair value of available-for-sale securities which were charged to equity, see Note 12.

Trading portfolio

On 31 December 2016, there was NIS 18.5 billion of debentures and just NIS 1 million in shares, compared with NIS 11.3 billion of debentures and NIS 617 million of shares at 31 December 2015. As of 31 December 2016, the trading portfolio constitutes 11.0% of the Group's total *nostro* portfolio, compared to 17.2% at 31 December 2015.

For further information relating to the composition of the portfolio, see Note 12.

In respect of trading debentures, realized and unrealized losses amounting to NIS 84 million were recorded in the statement of profit and loss, compared with losses amounting to NIS 67 million in 2015, and in respect of shares and funds, realized and unrealized losses were recorded amounting to NIS 32 million, compared with losses of NIS 5 million in 2015.

Investments in securities issued abroad

A. Investments in asset-backed securities issued abroad

The Group's asset-backed securities portfolio (both mortgage-backed and non-mortgage-backed), all of which is rated investment grade, amounted to NIS 10.0 billion (US$ 2.6 billion) at 31 December 2016, compared with NIS 10.3 billion at 31 December 2015. Of the said portfolio as of 31 December 2016, NIS 9.7 billion (US$ 2.5 billion) is classified in the available-for-sale portfolio and the balance in the trading portfolio.

The available-for-sale portfolio of investments in asset-backed securities abroad as at 31 December 2016 includes an investment in mortgage-backed debentures amounting to NIS 8.0 billion. Most of the holding of the total mortgage-backed debentures in the available-for-sale portfolio were issued by federal agencies in the United States (GNMA, FHLMC and FNMA) and rated at the date of the report as AAA.

As at 31 December 2016, the accumulated net impairment charged to shareholders' equity resulting from the mortgage-backed securities portfolio was NIS 16.1 million.

The total of the asset-backed debentures, which are not in the U.S. State guarantee and are not covered by U.S. federal institutions in the available-for-sale portfolio and the trading portfolio, amounts to some NIS 1,357 million.

The projected term to maturity for all the mortgage-backed securities portfolio is an average of 4.4 years. In addition to mortgage-backed securities, the Group's available-for-sale portfolio also includes other securities backed by assets other than mortgages (car financing credit and other types of credit), amounting to some NIS 1.8 billion. Of these, CLO-type debentures amount to NIS 1.4 billion. The projected term to maturity of the debenture portfolio backed by assets other than mortgages is 3.2 years on average.

For further information regarding investments in asset-backed debentures, see Note 12.

B. Investments in non-asset backed securities issued abroad

The Group's securities portfolio as at 31 December 2016 includes some NIS 27.2 billion (US$ 7.1 billion) of non-asset-backed securities issued abroad. Of these securities, NIS 24.3 billion (US$ 6.3 billion) are classified in the available-for-sale portfolio, with the balance in the trading portfolio.

For further information regarding exposure to overseas financial institutions, see chapter, "Credit Risk".

As at 31 December 2016, aggregate increase in value in shareholders' equity in respect of non-asset-backed securities issued abroad in the available-for-sale portfolio amounted to NIS 45 million (NIS 28 million after tax).

As stated above, in addition to the available-for-sale portfolio, the securities portfolio also includes non-asset backed securities in the trading portfolio. This includes mainly securities of states, banks and financial institutions, and securities funds. Most of the securities in the trading portfolio are of **investment grade**.

The value of the non-asset backed trading portfolio as of 31 December 2016 amounted to NIS 2.8 billion (US$ 0.7 billion). The difference between fair value and adjusted cost, if there is such a difference, is recorded in the profit and loss account.

Investments in debentures - issued in Israel

Investments in debentures issued in Israel amounted to NIS 39.6 billion on 31 December 2016, of which NIS 39.0 billion was in debentures issued by the Government of Israel in shekels, with the balance in debentures of the Government of Israel in foreign currency and debentures issued by companies. Some 52.3% of the investments in corporate debentures amounting to NIS 0.3 billion were included in the available-for-sale portfolio, and the balance was in the trading portfolio.

Corporate debentures in the available-for-sale portfolio amounting to NIS 0.3 billion includes a positive capital reserve amounting to NIS 17.

All the corporate debentures in the trading portfolio and part of those in the available–for-sale portfolio are listed and traded on the Stock Exchange. The revaluation of the traded corporate debentures is based on market prices on the stock exchange, and the revaluation of the non-listed corporate debentures is carried out as described above.

Investments in shares and funds

Total investments in shares and funds amounted to some NIS 1,943 million on 31 December 2016, of which NIS 962 million was in listed shares and NIS 981 million was in non-listed shares. Of the total investment, NIS 1,942 million is classified in the available-for-sale portfolio and NIS 1 million is classified in the trading portfolio.

The capital required in respect of these investments at 31 December 2016 was NIS 243 million.

For further information, see Note 12.

Risk management objectives and policy with regard to investment in shares

Investment policy:

The Bank has defined the Group's investment policy to include setting limits for the volume of overall investment and in a single company, the investment mix, and the various levels of risk between types of non-banking investments.

Definition of the aim of the investment:

- Achieving a higher return in comparison with a *nostro* financial investment;
- Maximizing the value of the investment and achieving better investment terms by leveraging the reputation of the Leumi Group;
- Widening the spread of risk and varying the Group's sources of revenue;
- Moderating the volatility of the *nostro* portfolio (time gaps).

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

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

The Israel Corporation

On 21 April 2016 the Bank sold, in a deal outside of the Stock Exchange, the remaining shares that it held in the Israel Corporation Ltd., representing 5.86% of the issued and paid up capital of the Israel Corporation, in consideration of shares of Israel Chemicals Ltd. (ICL) which is about 1.4% of the issued and paid up capital of ICL. Profit before tax recorded by the Bank in respect of the sale of the shares is some NIS 87 million.

ICL

In the second quarter of 2016, the Bank sold NIS 16.8 million shares of ICL, representing about 1.3% of the issued and paid-up capital of ICL. The loss before tax recorded by the Bank in respect of the sale of the shares was about NIS 38 million.

In the third quarter of 2016, the Bank sold the balance of the shares in ICL, representing 0.09% of the issued and paid-up capital of ICL. The Bank recorded a loss before tax amounting to NIS 3 million in respect of the sale of the shares.

Kenon

On 23 June 2016, the Bank sold 3.8 million shares in Kenon Holdings Ltd (hereinafter: "Kenon") representing some 7.08% of the issued and paid-up capital of Kenon, to Ansonia Holdings Singapore B.V. The profit before tax recorded by the Bank in respect of the sale of the shares was about NIS 9.5 million.

In the first quarter of 2017, the Bank sold the balance of the shares it held in Kenon. The profit before tax recorded by the Bank in respect of the sale of the shares amounted to NIS 13.5 million.

For further information regarding a lien on securities, see Note 27.

Deposits of the Public

Deposits of the public in the Group amounted to NIS 346.9 billion at the end of 2016, compared with NIS 328.7 billion at the end of 2015, an increase of 5.5%.

The change in the exchange rate of the shekel against all foreign currencies reduced total deposits of the public by 0.9%, so that, excluding the effect of changes in the exchange rates, the increase in deposits of the public was 6.4%.

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

	31 December 2016			
	On demand	Short-term	Savings schemes	Total
	NIS millions			
Israeli currency:				
Unlinked	**126,241**	**89,939**	**-**	**216,180**
CPI-linked	**-**	**18,119**	**2,270**	**20,389**
Foreign Currency:				
Including linked to foreign currency	**65,248**	**44,529**	**-**	**109,777**
Non-monetary	**-**	**508**	**-**	**508**
Total	**191,489**	**153,095**	**2,270**	**346,854**

	31 December 2015			
	On demand	Short-term	Savings schemes	Total
	NIS millions			
Israeli currency:				
Unlinked	108,688	86,737	-	195,425
CPI-linked	-	23,152	2,431	25,583
Foreign currency:				
Including linked to foreign currency	57,458	49,763	-	107,221
Non-monetary	-	464	-	464
Total	166,146	160,116	2,431	328,693

Developments in the various types of deposits were as follows:

- Unlinked shekel deposits of the public fell by NIS 20.8 billion, compared with 31 December 2015, mainly as a result of an increase in deposits on demand.
- Deposits of the public denominated in or linked to foreign currency decreased by NIS 2.6 billion, an increase of 2.4|%, compared with 31 December 2015, and excluding the effect of the changes in the exchange rate of the shekel, these deposits rose by 5.2%.
- CPI-linked shekel deposits fell by NIS 5.2 billion, compared with 31 December 2015, mainly in fixed term deposits.

Deposits from Governments

Deposits from Governments amounted to some NIS 900 million at the end of 2016, an increase of NIS 150 million, compared to 2015.

This item includes deposits of foreign governments in overseas offices which, at the end of 2016, amounted to NIS 722 million, compared with NIS 604 million at the end of 2015, and deposits from government sources which were extended to the banks in previous years mainly for restructuring debts of the kibbutzim and deposits for granting housing loans to eligible members of the public.

Deposits with banks and deposits from banks

A. Deposits with banks (central and commercial):

	31 December 2016		31 December 2015	
	Central banks	Commercial banks	Central banks	Commercial banks
	NIS millions			
Israeli currency:				
Unlinked	**60,371**	**590**	46,777	1,474
CPI-linked	**-**	**247**	-	246
Foreign currency including linked to foreign currency	**6,425**	**4,361**	5,279	3,619
Total deposits with banks	**66,796**	**5,198**	52,056	5,339

Total deposits with banks increased by 25.4%.

B. Deposits from banks (central and commercial):

	31 December 2016		31 December 2015	
	Central banks	Commercial banks	Central banks	Commercial banks
	NIS millions			
Israeli currency:				
Unlinked	**-**	**987**	-	1,886
CPI-linked	**-**	**18**	-	72
Foreign currency including linked to foreign currency	**-**	**2,389**	-	1,901
Total deposits with banks	**-**	**3,394**	-	3,859

By law, the Bank of Israel is permitted to provide loans to banking corporations against collateral. The Bank uses its deposits with the Bank of Israel for this purpose, as well as a pledge against its securities portfolio.

On 31 December 2016, deposits of the Group with the Bank of Israel amounted to NIS 60.6 billion, against which there were no loans from the Bank of Israel.

As may be seen from these tables, the liquidity position of the Group is extremely high, and the Group has net deposits with banks amounting to NIS 68.6 billion.

Debentures, capital notes and subordinated notes

	31 December 2016	31 December 2015	Change	
	NIS millions			%
Debentures and notes	**6,444**	3,182	3,262	+
Subordinated notes	**16,196**	18,126	(1,930)	(10.6)
Total	**22,640**	21,308	1,332	(10.0)

Shelf prospectus and issue of debentures

On 28 May 2016, the Bank published a shelf prospectus in accordance with a permit received from the Securities Authority.

On 21 January 2016, the Bank made a further issue of Series 177 under the above shelf prospectus amounting to about NIS 3.6 billion.

Series 177 debentures are due for repayment in one installment on 30 June 2020, are linked as to principal and interest to the consumer price index and bear interest of 0.59% per annum, payable twice a year on 30 June in the years 2016 to 2020 (inclusive) and on 31 December in the years 2016 to 2019 (inclusive).

Debentures are not recognized for purpose of regulatory capital.

Pursuant to a shelf proposal dated 20 January 2016, on 21 January 2026, the Bank issued a total of NIS 926 million of Series 400 deferred notes.

The deferred notes are due for maturity in one lump-sum on 21 January 2026, with an option for the issuer for early repayment not before 21 January 2021 and not after 21 February 2021, are not linked to any linkage base, and bear interest of 3.25% per annum. On this date, given the failure to exercise the Bank's right to early redemption, the nominal interest in the fee will be updated according to the difference between the anchor interest (as defined in the shelf proposal report) on the date of the issue and that which is on the update of the interest.

On fulfillment of circumstances for a defined event (a defined event for non-existence or a defined event for absorbing principal losses, whichever is earlier), the deferred notes will be converted to shares at the fair value of the shares on the conversion date or at the floor rate which is determined (NIS 6.78 per share), whichever is higher.

These notes are eligible for inclusion in Tier 2 from the date of issue.

Early redemption of deposits / deferred capital notes

On 26 January 2017, the Board of Directors of the Bank resolved to redeem during June-July 2017 by full early redemption NIS 400,000,000 par value of deposits / deferred capital notes (not marketable) index linked which were offered in 2002. The estimated amount of the redemption of the capital notes (including linkage differences) is NIS 500 million. The full early redemption will be effected in accordance with the right held by the Bank to effect a full early redemption according to the terms of the capital notes.

Capital Resources and Capital Adequacy

Capital attributable to the shareholders of the banking corporation (hereinafter "capital") of the Group as at 31 December 2016 amounted to NIS 31,347 million, compared with NIS 28,767 million at the end of 2015, an increase of 9.0%. The increase derives, inter alia, from the net profit for the period and the issue of shares to employees and office-holders amounting to NIS 636 million pursuant to a special collective agreement relating to the conversion of employee rights to the shares of the Bank.

.Capital to total assets as at 31 December 2016 reached 7.1%, compared to 6.9% as at 31 December 2015.

Capital adequacy structure

	31 December 2016	31 December 2015
	Audited	Audited
	NIS millions	
Capital for purposes of calculating capital ratio		
Tier 1 shareholders' equity, after regulatory adjustments and deductions	**32,586**	29,001
Tier 2 capital, after deductions	**11,850**	12,593
Total capital	**44,436**	41,594
Weighted balances of risk assets		
Credit risk	**266,534**	277,034
Market risk	**4,788**	5,167
Operational risk (b)	**20,843**	20,432
Total weighted balances of risk assets	**292,165**	302,633
Ratio of capital to risk components		
Ratio of Tier 1 shareholders' equity to risk components	**11.15%**	9.58%
Ratio of total capital to risk components	**15.21%**	13.74%

Implementation of the Basel III directives in Israel

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

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

1. Tier 1, including Tier 1 shareholders' equity and additional Tier 1 capital;
2. Tier 2 capital.

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

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

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

In addition to the above, adjustments to Tier 1 shareholders' equity are included, arising from the implementation of an operating streamlining program and from the method of calculating of capitalization interest used to compute the obligation for employee rights, as detailed below.

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

Tier 2 capital:

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

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

With regard to the capital instruments which were included in Tier 2 capital on 31 December 2013, the transitional provisions and the asset recognition ceiling which was computed to 1 January 2014, according to 80% of the balance of instruments as of 31 December 2013, were determined, and at the beginning of each successive year, this ceiling is lowered by 10%until 1 January 2022 (in 2016, 60% of the balance was recognized.). The capital instruments which were part of Tier 2 at 31 December 2013 include compound capital instruments which were, till now, classified to upper Tier 2 capital, and deferred notes, which were classified to lower Tier 2.

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

It should be noted that the amount actually recognized as Tier 2 capital is the lower of the amortized amount of the instruments themselves and their recognition ceiling according to the transitional provisions. From the beginning of 2014, capital instruments to be issued are required to comply with all the criteria set forth in Proper Conduct of Banking Business Management Regulation No. 202 for the purpose of their inclusion in capital. The main criteria are that the instrument must include: (1) a mechanism for absorbing the losses of the reserve by conversion to ordinary shares or the amortization of the instrument when the Tier 1 shareholders' equity ratio of the banking corporation falls below 5%; (2) an item determining that, on the occurrence of the defining event for non-compliance (as defined in Appendix E to Proper Conduct of Banking Business Regulation no. 202), the instrument will be converted immediately to ordinary shares or will be expunged.

For further information on the issue, see chapter "Structure and development of the balance sheet, debentures, capital notes and deferred notes".

Restrictions on capital structure

Proper Conduct of Banking Business Regulation no. 202 provides restrictions on capital structure:

- Tier 2 capital must not exceed 100% of Tier 1 capital, after the required deductions from this capital.
- The capital instruments eligible to be included in Tier 2 capital must not exceed 50% of Tier 1 capital after the required deductions from this capital. This restriction does not include the capital instruments included prior to the inception of this directive in Upper Tier 2 capital, this at the amount of the balance of those instruments as of 31 December 2013, and in accordance with the transitional provisions provided in Proper Conduct of Banking Business Regulation no. 299 (Regulatory Capital – Transitional Provisions)

Capital adequacy target

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

The capital adequacy targets prescribed by the Bank of Israel are as follows:

Pursuant to Proper Conduct of Banking Business Regulation 201, "Measurement and Capital Adequacy – Introduction, Incidence and Calculation of Requirements", all banking corporations are required to comply with a minimum Tier 1 capital ratio of 9% with effect from 1 January 2015. In addition, a large banking corporation, whose total balance sheet assets on a consolidated basis constitutes at least 20% of the balance sheet assets in the banking system in Israel, is required to comply with a minimum Tier 1 capital ratio of 10%, with effect from 1 January 2017. This additional provision applies to the Bank. In addition, all banking corporations in Israel are required to maintain a minimum overall capital ratio of 12.5% from 1 January 2015. A large banking corporation will be required to maintain a minimum overall capital ratio of 13.5% by 1 January 2017. Leumi is subject to this additional directive.

On 28 September 2014, the Supervisor of Banks published a circular for an amendment to Proper Conduct of Banking Business Management Regulation no. 329 "Restrictions on the Grant of Housing Loans". Pursuant to the amended directive, the banking corporation will be required to increase Tier 1 shareholders' equity target at a rate expressing 1% of the balance of housing loans. The date for commencing compliance with the capital target determined is 1 January 2017, and banking corporations are to increase the capital target in fixed quarterly rates from 1 January 2015 until 1 January 2017. The effect of the amendments to the regulation on Leumi Group at the final effective date is 0.27% of the capital adequacy ratio, with the effect being spread in accordance with the regulation over eight quarters.

Capital adequacy targets prescribed by the Bank:

Capital planning in Leumi Group reflects a forward-looking vision of the risk appetite and the capital adequacy required as a result thereof. The Group policy approved by the Board of Directors is to strengthen a higher level of capital adequacy than the minimum threshold that will be periodically specified by the Bank of Israel and will not be less than the rate required for covering risks as estimated in the ICAAP process. In addition, targets that the Group wishes to meet in the event of a stress scenario have been defined.

As part of the regulatory review procedure, the Supervisor directed the determination of internal capital targets which matched the Bank's risk profile. Further thereto, the Board of Directors of the Bank approved an increase in the Bank's internal Tier 1shareholders' equity target such that from 31 December 2017, it will stand at 10.5%. This target was ratified by the Board of Directors in January 2017.

The regulations regarding employee rights, which were initially implemented in January 2015, were the significantly influencing factor on Leumi's Tier 1 shareholders' equity, mainly due to the fact that the measurement of the liability is in accordance with market interest rates which is at historically low levels and due to the high volatility that this kind of measurement brought to the Bank's regulatory capital.

In this context, on 12 July 2016, the Bank received specific approval from the Bank of Israel regarding the method of calculating the capitalization interest to be used in computing the liability for employee rights for the purpose of measuring regulatory capital. Pursuant to the approval, capitalization interest will be calculated according to a moving average of the market yield for a period of eight quarters ended on the reporting date. The change is being implemented from the financial statements for the period ended 30 June 2016 and through the financial statements for 31 December 2020 (inclusive). The change in the method has significantly moderated the fluctuations arising from changes in capitalization interest. The change in the method of calculation increased regulatory capital as of 30 June 2016, amounting to NIS 380 million.

On 15 November 2016, the Board of Directors of the Bank resolved, based on the recommendation of the Audit Committee, to calculate the pension liability to employees, a fixed margin of international AA-rated debentures. The effect of the change on regulatory capital as of 30 September 2016 totaled NIS 296 million.

For further information, relating to the discounting methodology, see Chapter, Accounting Policy and Estimates on Critical Subjects

As of December 2016, the Bank's Tier 1 shareholders' equity ratio is 11.15%. During 2016, a number of significant measures were completed which improved the capital adequacy ratio, including:

- **Conversion of employee rights to the Bank's shares:** On 20 March 2016, the Board of Directors of the Bank approved the issuance of shares to employees and office holders. The total amount of the employee and office-holder rights that was converted to the Bank's shares, amounts to NIS 636 million. The value of the Bank's shares for the purpose of converting rights is NIS 13.0 (closing rate of the Bank's shares on 6 March 2016). Accordingly, the Bank's Board of Directors approved an issuance of 48,938,037 shares, constituting 3.21% of the issued and paid-up capital of the Bank (after the allocation). The shares were allocated to a trustee who will hold the shares in trust on behalf of the employees, in accordance with the instructions of Section 102 of the Income Tax Ordinance. The increase in capital resulting from this conversion of rights improved the Tier 1 shareholders' equity adequacy ratio of the Bank by 0.24%, as of 31 March 2016.

  For further information on the special collective agreement see Note 23L.

- **Insurance for portfolio of guarantees by virtue of Sales Law -** On 8 March 2016, the Bank entered into an agreement with international reinsurers with high international-rating to purchase insurance for the portfolio of guarantees by virtue of the Sales Law (Apartments) and obligations to take out guarantees as aforesaid. The insurance policy ensures the Bank in the event that it will have to pay due to the realization of the guarantees, all according to the terms of the policy. The purchase of the insurance policy enables the reduction of the restricted capital in respect of the risk of the credit deriving from the issue of the guarantees, while using the policy as a "credit risk mitigation policy", in accordance with Proper Conduct of Banking Business Directive No. 203, and contributed to an improvement of 0.23% in the Bank's Tier 1 shareholders' equity ratio as of 31 March 2016.

- **Deduction from capital in respect of deferred tax asset -** On 4 April 2016, an amendment to the Question and Answer file from the Supervisor of Banks on the implementation of Proper Conduct of Banking Business Directives was published, on the subject of measurement and capital adequacy. The purpose of the amendment is to clarify the method of treating the salary tax component in all matters related to the calculation of the capital requirements and the deduction from capital in respect of deferred tax asset. According to the clarification, when a banking corporation reaches the conclusion that, under the circumstances at the time of the report, it is virtually certain that the deferred tax asset equals the sum of the salary tax included in the books of the Bank, it is permissible not to apply the threshold tax deduction included in Section 13 of the directive on this portion of the deferred tax asset. For this purpose, the Bank will be permitted to implement the test of threshold deduction on the net sum of deferred taxes, after deducting salary tax as stated above. The deferred tax asset, as stated, which is not deducted from the capital, will be weighted as a risk asset at a rate of 250%. The Bank is implementing the directives in effect from the date of their publication and onwards without adjustment to comparative figures and subject to the transitional provisions stipulated in Proper Conduct of Banking Business Directive no.299 of the Banking Supervision Department. This update contributed to an improvement of 0.20% in the Bank's Tier 1 shareholders' equity ratio as of 31 March 2016.

On 28 February 2016, Leumi signed an agreement with Harel for the joint extension of secured housing loans, secured, *inter alia*, in mortgages and pledges on contractual rights in connection with land. In accordance with the agreement, Harel will participate with the Bank in the extension of housing loans, in which the ratio of the amount of the loan to the value of its asset (LTV) is only up to 60% (as long as Harel is not given regulatory approval to participate in loans at a higher financing rate). On 13 June 2016, after fulfillment of the conditions precedent in the agreement, the parties commenced the joint extension of housing loans pursuant to the agreement.

Total loans extended in 2016 in conjunction with Harel amounted to NIS 2.9 billion.

On 27 September 2016, the Bank signed an agreement with institutional entities from the Menora Mivtahim Group ("the sale agreement" and Menora Mivtahim", respectively), according to which, the Bank sold to Menora Mivtahim 80% of the Bank's rights and the related obligations in the housing loan portfolio (as defined in Proper Conduct of Banking Business Directive no. 451), which is secured, inter alia, by mortgages on the interests in land and/or pledges on the contractual rights in land, as applicable, and fulfils the criteria in the sale agreement ("the loan portfolio"), with the Bank continuing to hold 20% of the remainder, which will be on an equal status to the loans sold to Menora.

For further information, see Chapter "Material agreements"

Efficiency Plan

On 12 January 2016, the Supervisor of Banks published a circular on "Operating Efficiency of the Banking System in Israel". According to this circular, a banking corporation which meets the conditions defined, will receive a relief according to which, for the purpose of calculating the capital adequacy ratios and leverage ratio, it will be able to spread the effect of the plan over five years on a straight-line basis commencing mid-2017. On 1 June 2016, the Board of Directors of the Bank approved the efficiency plan, the cost of which was NIS 438 million. Excluding the abovementioned relief, the implementation of the efficiency plan, as of 31 December 2016, would result in a decrease of 0.14% in the Tier 1 shareholders' equity ratio.

The relief in the regulatory capital is being gradually reduced through 30 June 2021.

- **Regulatory changes which are likely to impact capital requirements and planning:**

  Capital requirements in respect of exposures to central counterparties

  On 22 October 2015, the Banking Supervision Department published a circular regarding "Capital requirements in respect of exposures to central counterparties" (hereinafter "the circular"). central counter The circular sets forth the new directives which will apply to exposures to central counterparties which are caused by OTC derivatives, derivative transactions marketable on the stock exchange and securities financing transactions.

  For further information, see Note 25B.

The following is an analysis of the sensitivity to the main factors affecting the capital adequacy of Leumi Group:

- A change in the volume of risk assets – The risk assets of Leumi amounted to NIS 292.2 billion at the end of December 2016. Every increase of 1% in the risk assets (approx. NIS 3 billion) in future years will reduce the Tier 1 shareholders' equity ratio by 0.11%, and the overall capital ratio by 0.15%.
- Profit that will accrue or a change in the capital reserve – The Tier 1 shareholders' equity of Leumi amounted to NIS 32.6 billion at the end of December 2016. The overall capital amounted to NIS 44.4 billion. Every accrual of net profit and/or positive change in the capital reserve amounting to NIS 1 billion will improve the Tier 1 shareholders' equity adequacy ratio and the overall capital ratio by 0.34%.
- Obligation for employee rights –The actuarial liability for employees is discounted according to a moving average of eight quarters of market yields which are influenced by the Government of Israel debenture curve and by the United States AA corporate debenture margin. A change of 0.1% across the interest curve for discounting, under the assumption that the curve rises and falls consistently, means a cumulative impact of 0.07% in the Tier 1 shareholders' equity ratio and in the overall capital ratio, (of which according to the moving average calculation for eight quarters, an increase of 0.01% in the overall Tier 1 shareholders' equity ratio and in the overall capital ratio, for the current quarter.

The above information regarding capital adequacy policy and management refers to future activities of the Bank, and is defined as "forward-looking information". For the meaning of this term, see the chapter, "Forward-Looking Information".

Dividend distribution policy

On 29 March 2017, the Board of Directors of the Bank approved a dividend distribution policy, with effect from the date of publication of the financial statements for the first quarter of 2017. Pursuant to the dividend policy, the Bank will, each quarter, distribute 20% of the Bank's net profit according to the Bank's financial statements for the previous quarter and subject to, among other things, the Bank being in compliance with its capital adequacy targets, even after the distribution of the dividend. The actual dividend distribution is subject to the specific resolutions of the Board of Directors prior to each distribution, and subject to the provisions of the law which apply to a distribution of dividends, including the provisions of the Companies Law and directives of the Bank of Israel.

Operating segments – management approach

The reporting of the operating segments according to the management approach presents the Bank's results divided into lines of business, pursuant to the Bank's organizational structure

The business lines specialize in providing service to customer segments having similar characteristics and needs.

The Bank in Israel is organized into six business lines:

1. Banking – providing banking services to private and small business customers. The business line includes the Mortgage Department and Private Banking Department.
2. Commercial - providing banking and financial services to middle-market companies and interested parties in these companies.
3. Corporate - providing banking and financial services to large companies and international corporations in the economy, with their activity in Israel and abroad.
4. Real estate - providing banking and financial services to the real estate and construction segment.
5. Capital market – managing the Bank's nostro, managing assets and liabilities, and managing investments and financial assets.
6. Other – activities not attributed to other business lines.

Operational results are attributed to the business line in which the customer's account is managed.

- Net interest income - the business line is credited with interest received from loans that it made available, less the cost of raising the sources (transfer cost). In addition, the business line is credited with the transfer cost for deposits that were raised less the interest that was paid to the customer.
- Noninterest incomes (financing incomes that are not from interest, commissions and other income) – are attributed to the business lines according to the customer's activity.
- Business line expenses – include the direct expenses of the business lines, and also expenses of headquarters' units providing services are charged to the business lines.

The results of the business lines' activity, both on the side of the balance sheet and on the profit and loss side, are regularly examined by the Board of Directors and the management. Examination of the results is done using targets set within the framework of the annual work plan and against data from the corresponding period in the previous year. Additionally, an examination is carried out of a variety of additional metrics relating to the business lines' activity.

Condensed operating results according to management approach:

	For the year ended 31 December 2016								
	NIS millions								
	Bank						Subsidiaries in Israel	Overseas subsidiaries	
	Banking	Commercial	Corporate	Real estate	Financial management	Other			Total
Net interest income	**3,761**	**895**	**521**	**526**	**650**	**(1)**	**237**	**937**	**7,526**
Noninterest income	**1,768**	**401**	**209**	**343**	**863**	**686**	**1,130**	**8**	**5,408**
Total income	**5,529**	**1,296**	**730**	**869**	**1,513**	**685**	**1,367**	**945**	**12,934**
Expenses (income) in respect of credit losses	**755**	**(72)**	**(376)**	**(392)**	**(55)**	**(20)**	**37**	**(2)**	**(125)**
Total operating and other expenses	**4,505**	**701**	**356**	**176**	**368**	**625**	**905**	**944**	**8,580**
Profit before tax	**269**	**667**	**750**	**1,085**	**1,200**	**80**	**425**	**3**	**4,479**
Tax expenses	**96**	**240**	**269**	**389**	**431**	**5**	**218**	**69**	**1,717**
Net profit attributable to shareholders in the Bank	**173**	**427**	**481**	**696**	**774**	**75**	**231**	**(66)**	**2,791**
Net credit to the public	**138,638**	**34,089**	**30,238**	**21,229**	**3,779**	**2,966**	**7,407**	**23,567**	**261,913**
Deposits of the public	**191,156**	**41,698**	**19,772**	**7,702**	**59,696**	**40**	**68**	**26,722**	**346,854**
Assets under management	**176,638**	**26,781**	**18,607**	**1,814**	**362,413**	**25,503**	**189,681**	**19,244**	**820,681**

	For the year ended 31 December 2015								
	NIS millions								
	Bank						Subsidiaries in Israel	Overseas subsidiaries	
	Banking	Commercial	Corporate	Real estate	Financial management	Other			Total
Net interest income	3,482	822	573	536	644	-	191	870	7,118
Noninterest income	1,848	416	205	361	431	948	1,461	627	6,297
Total income	5,330	1,238	778	897	1,075	948	1,652	1,497	13,415
Expenses (income) in respect of credit losses	470	(126)	(140)	78	(24)	(84)	13	12	199
Total operating and other expenses	4,537	741	360	173	316	644	864	1,201	8,836
Profit before tax	323	623	558	646	783	388	775	284	4,380
Tax expenses	124	224	201	232	279	174	238	219	1,691
Net profit attributable to shareholders in the Bank	199	399	357	414	632	214	550	70	2,835
Net credit to the public	137,904	33,109	30,762	24,275	2,887	2,945	6,173	23,344	261,399
Deposits of the public	173,809	41,720	20,150	6,859	59,350	178	65	26,562	328,693
Assets under management	183,037	28,470	17,613	1,419	333,278	28,824	185,883	19,382	797,906

Regulatory operating segments

The following is a description of the main operating segments prescribed by Bank of Israel directives:

1. Households segment - Private individuals, except customers included in Private Banking.
2. Private Banking segment -Private individuals whose balance of the financial asset portfolio they have in the Bank (including monetary deposits, securities portfolio and other monetary assets) exceeds NIS 3 million.
3. Small and micro-businesses segment - Businesses whose activity turnover (annual total sales or annual total income) is less than NIS 50 million.
4. Mid-sized business segment - Businesses whose activity turnover is greater than or equal to NIS 50 million and less than NIS 250 million.
5. Large businesses segment - Businesses whose activity turnover is greater than or equal to NIS 250 million.
6. Institutional entities – including provident funds, mutual funds, pension funds, training funds, insurance companies, according to the definition of the Supervisor of Banks.
7. Financial management segment - Includes the following activities:
    a. Trading activity – Investment in securities for trading, market-making activity in securities and derivative instruments, activity in derivative instruments non-designated for hedging and not part of the management of the assets and liabilities of the banking corporation, repurchase and lending transactions of securities for trading, short selling of securities, underwriting of securities services.
    b. Asset and liability management activity – Including investment in available-for-sale debentures and debentures held to maturity, that are not attributed to other activity segments (with a borrower having no indebtedness to the Bank, apart from securities), hedging derivative instruments and derivative instruments which are part of asset and liability management, deposits in banks and from banks in Israel and around the world, hedging or protective exchange rate differences of investments in overseas offices, deposits in and of governments.
    c. Non-bank investment activity – Investment in available for sale shares and investment in companies included on equity basis of businesses.
    d. Other – Management, operating, trust and custody services for banks, consultancy services, selling activity and credit portfolio management, and financial product development activities.
8. Other segment - Including discontinued activities, designated profits and other results connected to employee rights not attributed to the other activity segments, activities not attributed to other segments, and adjustments between the total of all the items attributed to the segments and the total of all the items in the consolidated financial statements.

Activity according to regulatory operating segment in Israel:

	For the year ended 31 December 2016									
	NIS millions									
	Activity in Israel								Overseas activity	
	Household	Private Banking	Small and micro businesses	Mid-sized businesses	Large businesses	Instituional entities	Financial management	Other		Total
Net interest income	**2,578**	**86**	**1,600**	**571**	**1,162**	**57**	**576**	**(10)**	**906**	**7,526**
Noninterest income	**1,737**	**161**	**682**	**318**	**657**	**163**	**1,308**	**139**	**243**	**5,408**
Total income	**4,315**	**247**	**2,282**	**889**	**1,819**	**220**	**1,884**	**129**	**1,149**	**12,934**
Expenses (income) in respect of credit losses	**521**	**1**	**222**	**(120)**	**(687)**	**(33)**	**(64)**	**-**	**35**	**(125)**
Total operating and other expenses	**4,112**	**131**	**1,333**	**501**	**646**	**285**	**178**	**448**	**946**	**8,580**
Profit before tax	**(318)**	**115**	**727**	**508**	**1,860**	**(32)**	**1,770**	**(319)**	**168**	**4,479**
Tax expenses	**(146)**	**42**	**257**	**179**	**662**	**(11)**	**641**	**(11)**	**104**	**1,717**
Net profit attributable to shareholders in the Bank	**(214)**	**73**	**466**	**327**	**1,194**	**(21)**	**1,196**	**(294)**	**64**	**2,791**
Return on capital										**-**
Net credit to the public	**114,516**	**615**	**47,572**	**24,178**	**53,137**	**1,486**	**-**	**-**	**23,946**	**265,450**
Deposits of the public	**117,863**	**28,696**	**36,535**	**33,026**	**48,151**	**55,862**	**-**	**-**	**26,721**	**346,854**
Assets under management	**79,623**	**49,663**	**27,223**	**20,484**	**65,588**	**528,324**	**30,532**	**-**	**19,244**	**820,681**

	For the year ended 31 December 2015									
	NIS millions									
	Activity in Israel								Overseas activity	
	Household	Private Banking	Small and micro businesses	Mid-sized businesses	Large businesses	Instituional entities	Financial management	Other		Total
Net interest income	2,448	62	1,675	583	934	36	512	14	854	7,118
Noninterest income	1,673	172	828	372	499	163	1,654	197	739	6,297
Total income	4,121	234	2,503	955	1,433	199	2,166	211	1,593	13,415
Expenses (income) in respect of credit losses	297	(7)	218	(82)	(250)	23	(44)	-	44	199
Total operating and other expenses	3,916	150	1,500	488	538	260	232	553	1,199	8,836
Profit before tax	(92)	91	785	549	1,145	(84)	1,978	(342)	350	4,380
Tax expenses	(63)	33	279	192	409	(30)	663	(22)	230	1,691
Net profit attributable to shareholders in the Bank	(63)	58	503	356	733	(54)	1,493	(316)	125	2,835
Return on capital										
Net credit to the public	116,005	613	57,773	24,588	41,590	713	-	-	23,788	265,070
Deposits of the public	110,674	26,097	41,581	25,950	41,939	55,889	-	-	26,563	328,693
Assets under management	84,990	50,743	37,342	20,725	73,980	475,376	35,346	24	19,380	797,906

Activities in products

1. Housing loans

	For the year ended 31 December							
	2016			**2015**			Change	
	Household	Private Banking	Total housing loans	Household	Private Banking	Total housing loans	Total	%
	NIS millions							
Net interest income	**716**	**1**	**717**	664	-	664	53	8
Noninterest income	**45**	**-**	**45**	46	-	46	(1)	(2)
Total income	**761**	**1**	**762**	710	-	710	52	7
Expenses in respect of credit losses	**(3)**	**-**	**(3)**	12	-	12	(15)	-
Operating and other expenses	**281**	**1**	**282**	313	1	314	(32)	(10)
Profit (loss) before taxes	**483**	**-**	**483**	385	(1)	384	99	26
Tax expenses (benefit)	**171**	**-**	**171**	136	-	136	35	26
Profit (loss) attributable to noncontrolling interest holders	**312**	**-**	**312**	249	(1)	248	64	26

Credit cards

	For the year ended 31 December							
	2016			2015			Change	
	Households	Private Banking	Total credit cards	Households	Private Banking	Total credit cards	Total	%
	NIS millions							
Net interest income	**242**	**-**	**242**	228	-	228	14	6.1
Noninterest income	**876**	**3**	**879**	730	2	732	147	20.1
Total income	**1,118**	**3**	**1,121**	958	2	960	161	16.8
Expenses (income) in respect of credit losses	**76**	**1**	**77**	42	1	43	34	79.1
Operating and other expenses	**741**	**3**	**744**	658	2	660	84	12.7
Profit (loss) before taxes	**301**	**(1)**	**300**	258	(1)	257	43	16.7
Tax expenses (benefit)	**78**	**-**	**78**	69	-	69	9	13.0
Net profit (loss) attributed to noncontrolling interest holders	**181**	**(1)**	**180**	155	(1)	154	26	16.9

Construction and real estate

	For the year ended 31 December									
	2016				2015			Change		
	Small and micro businesses	Mid-size businesses	Large businesses	Total construction and real estate	Small and micro businesses	Mid-size businesses	Large businesses	Total construction and real estate	Change in total construction and real estate	
	NIS millions									In %
Net interest income	**484**	**177**	**485**	1,146	581	186	306	1,073	73	6.8
Noninterest income	**112**	**57**	**302**	471	192	111	206	509	(38)	(7.5)
Total income	**596**	**234**	**787**	1,617	773	297	512	1,582	35	2.2
Expenses (income) in respect of credit losses	**19**	**(44)**	**(281)**	(306)	97	(26)	(109)	(38)	(268)	-
Operating and other expenses	**217**	**68**	**154**	439	278	72	90	440	(1)	(0.2)
Profit (loss) before taxes	**360**	**210**	**914**	1,484	398	251	531	1,180	304	25.8
Tax expenses (benefit)	**129**	**75**	**326**	530	143	90	191	424	106	25.0
Profit attributable to shareholders of the Bank	**231**	**135**	**588**	954	255	161	340	756	198	26.2

Information according to geographical regions[a]:

The following table presents principal data according to geographical regions:

	Total Balance Sheet			Credit to the Public			Deposits of the public		
	31 December 2016	31 December 2015	Change	**31 December 2016**	31 December 2015	Change	**31 December 2016**	31 December 2015	Change
	NIS millions		%			%			%
Israel	**400,708**	381,377	5.1	**238,345**	238,054	0.1	**320,133**	302,130	6.0
United States	**28,430**	23,685	20.0	**17,329**	15,530	11.6	**20,423**	17,675	15.5
United Kingdom	**8,224**	9,149	(10.1)	**5,566**	6,836	(18.6)	**5,572**	7,156	(22.1)
Switzerland	**73**	609	(88.0)	**-**	36	(100.0)	**-**	4	(100.0)
Luxembourg	**21**	505	(95.8)	**-**	238	(100.0)	**-**	985	(100.0)
Romania	**1,133**	1,158	(2.2)	**672**	705	(4.7)	**726**	743	(2.3)
Others abroad	**14**	16	(12.5)	**1**	-	-	**-**	-	-
Total	**438,603**	416,499	5.3	**261,913**	261,399	0.2	**346,854**	328,693	5.5

The following table presents a breakdown of the net profit by geographical regions:

	Net profit (loss)			
	Year ended December 31			
	2016	2015	Change	
	NIS millions			%
Israel (a)	**2,727**	2,710	17	0.6
United States (b)	**107**	242	(135)	(55.8)
United Kingdom (c)	**(16)**	81	(97)	-
Switzerland (d)	**(58)**	(127)	69	54.3
Luxembourg	**24**	(35)	59	+
Romania (e)	**(2)**	(51)	49	+
Others abroad (f)	**9**	15	(6)	(40.0)

Classified by location of office.

For further details, see chapters "Major Investee Companies, "Credit Risk", and Note 29A.d.

Major Investee Companies[1]

The Leumi Group operates in Israel and abroad through subsidiaries which are: banks, finance companies and financial services companies. The Group also invests in non-bank corporations operating in the fields of insurance, energy, chemicals, infrastructure, etc.

The Bank's total investments in investee companies (including investments in capital notes) amounted to NIS 11.4 billion on 31 December 2016, compared with NIS 12.5 billion on 31 December 2015, and the contribution of the investee companies to the Group's net profit in 2016 amounted to a loss of NIS 183 million, compared with a loss of NIS 820 million in 2015.

For information relating to investment and contribution to profit of the Group of each of the major companies – see Note 15.

Consolidated companies in Israel

The Bank's total investments in consolidated companies in Israel amounted to NIS 5,783 million on 31 December 2016, compared with NIS 6,263 million on 31 December 2015. Their contribution to Group net operating profits amounted to some NIS 244 million in 2016, compared with NIS 657 million in 2015, a decrease of 62.9%. The Group's return on its investment in consolidated companies in Israel was 4.2% in 2016 compared with 10.9% in 2015.

Leumi Card

Leumi Card Ltd. (hereinafter: "Leumi Card") is a credit card company which is engaged in issuing credit cards, clearing credit card transactions, credit card operations and providing payment solutions and financial products.

The income of Leumi Card totaled some NIS 1,126 million in 2016, compared with NIS 1,054 million in 2015.

Leumi Card ended 2016 with a net profit of NIS 184 million, compared with NIS 180 million in 2015.

Issuance segment – Leumi Card issues cards under the brand names Visa and MasterCard, through which businesses that accept these brands in Israel and around the world may be paid. Leumi Card issues two types of credit card:

Credit cards issued jointly with Bank Leumi and Bank Mizrahi to their customers and credit cards issued, usually in cooperation with business entities to customers of all of the banks ("non-bank credit cards").

The number of valid cards held by Leumi Card customers at the end of 2016 amounted to 2.58 million (of which 1.66 million were bank cards and 920 thousand were non-bank cards), compared with 2.48 million cards (of which 1.64 million were bank cards and 841 thousand were non-bank cards) at the end of 2015 – an increase of 4%. The percentage of active cards stands at 82% of total valid cards (for this purpose, "active cards" are valid cards with which at least one transaction has been made in the course of the last quarter).

The total issuance turnover of Leumi Card in 2016 – (The volume of transactions made in all of the cards of Leumi Card during the period, excluding withdrawals of cash in Israel, and net of elimination of transactions) amounted to NIS 74.0 billion (of which NIS 54.5 billion was for bank cards and NIS 19.5 billion was for non-bank cards), compared to NIS 67.8 billion in 2015 (of which NIS 50.2 billion was for bank cards and NIS 17.6 billion was for non-bank cards) – an increase of 9%.

Clearing sector – Leumi Card clears the Visa and MasterCard-type credit cards, and from May 2012, also clears the Isracard-type credit cards.

The clearing services include the securing of payment to businesses with which Leumi Card is connected in clearing agreements in respect of transaction vouchers executed by credit cards of the types that Leumi Card clears, this, in exchange for a commission collected by Leumi Card from the business ("business commission"). In addition, Leumi Card offers businesses credit products and financial solutions, such as loans, discounting of vouchers and advance payments.

The tax impact is expected to apply if and when the Bank sells Leumi Card at its equity value in the books is estimated to be NIS 85 million, according to the tax rate known at the publication date of the financial statements.

For information relating to legislation regarding credit cards, see Chapter "Legislation and Regulation relating to the Banking System".

Leumi Partners Ltd.
Leumi Partners is the investment banking vehicle of the Leumi Group

Leumi Partners finished 2016 with a profit of NIS 154 million, which arose mainly from the investments and income from commissions, compared with a profit of NIS 405 million in 2015.

Shareholders' equity as at 31 December 2016 totaled NIS 1,471 million, compared with NIS 1,326 million at the end of 2015.

Leumi Partners Below is engaged in four main areas of activity:

1. **Management of the non-banking investment portfolio of the Leumi Group.**

   Leumi Partners (hereinafter – the Company) engages in initiating, locating and carrying out direct and indirect investments in companies, projects and private investment funds.

   The non-banking investment policy of the Leumi Group is in line with its risk appetite and the restrictions of the Banking (Licensing) Law, and therefore, includes minority holdings only (up to 20% of all means of control, and without control). The Company focuses on investments with a medium to long-term horizon, appropriate to the policy which has been established. The non-bank investment strategy has determined a preference for private companies and for a high feasibility of realization.

   Pursuant to a directive received from the Bank of Israel on 23 March 2015 on the maximum amount of non-bank investment must be contracted through 1 January 2017 to NIS 2.5 billion. On 1 January 2017, the total of non-bank investments was within this limit. On 24 January 2017, the Bank contacted the Bank of Israel with a request to make a gradual increase in the level of non-bank investment in Leumi Group up to a maximum amount of NIS 3.5 billion.

   During 2016, the company invested NIS 127 million in companies and extended a loan of NIS 261 million. In addition, it undertook further investments and loans amounting to NIS 67 million. The balance of the Company's liabilities for investment in private investment funds amounted to NIS 429 million at 31 December 2016.

2. **Underwriting, consulting and management of private and public capital mobilizations in Israel**

   Through the subsidiary, Leumi Partners Underwriters, the Company provides a wide range of services in the area of underwriting and consulting to companies and interested parties.

   In 2016, Leumi Partners Underwriters was one of the leading firms of underwriters in the Israeli market. Leumi Partners Underwriters participated in public offerings amounting to NIS 38 billion, and led 25 public offerings amounting to NIS 12.5 billion.

3. **Consulting and management of the processes of mergers and acquisitions (M&A) and capital mobilizations**

   The services are provided to Israeli and foreign companies who wish to effect a strategic expansion through purchases, or investors or controlling owners who are interested in selling or reducing their holdings.

   The basket of services within this framework includes: assistance in the definition of the company's requirements and strategic objectives, the determination of the optimal investment/investor for the achievement of those objectives, the identification of target investments/investors on a global basis, assistance in making contact with the target company, involvement in negotiations until their conclusion (deal structuring) in a manner that serves the customer's objectives and assistance in accessing sources of finance for the transaction.

   In its operations, Leumi Partners cooperates with investment houses and other entities in Israel and abroad.

4. **Economic analyses and appraisals**

   Through, the subsidiary, Leumi Partners Research, the Company is engaged in conducting economic analyses and appraisals, mainly for the Leumi Group and outside economic entities.

Consolidated companies the Bank in overseas units

The total investments of the Bank in overseas units at the end of 2016 amounted to NIS 4,108 million, compared with NIS 4,295 million at the end of 2015. The contribution of the overseas units to the net loss in shekels of the Group in 2016 amounted to a profit of NIS 67, compared with a profit of NIS 35 million in 2015. The profit for all the consolidated overseas companies, including overseas branches, as published by them, totaled US$ 54.24 million in 2016, compared with a loss of US$ 33.4 million in 2015, a decrease of US$ 20.8 million.

The Bank has offices in New York, London and Romania.

In 2016, the changes continued in the international presence of the Group to reduce international private banking activity, as follows: In 2016, regulatory approvals were received for the return of the banking licenses of the Switzerland office and the Luxembourg office and the process of their voluntary liquidation commenced. In addition, the Latin American offices were closed and their liquidation commenced, the Leumi representative office was closed and the activity in Jersey was sold and the activity of the trust company in Jersey was discontinued.

Bank Leumi USA

Bank Leumi USA (BLUSA), incorporated in 1968, holds a commercial banking license from the State of New York and is a member of the FDIC (Federal Deposit Insurance Corp.).

BLUSA engages in commercial banking, primarily financing medium and larger sized (middle-market) local companies, in international banking, mainly with Israeli companies, and also private banking for U.S. and non-U.S. residents. Most of its commercial activity is in the areas of real estate, retirement homes and nursing institutions and commerce. BLUSA operates through five branches in New York, California, Florida and Illinois.

Principal data of BLUSA are as follows:

	December 31			
	2016	2015	Change	
	NIS millions			%
Total balance sheet	**7,420**	6,073	1,347	22.2
Credit to the public	**4,462**	3,905	557	14.3
Deposits of the public	**6,132**	5,097	1,035	20.3
Capital attributed to the shareholders in the banking corporation	**636**	621	15	2.4
Customers' 'securities portfolio	**4,038**	3,793	245	6.5
Net profit	**26**	61	(35)	(57.4)
Return on capital	**4.02**	10.99		

The decrease in net profit in 2016 compared with 2015 derives from the net profit of US$ 53 million from the sale of real estate assets in New York last year.

Bank Leumi UK

Bank Leumi UK plc was founded in 1959 and continues the activity of the Group in England that began in 1902. Leumi UK has full control over Leumi ABL Ltd., operating in the field of discounting and factoring of invoices.

Bank Leumi UK is engaged in commercial and private banking. The commercial banking activity includes real estate financing, international trade, finance of media, mainly in Europe, Israel-related business and Israeli companies active in the UK.

The real estate financing finances a range of activities in the UK and Western Europe, including investments and development of residential real estate and the financing of commercial real estate (mainly hotels, retirement homes, and student halls of residence). The financing is provided to both local and non-resident customers (mostly Israelis).

Bank Leumi UK is regulated by the Prudential Regulation Authority (PRA) which is an extension of the Bank of England, and by other regulatory authorities.

Principal data of Bank Leumi UK are as follows:

	December 31			
	2016	2015	Change	
	NIS millions			%
Total balance sheet	**1,740**	1,586	154	9.7
Credit to the public	**1,175**	1,179	(4)	(0.3)
Deposits of the public	**1,201**	1,265	(64)	(5.1)
Capital attributed to the shareholders in the banking corporation	**184**	148	36	24.3
Customers' 'securities portfolio	**25**	101	(76)	(75.2)
Net profit	**17**	13	4	30.8
Return on capital	**14.14**	11.76		

The net profit of the Company in 2016 amounted to £ 17 million, an increase of 30.8%, compared with to the corresponding period last year. However, the Company's contribution to the Group's profit in shekels is a loss of NIS 64 million deriving from negative exchange rate differences due an appreciation in the pound sterling of 18.3%. The Bank has no economic exposure to the pound sterling as there a foreign currency deposits against the investment in the office.

Bank Leumi Romania

Leumi Romania is a banking corporation in Romania which was acquired in 2006. The bank operates 15 branches, after 22 branches of the Bank were closed during 2010-2015, and engages in banking activity that includes, *inter alia*, deposits, the extension of credit, international trade and foreign currency activities.

The commercial banking activity includes real estate financing, the financing of Israeli customers operating in Romania and the financing of small and medium-sized local businesses.

Principal data of Bank Leumi Romania are as follows:

	December 31			
	2016	2015	Change	
	NIS millions			%
Total balance sheet	**1,264**	1,223	41	3.4
Credit to the public	**753**	749	4	0.5
Deposits of the public	**813**	789	24	3.0
Capital attributed to the shareholders in the banking corporation	**162**	150	12	8.0
Net profit	**12**	(24)	36	|+
Return on capital	**7.45**	-		

1 Romanian ron = US$ 0.232 (end of 2015 - US$ 0.241)

The profit in 2016 was also affected by a profit of 18.4 million ron from the sale of the office's non-yielding portfolio (NPL) during the second quarter of 2016. The loss in 2015 was incurred as a result of high credit loss expenses, due to the implementation of general directives of the central bank in Romania to reduce the proportion of the non-income-earning portfolio from the total credit portfolio in the banking system in Romania.

Exposure to Risk and Methods of Risk Management

Risk management in Leumi

Risk management in Leumi is considered an essential condition for fulfilling the Group's long-term goals. The Group deals with a wide range of activities connected with the taking of financial risks, such as credit risk, market and liquidity risks, including pension risks, and other risks which are not financial risks, such as operating risks, including, technological and cyber risks, legal risks, regulatory risks, reputational risks, compliance risks and conduct risks (fair conduct with customers).

The concept of risk management in Leumi is based on three "lines of defense" which assume part of the risk management. The division of responsibility between the lines of defense is follows:

First line of defense – The conduct of the business lines, including supporting functions, such as information technology management with full responsibility for risk management built into products, activities, processes and systems which are subject to their authority and to the implementation of a proper control environment of its activity through identification, measurement, control, mitigation and reporting processes.

Second line of defense – The Risk Management Division which is an independent function, the responsibility for the planning and development of an overall working framework for risk management in the Bank as defined in Proper Conduct of Banking Business Directive no. 310 "Risk Management", including responsibility for risk management at the Group and Bank level, directing the preparation of Leumi's risk policy with regard to all of the main risks, assisting the Board of Directors in crystallizing the Bank's risk appetite, leading the process of assessing the fairness of the capital adequacy (ICAAP) in all its various components.

In addition, , the Division has responsibility for authorities in credit and market activity, responsibility for monitoring and control of the main risk appetite limitations, responsibility for determining a working framework for managing conduct risks (fair conduct vis-à-vis the customers), development and validation of models, risk assessment and validation of the borrower's internal rating in specific portfolios in credit according to the stipulated thresholds, overall responsibility for the correctness of the classifications and allowances in credit and the computation for the collective allowance, involvement in the management of risks in central and strategic projects in real time, performance of independent analyses when making strategic decisions and approval processes of new products and forming an overall and up-to-date picture of the risk for making decisions.

The second line of defense includes additional functions, such the Bank's Chief Legal Counsel, who is responsible for the management of legal risks and the management compliance risks and the Accounting Division which is responsible for financial reporting and SOX.

The third line of defense is the Internal Audit Division, which is directly subject to the Board of Directors. The Internal Audit is responsible for conducting an independent and objective review, challenging controls, processes and risk management systems in the banking corporation. The audit is usually conducted retrospectively on the first and second lines, ensuring implementation of the instructions of the management and the Board of Directors.

The Board of Directors of the Bank is responsible, inter alia, for the formulation of an overall risk strategy, including the risk appetite, supervision of the risk management strategy in the Group, the approval of risk management policy for each of the material risks, regulating and challenging the risk levels to which the Group and the Bank are exposed, ensuring compliance with the risk appetite.

Organizational structure of risk management in the Leumi Group.

The main risks inherent in the Bank's activity are credit risks, market risk and operational risks, which are outlined below in this chapter.

Changes in the risk environment and their impact on the Group

In general, in the course of the year, there have been no significant changes in the map of risks and threats, although there have been changes in the relative force of the various risks. The banking system, around the world and in Israel, including Leumi, are profoundly impacted by the risks related to regulations and legislation, a volatile macroeconomic environment, changes occurring in the business model, including the transition to "new banking" which is based on the digital and social and consumer trends. From the range of risks in the banking system, we should note the macroeconomic risk and operating risk, including cyber risk and technology risks as significant threats.

The main risk areas which are expected to impact the Bank's activities in the coming year are as follows:

Macro-economic risk

Macro-economic risk is risk to the Group's income and capital arising from macroeconomic conditions, including a low interest environment, political power relationships in the world and their impact on international trade – also in light of the results of elections in the United States, developments in China and emerging markets, concern over the stability of the Euro Area and geopolitical instability in points of conflict around the world, including, due to the increasing threats of terrorism.

The Bank is examining its ability to withstand negative developments in the macroeconomic environment through systemic stress scenarios. In addition, monitoring and review procedures of developments in the market are regularly carried out, in order to be prepared in advance and to adapt the activity, as necessary.

Tighter regulatory requirements

The tightening of the regulatory requirements, in Israel and around the world, impacts the Group's business model, profitability and capital adequacy requirements.

In recent years, the demands on banks have become considerably broader in Israel and abroad, with regard to capital and liquidity, against a backdrop of the conclusions that have been drawn from the financial crisis (Basel III requirements). In addition, international drafts have been published recently relating to new standards which are liable to affect the Bank's capital (Basel IV, etc.). These trends influence the way capital is allo9cated for the various business activities in the Group.

In addition, laws and regulations have recently been published with an emphasis on the consumer environment, which are aimed at, inter alia, increasing competition, for example, the Data Credit Law and the Intensification of Competition in the Banking System Law (Strum Committee).

The Bank is closely following these developments, studying them and preparing accordingly.

Information security and cyber threat

Rapid developments in cyberspace have led to an increase in the scope and intensity of the threats, the abilities of the attackers and the level of complexity of the attacks and accordingly, a significant increase in exposure to cyber risk.

These risks are liable to expose the Bank to impairment in its business activity and impairment to its goodwill.

In light of the constant changes in the financial business environment and in the outline of threats in cyberspace, the cyber defense and security strategy and policy have been updated. The concept of cyber protection in the allocation of defense resources is focused according to the inherent risk level, and in relation to the technological, business, human and physical aspect.

In this context, pursuant to the principle of materiality, a process for defining the most sensitive information took place and perceptions in the context of the human factor (authorizations, functions and employees) were established.

For further information regarding information technology and cyber risk, see Chapter "Operating Risks".

Technology risk

Bank Leumi is a progressive bank and a leader in product technological innovation, with the aim of creating advanced services for its customers. To facilitate these services, the Bank requires advanced digital infrastructures which, on the one hand, create business opportunities, while on the other hand, raises the level of exposure to technological risks in the business and operating processes.

The IT environment is complex, changes rapidly and dependency on it is ever-increasing. Consequently, it is extremely important that the technology infrastructure is stable, durable and strong.

Leumi is meticulous in maintaining the quality and proper functioning of the information systems, including the necessary working processes and invests numerous resources in the technological infrastructures.

For further information regarding technological risk, see Chapter "Operational risks"

Conduct risk – Fair conduct vis-à-vis customers

Conduct risk is the risk that conduct vis-à-vis the customers which is unfair, non-transparent and not adapted to their needs will lead to losses as a result of legal damage, fines or damage to goodwill.

Bank Leumi maintains strict control of transparent and fair conduct in order to provide its customers with valuable services and products. The initiation and selling processes are subject to procedures and controls which ensure appropriate conduct. These processes are regularly examined, with the view to their update. The working process for the management of this risk relates to business initiation, processes in the current interface with the customer, remuneration programs, etc.

Internal Capital Adequacy Assessment Process (ICAAP)

The process of assessing capital adequacy serves to examine the capital required for supporting the various risks, both in the ordinary course of business, and under stress scenarios, to which the Group is exposed, in order to ensure that the Group's capital actually exceeds the said capital requirements at any time. As part of the process, the risk appetite and the risk-bearing capacity were defined, a comprehensive process of mapping and assessment of risks to which the Group is exposed was carried out, a comprehensive framework for analyzing stress scenarios was developed, and processes of managing the risks and the risk management structure in the Group were examined.

From the performance of the process, it appears that the Bank has adequate capital and liquidity for dealing with all of the risks identified, both in the ordinary course of business, and in the materialization of serious stress scenarios.

The results of the process were formally collated in the ICAAP document which was submitted to the Supervisor of Banks in January 2017. This process was examined by the Supervisor of Banks as part of the Supervisory Review Process (SREP).

Risk appetite of the Group

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

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

The declaration of the Group's risk appetite discusses the scope and types of aggregate risk which the Bank is interested to bear in order to achieve its corporate goals, indices in various areas, both quantitative and qualitative, are determined, based on foreseeable assumptions which reflect the declarations of the Group's aggregate risk appetite.

When the outline of the risk appetite is calculated on a routine basis, the risk capacity – the maximum level of risk which the Group can bear without breaching the restrictions on capital, leverage, liquidity, liability and other regulatory limits, including from the point of view of the shareholders and customers. The risk capacity is examined, *inter alia*, using stress scenarios.

Use of stress tests within the context of risk management

The performance of a uniform stress test is a generally accepted international standard in accordance with the recommendations of the Basel Committee, and contributes to an understanding of the risk focal points to which the banking system and a single bank is exposed. This process strengthens transparency in the banking system, facilitates the resistance of the banking corporations in a situation of the development of negative market conditions to be examined and compared. The process supports the improvement of the methodologies and an understanding of the risk factors in the banking corporations and in the Banking Supervision Department.

The effect of the most severe stress tests on the Group's capital planning is examined with the aim of checking that the Group complies with all of the regulatory and internal restrictions established under the scenario.

Since 2012, the Banking Supervision Department in the Bank of Israel has conducted a macro-economic stress test for the banking system based on a uniform scenario. Within this context, Bank Leumi, like all other banks, estimates the results of the test using a variety of models and methodologies that are also based on subjective "expert valuations".

At the basis of the uniform stress tests which are carried out once a year, banks have two macro-economic scenarios which were designed by the Bank of Israel – a basis scenario and a stress scenario, which varies from year to year. It is important to note that the scenarios that are taken into account should not be construed as a forecast, but rather hypothetical scenarios which are intended to examine the compliance of the banking corporations in a very severe macro-economic environment.

The Banking Supervision Department integrates the results of the uniform stress test as a complementary component in the supervisory assessment processes (SREP), including quantitative and qualitative consideration. At the same time, the banking corporations are required to combine the uniform stress test in an internal process for assessing the ICAAP in the banks.

In the first quarter of 2016, Bank Leumi carried out a uniform stress scenario for 2015-2016 (a local stress scenario). In addition, in January 2017, the Bank completed the computation of a uniform stress scenario for 2016-2017 (a global stress scenario), at the directive and requirements of the Bank of Israel.

In addition, Leumi Group performs a set of internal stress scenarios, which is routinely updated. This is in order to examine principal focal points of risk, in view of the various developments in the environment in which the Bank operates, such as changes in the business environment, regulatory requirements, etc. Leumi's set of scenarios include, *inter alia*, a global systemic scenario, a local systemic scenario, operating scenarios, etc.

Risk profile - Definition of severity of the risk factors

The methodology for classifying the degree of severity of exposures to the various risks, as outlined in the table of severity of risk factors, is based on a subjective estimate of the quantification of the impact of the materialization of various scenarios on the Group's capital, i.e., its stability. The starting point for the degrees of severity defined below are based on the results of the realization of potential stress scenarios, assuming they will happen, and present the level of risk as divided into five levels. This is a function of the extent of impairment in relation to the Group's Tier 1 shareholders' equity adequacy in the event of the risk materializing. Risk at a "low" level of severity is defined as impairment of up to 0.5% in capital adequacy; "low-medium" as impairment in a range of 0.5%-1%, "medium" as impairment in a range of 1%-2%, "medium-high" as impairment of more than 2%, but without reducing the Tier 1 shareholders' equity adequacy ratio to below 6.5%. Impairment that will lead to a decrease in the Tier 1 shareholders' equity adequacy ratio to below 6.5% is defined below as risk of "high" severity. Beyond this starting point, subjective opinions are made regarding the risks which are complicated to quantify. Additional considerations, such as risk management processes, the effect of mutual relationships vis-à-vis other risks and changes in the external risk environment can raise or lower the assessment of the severity of the risks beyond that reflected in the quantitative assessment of the damage to the capital.

It is important to note that the said methodology for assessing the severity of the risk factors is also based on subjective valuations by an expert from among the relevant factors in the Bank. When any quantitative index, according to our estimate, does not give sufficient expression to the severity of the risk factor, more weight is given to a qualitative assessment.

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

Details of the risks are as follows:

1. Credit risk

Credit risk - The severity of overall credit risk is medium.

For further details on risk management, see below in chapter "Credit Risk".

Details of sub-risks included in the definition of credit risk according to the Group mapping are as follows:

1.1 Risk in respect of the quality of borrowers and collateral: The risk of the entry of a borrower/counterparty into default, leading to failure to meet contractual monetary obligations. The severity of the risk is defined as medium.

1.2 Concentration risk: The risk inherent in significant exposure to borrowers with similar economic or business characteristics or who are under the control and/or management of a certain factor These factors may lead, in the case of a change in the economic or business situation, to a similar effect on the ability to meet debt repayments of those borrowers. Below are details of sub-risks included in the definition according to the Group mapping:

1.2.1 Large borrower and group of borrowers' concentration risk: The severity of the risk level is defined as low;

1.2.2 Sectoral and segmental concentration risk: The severity of the risk is defined as medium;

2. Market risk

Market risk - The level of overall market risk is defined as low-medium.

For further details on market risk management, see below in the chapter "Market Risk".

2.1 Basis risk: The severity of the risk is defined as low;

2.2 Interest risk: The severity of the risk is defined as low-medium;

2.3 Bond margin and share prices risk: The severity of the risk was defined as low-medium.

3. Liquidity risk:

Uncertainty with regard to the possibility of raising funds and/or realizing assets, unexpectedly within a short timeframe, without causing material loss. In view of the fact that the Bank and the subsidiaries comply with the liquidity ratios they have set for themselves and the monetary damage in the most severe liquidity scenario, this risk is determined as low.

4. Operating risk

Operating risk - The evaluation of the level of severity relates to damage at a highly serious level and a review of historical events. The assessment of the operating risk relates, *inter alia*, to technological risks and to cyber risks. The level of severity of the operating risk is defined as medium.

For further information on management of operating risk, see chapter "Operating Risks".

5. Regulatory risk

Regulatory risk is comprised of three inter-connected risks:

- Legal risk - The risk of loss resulting from the inability to legally enforce the performance of an agreement or contingent liability, including in respect of claims and demands from the Bank. The definition includes risks deriving from legislation, regulations, case law and authority directives, risks deriving from operations not backed by adequate agreements or without legal counseling or according to deficient legal counseling, and as a result of interpretation with regard to mutual employee rights by virtue of agreements between the Bank and its customers.
- **Compliance risk:** The risk that may derive from non-compliance with regulatory requirements and laws of the various authorities in Israel and abroad.
- **Regulatory and legislation risk** – The risk that future changes in the provisions of the law will adversely impact the Bank's business activity.

6. Reputational risk

The risk that the publication or public disclosure of a transaction or customer-related business practice, as well as business results and events pertaining to the Group, may have an adverse impact on the public's confidence in the Group or cause a decline in the customer base or result in high legal costs or a drop in income.

The level of severity of reputational risk was defined as low-medium.

For further information regarding reputational risk, see Chapter "Other risks".

7. Pension risk

Pension risk is defined as all of the risks related to the pensions of the Bank's first-generation employees, including, changes in the actuarial parameters (e.g. life expectancy) and changes in interest rates and debenture margins which are likely to increase the extent of future obligations, which is a high monetary total compared with the Bank's capital and is characterized by a long duration. On the other hand, the effect of changes in interest rates, inflation, currency rates, credit margins and the prices of shares and funds on the revaluation of assets which the Bank has placed against the pension liabilities. The individual approval received by the Bank, whereby the capitalization interest will be calculated according to a moving average of the market yields over a period of eight quarters, has significantly moderated the volatility and has a greater weight than in the past in its effect on regulatory capital. The level of severity of pension risk of the Group is assessed as low - medium.

8. Strategic risk – Competition and customers

Business risk, including the current and future implications on capital, profits, goodwill or a status arising from erroneous business decisions, the improper implementation of the decisions or the lack of a response to sectoral, economic, regulatory and technological changes. Risk, the realization of which is likely to lead to impairment in the Group's ability to achieve its targets.

In view of the profitability challenges in the environment of competition, uncertainty in relation to the impact of the regulations prevailing on the financial system in Israel. challenges around the banking world and technological changes, we believe that the impact of this risk is low-medium.

9. Global systemic risk

Risks deriving from economic, political, and geopolitical events around the world that can jeopardize the Group's stability, such as a global economic crisis. The assessment of the risk is based on the total loss in a very severe global stress scenario of the Group including the occurrence of a number of risks together. The degree of severity of risk in Leumi was defined as medium-high.

10. Local systemic risk

Risks deriving from economic, political, and geopolitical events in Israel, which can jeopardize the Group's stability, and result in a local real estate crisis. The assessment of the risk is based on the total loss in a real estate stress scenario of the Group including the occurrence of a number of risks together. The degree of severity of risk in Leumi is defined as medium.

Credit risk

Credit is a central core activity of the Bank and the Group, which is conducted in a number of business lines in a decentralized manner.

Credit risk is the Bank's risk of a loss as a result of the possibility that a borrower/counterparty does not meet its obligation vis-à-vis the banking corporation, as agreed.

The Bank implements an overall policy for credit risk management, in accordance with the provisions of Proper Conduct of Banking Management Regulation no. 311.

Core activity in all the lines of business and the credit risk is managed respectively through three lines of defense. The central principles in the management of credit risk are laid out in the document "Credit Policy and Credit Risk" which is scanned each year and updated as necessary with the approval of the Bank management and the Board of Directors.

Control and management processes

In the area of credit management, there are procedures for the monitoring and control of the risks, adapting them to the characteristics of the customers and the organizational units which deal with them. Further to the steps taken in recent years, such as the establishment of centers of expertise for the area of credit in the Retail Division, the merger of mortgage activity in the Banking Division, in 2016, further measures were carried out which contributed to the improvement of the control and monitoring of credit risk. The main changes were: the merger of the Arab Israel Bank in the Banking Division and the "segmentation" of customers in the framework of specialist branches.

In addition to the treatment and control at the individual credit level, considerable resources are devoted to the management of credit portfolio as a whole, and segments within it, including monitoring and control of the relevant concentration focal points.

Reporting on credit risk

The Bank is meticulous in maintaining routine and up-to-date reporting to members of the Bank Management, the Board of Directors and the Banking Supervision Department.

The lines of reporting are defined and are maintained at the level of the individual borrowers and at the level of monitoring the credit portfolio in its entirety and segments thereof.

Tools for managing credit risk

Pursuant to the tools and methods for managing credit risk, use is also made of quantitative models for rating the risk of borrowers and for evaluating and monitoring the risk at portfolio level.

The internal rating is a central layer in the process of decision-making and credit pricing and in monitoring quality over the long term.

Two main tools are used by the Bank to estimate the internal rating of borrowers. One – a rating system intended for retail customers, based on the features of the customer's activity over the long term; and two – a rating system for borrowers - intended for corporate-commercial customers, based on structured expert questionnaires. The models according to which the rating is carried out in the abovementioned systems are routinely validated and monitored.

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

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

Problem Credit Risk

	31 December 2016		
	Balance sheet	Off-balance sheet	Total
	NIS millions		
1. Problem credit risk: (a)			
Impaired credit risk	**3,657**	**331**	**3,988**
Substandard credit risk	**1,271**	**81**	**1,352**
Special mention credit risk (b)	**2,787**	**1,284**	**4,071**
Total problem credit	**7,715**	**1,696**	**9,411**
Of which: unimpaired debts in arrears 90 days or more (b)	**1,003**	**-**	**-**
2. Non-performing assets:			
Impaired debts	**3,223**	**-**	**-**
Assets received in respect of loans repaid	**14**	**-**	**-**
Total non-performing assets	**3,237**	**-**	**-**

	31 December 2015		
	Balance sheet	Off-balance sheet	Total
	NIS millions		
1. Problem credit risk: (a)			
Impaired credit risk	3,940	295	4,235
Substandard credit risk	1,413	235	1,648
Special mention credit risk (b)	2,995	886	3,881
Total problem credit	8,348	1,416	9,764
Of which: unimpaired debts in arrears 90 days or more (b)	942	-	-
2. Non-performing assets:			
Impaired debts	3,485	-	-
Assets received in respect of loans repaid	7	-	-
Total non-performing assets	3,492	-	-

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

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

(b) Including in respect of housing loans in respect of which there is an allowance according to the extent of arrears and in respect of housing loans in respect of which there is no allowance according to the extent of arrears which are in arrears of 90 days or more.

Details of Credit Risk Metrics

	31 December 2016	31 December 2015
	%	
Balance of impaired credit to the public as a percentage of the balance of credit to the public	**1.38**	1.48
Balance of credit to the public which is not impaired in arrears of 90 days or more as a percentage of the balance of credit to the public	**0.38**	0.36
Problem commercial credit risk in respect of the public as a percentage of total credit risk in respect of the public	**2.90**	3.14
Balance of the allowance for credit losses in respect of the public as a percentage of the average balance of credit to the public	**(0.05)**	0.08
Net write-offs in respect of credit to the public as a percentage of the average balance of credit to the public	**-**	0.20

For further information regarding the provisions governing the measurement and disclosure of impaired debts, credit risk and credit loss allowance, see Chapter "Critical Accounting Policy, Provision for credit losses and classification of problem debts".

Balance of impaired debts

	31 December 2016	31 December 2015
	NIS millions	NIS millions
Balance of impaired debts at the beginning of the year	**3,921**	4,792
Debts classified as impaired debts during the year	**1,559**	1,399
Debts returned classification as unimpaired	**(162)**	(205)
Accounting write offs	**(162)**	(205)
Collection of debts written off in previous years	**30**	7
Other	**(1,403)**	(1,058)
Balance of impaired debts at the end of the period	**3,653**	3,921

Disclosure, assessment, classification and rules for credit loss allowance

On the subject of expenses in respect of credit losses and the classification of problem debts, the Bank follows the directives of the Supervisor of Banks, which came into force on 1 January 2011, and the updates of said directives since that date. The Bank's practice is to estimate, assess and update the amount of the allowance for credit losses on a current basis, in accordance with economic forecasts, assessments regarding the various markets and past experience.

The allowance for credit losses in relation to the credit portfolio may be divided into an individual allowance and a collective allowance.

Income in respect of credit losses for 2016 amounted to NIS 125 million, representing a rate of 0.05% of the portfolio of credit to the public. The rate is influenced by a number of principal factors:

- A low rate of individual allowances in light of the lack of allowances in respect of prominent customers.
- The significant amounts of collections, including in respect of debts written off.

For further information, see Note 13.

	31 December 2016	31 December 2015
	%	
Balance of the allowance for credit losses in respect of credit to the public as a percentage of the balance of credit to the public	**1.5**	1.6
Balance of the allowance for credit losses in respect of credit to the public as a percentage of the balance of impaired credit to the public	**110.2**	105.9
Balance of the allowance for credit losses in respect of credit to the public as a percentage of the balance of impaired credit to the public with the addition of the balance of credit to the public in arrears of 90 days or more	**86.4**	85.4
Net write-offs in respect of credit to the public as a percentage of the balance of the allowance for credit losses in respect of credit to the public	**0.1**	(12.8)

For further information regarding the provisions governing the measurement and disclosure of impaired debts, credit risk and credit loss allowance, see chapter "Critical Accounting Policy, Provision for credit losses and classification of problem debts".

Credit concentration

Concentration risk is defined as a single exposure or group of exposures with a common denominator and a potential for causing significant losses. Concentration risk management is conducted by determining restrictions and monitoring and controlling compliance therewith. The aspect of concentration is also reflected in the pricing of credit which reflects the risk.

Dispersal of the credit portfolio among the various market sectors

The Bank's credit portfolio is split among the various market sectors in order to disperse the risk inherent in a situation of high concentration in one sector. In the market sectors characterized by a relatively low level of risk, we strive to achieve a high rate of financing from our share in the system.

The Bank's credit policy with regard to various operating segments and different market sectors varies from time to time in accordance with the business environment, the Bank's business focus, the Bank's risk appetite and the specific and general directives of the Bank of Israel.

In addition, to the sectoral dispersal limit imposed by the Bank of Israel with regard to the 20 main market sectors, the Bank defines internal limits for the dispersal of the credit as a part of its risk policy on the basis of the market sectors and sub-sectors, as a percentage of the credit risk (and in the part of the sub-sectors in an absolute amount).

Overall credit risk to the public by sector of the economy

	31 December 2016									
	Overall credit risk (a)			Debts (b) and off-balance sheet credit risk (excluding derivatives) (c)						
								Credit losses (d)		
					[1]Of which:					
	Total	Credit performance rating	Problematic (e)	Total[1]	Debts (b)	Problematic (e)	Impaired	Expenses in respect of credit losses	Net accounting write-offs	Balance of allowance for credit losses
	(NIS millions)									
In respect of activity of borrowers in Israel										
Public - commercial										
Agriculture	**2,168**	**1,975**	**193**	**2,165**	**1,863**	**192**	**93**	**23**	**7**	**(54)**
Mining and quarrying	**726**	**717**	**9**	**703**	**290**	**9**	**-**	**-**	**-**	**-**
Industry	**20,837**	**19,559**	**1,278**	**20,531**	**13,941**	**1,281**	**460**	**(189)**	**(203)**	**(526)**
Construction and real estate - construction	**45,662**	**44,106**	**1,556**	**45,588**	**15,576**	**1,556**	**380**	**(7)**	**17**	**(328)**
Construction and real estate - real estate activity	**26,440**	**25,313**	**1,127**	**26,373**	**23,878**	**1,127**	**751**	**(303)**	**(79)**	**(433)**
Electricity and water	**4,849**	**4,483**	**366**	**4,569**	**3,060**	**366**	**269**	**23**	**4**	**(68)**
Commerce	**28,011**	**26,960**	**1,051**	**27,842**	**22,685**	**1,033**	**252**	**33**	**13**	**(321)**
Hotels, accomodation and food services	**2,587**	**2,364**	**223**	**2,566**	**2,307**	**223**	**94**	**(74)**	**(76)**	**(28)**
Transport and storage	**7,872**	**7,613**	**259**	**7,739**	**6,789**	**254**	**169**	**(52)**	**(57)**	**(44)**
Communications and computer services	**5,707**	**5,495**	**212**	**5,445**	**4,067**	**208**	**197**	**(15)**	**(2)**	**(69)**
Financial services	**19,520**	**19,037**	**483**	**14,605**	**10,854**	**482**	**476**	**(82)**	**(23)**	**(222)**
Other business services	**8,908**	**8,762**	**146**	**8,876**	**6,264**	**146**	**50**	**95**	**37**	**(147)**
Public and community services	**8,524**	**8,469**	**55**	**8,500**	**7,148**	**55**	**13**	**5**	**(5)**	**(52)**
Total commercial	**181,811**	**174,853**	**6,958**	**175,502**	**118,722**	**6,932**	**3,204**	**(543)**	**(367)**	**(2,292)**
Private individuals - housing loans	**80,570**	**79,850**	**720**	**80,570**	**78,645**	**719**	**-**	**(10)**	**25**	**(462)**
Private individuals - other	**67,691**	**67,035**	**656**	**67,683**	**38,141**	**656**	**108**	**458**	**291**	**(820)**
Total public - activity in Israel	**330,072**	**321,738**	**8,334**	**323,755**	**235,508**	**8,307**	**3,312**	**(95)**	**(51)**	**(3,574)**
Israeli banks	**6,233**	**6,233**	**-**	**1,801**	**1,742**	**-**	**-**	**(2)**	**-**	**(1)**
Government of Israel	**41,992**	**41,992**	**-**	**206**	**206**	**-**	**-**	**-**	**-**	**-**
Total activity in Israel	**378,297**	**369,963**	**8,334**	**325,762**	**237,456**	**8,307**	**3,312**	**(97)**	**(51)**	**(3,575)**

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments as calculated for borrower debt limitations in the sum of NIS 237,456, 41,059, 3,298, 1,284, 95,200 million, respectively.
(b) Credit risk to the public, credit to governments, deposits with banks and other debts, except for bonds and securities borrowed or purchased under agreements to resell.
(c) Credit risk of off-balance sheet financial instruments as calculated for the purpose of single borrower debt limitation, except in respect of derivative instruments.
(d) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other liabilities").
(e) Impaired, substandard, or special mention balance sheet credit risk, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans for which there is no provision by extent of arrears that are in arrears of 90 days or more.
(f) Credit risk whose credit rating on the report date corresponds with the credit rating for making new credit in accordance with the Bank's policy.
(g) Including housing loans, extended to certain purchasing groups in the process of construction.
(h) The balance of commercial debts includes the balance of housing loans, amounting to NIS 909 million, which were extended to purchasing groups in the process of construction.

Overall risk of credit to the public by sector of the economy (contd.)

	31 December 2016									
	Overall credit risk (a)			Debts (b) and off-balance sheet credit risk (excluding derivatives) (c)						
								Credit losses (d)		
					[1]Of which:					
	Total	Credit performance rating	Problematic (e)	Total[1]	Debts (b)	Problematic (e)	Impaired	Expenses in respect of credit losses	Net accounting write-offs	Balance of allowance for credit losses
	(NIS millions)									
In respect of activity of borrowers abroad Public - commercial										
Agriculture	**85**	**84**	**1**	**83**	**58**	**1**	**1**	**(1)**	**-**	**(1)**
Mining and quarrying	**12**	**12**	**-**	**11**	**5**	**-**	**-**	**-**	**-**	**-**
Industry	**8,630**	**8,427**	**203**	**7,229**	**4,613**	**205**	**45**	**(18)**	**18**	**(45)**
Construction and real estate - construction (g)	**13,722**	**13,193**	**529**	**13,342**	**9,540**	**529**	**326**	**(34)**	**2**	**(189)**
Electricity and water	**169**	**169**	**-**	**80**	**45**	**-**	**-**	**-**	**-**	**-**
Commerce	**7,015**	**6,969**	**46**	**6,888**	**4,659**	**46**	**39**	**16**	**2**	**(89)**
Hotels, accomodation and food services	**1,995**	**1,991**	**4**	**1,978**	**1,705**	**4**	**-**	**(1)**	**-**	**(9)**
Transport and storage	**131**	**79**	**52**	**115**	**101**	**52**	**43**	**13**	**33**	**(5)**
Communications and computer services	**2,011**	**2,011**	**-**	**1,810**	**898**	**-**	**-**	**-**	**-**	**(1)**
Financial services	**16,305**	**16,201**	**104**	**1,972**	**1,465**	**104**	**104**	**(7)**	**(3)**	**(53)**
Other business services	**6,402**	**6,357**	**45**	**6,330**	**5,488**	**45**	**18**	**8**	**-**	**(24)**
Public and community services	**831**	**789**	**42**	**824**	**463**	**42**	**42**	**(4)**	**(4)**	**(19)**
Total commercial	**57,308**	**56,282**	**1,026**	**40,662**	**29,040**	**1,028**	**618**	**(28)**	**48**	**(435)**
Private individuals - housing loans	**494**	**448**	**46**	**494**	**486**	**46**	**46**	**1**	**6**	**(11)**
Private individuals - other	**486**	**481**	**5**	**486**	**416**	**5**	**5**	**(1)**	**-**	**(5)**
Total public - activity abroad	**58,288**	**57,211**	**1,077**	**41,642**	**29,942**	**1,079**	**669**	**(28)**	**54**	**(451)**
Foreign banks	**23,561**	**23,561**	**-**	**10,385**	**9,654**	**-**	**-**	**-**	**-**	**-**
Foreign governments	**15,220**	**15,220**	**-**	**833**	**436**	**-**	**-**	**-**	**-**	**-**
Total activity abroad	**97,069**	**95,992**	**1,077**	**52,860**	**40,032**	**1,079**	**669**	**(28)**	**54**	**(451)**
Total	**475,366**	**465,955**	**9,411**	**378,622**	**277,488**	**9,386**	**3,981**	**(125)**	**3**	**(4,026)**

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments as calculated for borrower debt limitations in the sum of NIS 40,032, 34,200 -, 7,361, 15,476 million, respectively.

(b) Credit risk to the public, credit to governments, deposits with banks and other debts, except for bonds and securities borrowed or purchased under agreements to resell.

(c) Credit risk of off-balance sheet financial instruments as calculated for the purpose of single borrower debt limitation, except in respect of derivative instruments.

(d) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other liabilities").

(e) Impaired, substandard, or special mention balance sheet credit risk, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans for which there is no provision by extent of arrears that are in arrears of 90 days or more.

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

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

Overall risk of credit to the public by sector of the economy (contd.)

	31 December 2015									
	Overall credit risk (a)			Debts (b) and off-balance sheet credit risk (excluding derivatives) (c)						
								Credit losses (d)		
					[1]Of which:					
	Total	Credit performance rating (f)	Problematic (e)	Total[1]	Debts (b)	Problematic (e)	Impaired	Expenses in respect of credit losses	Net accounting write-offs	Balance of allowance for credit losses
	(NIS millions)									
In respect of activity of borrowers in Israel										
Public - commercial										
Agriculture	2,075	1,951	124	2,070	1,775	123	50	16	(8)	(40)
Mining and quarrying	713	713	-	583	501	-	-	(2)	-	-
Industry	24,498	22,852	1,646	24,066	15,669	1,646	577	1	(60)	(527)
Construction and real estate - construction (g)	47,249	45,433	1,816	47,155	15,688	1,815	639	65	(15)	(348)
Construction and real estate - real estate activity	27,556	25,925	1,631	27,485	24,653	1,631	1,053	18	70	(630)
Electricity and water	4,985	4,925	60	4,735	3,162	60	-	(7)	-	(28)
Commerce (h)	26,552	25,614	938	26,374	21,531	908	244	(42)	12	(306)
Hotels, accomodation and food services	3,030	2,840	190	3,030	2,666	190	138	4	3	(31)
Transport and storage	6,757	6,420	337	6,645	5,897	337	268	15	15	(39)
Communications and computer services	6,162	5,895	267	5,871	4,128	263	255	(82)	(7)	(81)
Financial services	20,758	20,683	75	14,709	9,570	75	62	(151)	(12)	(267)
Other business services	7,720	7,628	92	7,701	5,462	92	34	40	30	(92)
Public and community services	7,781	7,755	26	7,742	6,523	26	11	(4)	17	(44)
Total commercial	185,836	178,634	7,202	178,166	117,225	7,166	3,331	(129)	45	(2,433)
Private individuals - housing loans	83,292	82,513	779	83,292	80,633	779	-	14	10	(497)
Private individuals - other	65,815	65,363	452	65,807	36,991	452	63	309	245	(653)
Total public - activity in Israel	334,943	326,510	8,433	327,265	234,849	8,397	3,394	194	300	(3,583)
Israeli banks	7,048	7,048	-	3,347	2,146	-	-	2	-	(2)
Government of Israel	37,243	37,243	-	262	262	-	-	-	-	-
Total activity in Israel	379,234	370,801	8,433	330,874	237,257	8,397	3,394	196	300	(3,585)

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments as calculated for borrower debt limitations in the sum of NIS 237,258, 36,036, 1,764, 5,081, 99,095 million, respectively.
(b) Credit risk to the public, credit to governments, deposits with banks (in 2014 except for deposits in the Bank of Israel) and other debts, except for bonds and securities borrowed or purchased under agreements to resell.
(c) Credit risk of off-balance sheet financial instruments as calculated for the purpose of single borrower debt limitation, except in respect of derivative instruments.
(d) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other liabilities").
(e) Impaired, substandard, or special mention balance sheet credit risk, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans for which there is no provision by extent of arrears that are in arrears of 90 days or more.
(f) Credit risk whose credit rating on the report date corresponds with the credit rating for making ne credit in accordance with the Bank's policy.
(g) In housing loans, extended to certain purchasing groups in the process of construction.
(h) The balance of commercial debts includes the balance of housing loans, amounting to NIS 1,216 million, which were extended to purchasing groups in the process of construction.

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Overall risk of credit to the public by sector of the economy (contd.)

	31 December 2015									
	Overall credit risk (a)			Debts (b) and off-balance sheet credit risk (excluding derivatives) (c)						
								Credit losses (d)		
					[1]Of which:					
	Total	Credit performance rating (f)	Problematic (e)	Total[1]	Debts (b)	Problematic (e)	Impaired	Expenses in respect of credit losses	Net accounting write-offs	Balance of allowance for credit losses
	(NIS millions)									
In respect of activity of borrowers in Israel Public - commercial										
Agriculture	127	125	2	127	72	2	2	2	1	(2)
Mining and quarrying	76	76	-	37	28	-	-	-	-	-
Industry	8,239	7,909	330	6,984	4,582	330	98	(4)	27	(92)
Construction and real estate - construction (g)	13,291	12,654	637	12,761	9,571	637	434	10	79	(230)
Electricity and water	371	371	-	88	56	-	-	-	-	-
Commerce	7,712	7,680	32	7,623	5,017	32	31	(2)	85	(79)
Hotels, accomodation and food services	1,577	1,549	28	1,577	1,441	28	24	(1)	-	(10)
Transport and storage	235	149	86	217	192	86	86	(2)	9	(31)
Communications and computer services	2,076	2,076	-	1,766	661	-	-	(1)	-	(1)
Financial services	16,994	16,902	92	2,768	1,587	92	92	45	7	(68)
Other business services	5,477	5,426	51	5,407	4,460	51	2	(2)	(1)	(16)
Public and community services	512	511	1	501	387	1	1	(39)	14	(19)
Total commercial	56,687	55,428	1,259	39,856	28,054	1,259	770	6	221	(548)
Private individuals - housing loans	1,176	1,126	50	1,176	1,172	50	29	-	2	(16)
Private individuals - other	1,120	1,098	22	1,108	995	22	22	-	8	(6)
Total public - activity abroad	58,983	57,652	1,331	42,140	30,221	1,331	821	6	231	(570)
Foreign banks	22,269	22,269	-	10,119	8,170	-	-	(3)	-	(1)
Foreign governments	11,667	11,667	-	480	191	-	-	-	-	-
Total activity abroad	92,919	91,588	1,331	52,739	38,582	1,331	821	3	231	(571)
Total	472,153	462,389	9,764	383,613	275,839	9,728	4,215	199	531	(4,156)

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, bonds, securities borrowed or purchased under agreements to resell, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments as calculated for borrower debt limitations in the sum of NIS 38,581, 30,120, 6,169, 18,049 million, respectively.

(b) Credit risk to the public, credit to governments, deposits with banks and other debts, except for bonds and securities borrowed or purchased under agreements to resell.

(c) Credit risk of off-balance sheet financial instruments as calculated for the purpose of single borrower debt limitations, except in respect of derivative instruments.

(d) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other liabilities").

(e) Impaired, substandard, or special mention balance sheet credit risk, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans for which there is no provision by extent of arrears that are in arrears of 90 days or more.

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

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

Activity and risk restrictions in the construction and real estate sector

The construction and real estate is the area of activity in which the Bank has the greatest exposure of all the corporate market sectors. As with other market sectors, methodologies and parameters for financing transactions in each of the sub-sectors of the real estate industry are defined for the real estate sector as part of the credit risk policy.

The emphasis given by Leumi to the financing of real estate sector is reflected, inter alia, in the fact that a significant part of the Bank's activity is concentrated in a specifically designated system specially adapted for dealing with customers in this area. The Construction and Real Estate Department supports large and/or complex transactions in the area, reflecting the expertise and practical experience of the credit officers manning it.

A significant part of the construction financing is done in a "closed project" (construction loan) format which is characterized by a periodic examination and a close review of the relevant parameters (such as the rate of sales, progress of construction, adherence to budget, etc.) relying on and with the assistance of qualified external building supervisors.

The Bank has a special unit to handle complex transactions for financing investments in infrastructure projects (power stations, desalination facilities, toll roads, BOT (Build-Operate-Transfer) projects and the like). This unit examines the projects and sets up the appropriate financing package, including possible collaboration with other banks and other capital market entities in financing the transaction.

As a part of the Bank's strategy to finance its customers also in particular countries in which they operate outside of Israel, and with the aim of dispersing risks, the Bank also regularly participates in the financing of real estate abroad. The projects which are financed abroad are examined in detail, taking into account also the political and economic risk in the country. The financing is effected on a selective basis, usually through the relevant offices of the Bank, in a controlled fashion and after examining all of the customers' activity.

The credit portfolio in the area of real estate is closely monitored. In addition, to the test of compliance with the internal and regulatory limits (see below), the trends and development of the risk are tested, including the macroeconomic features of the economy and secondary sectors, including a breakdown of internal ratings, the allocation between the various business lines, central parameters, forward-looking assessment regarding the expected level of risk, etc.

In order to continue improving the monitoring and analysis of the real estate portfolio, the Bank is investing in expanding the automated database which facilitates an aggregative analysis of the portfolio.

Below is the development of indebtedness to the construction and real estate sector (in Israel and abroad):

	31 December 2016	31 December 2015	Change	
	NIS millions		NIS millions	%
Balance sheet credit risk	**49,368**	50,419	(1,051)	(2.1)
Guarantees to apartment purchasers (a)	**8,421**	8,379	42	0.5
Other off-balance sheet credit risk	**28,035**	29,298	(1,263)	(4.3)
Total	**85,824**	88,096	(2,272)	(2.6)

(a) Weighted according to balance sheet value.

The credit risk of the construction and real estate sector in Israel constitutes 21.84% of total credit risk in Israel.

However, according to the calculation rules laid down by the Bank of Israel for determining the rate of concentration sector of the economy, in accordance with Proper Conduct of Banking Business Directive no. 315 "Supplementary Provision for Doubtful Debts", total indebtedness in the sector at the Bank amounts to some 17.86% of total indebtedness in Israel.

On 8 March 2016, an agreement was completed with international reinsurers with high international-rating to purchase insurance for the portfolio of guarantees by virtue of the Sales Law (Apartments) and to the liability portfolio to take out guarantees as aforesaid. The insurance policy ensures the Bank in the event that it will have to pay due to the realization of the guarantees, all according to the terms of the policy. The purchase of the insurance policy enables the reduction of the restricted capital in respect of the risk of the credit deriving from the issue of the guarantees, while using the policy as a "credit risk mitigation policy".

On 29 September 2016, the Supervisor of Banks published an amendment to Proper Conduct of Banking Business Directive no. 315. According to the amendment, the method by which sector indebtedness is measured will be changed, such that the credit risk deriving from bank guarantees pursuant to the Sales Law (Apartments) against which the banks have effected insurance vis-à-vis overseas insurance companies, for the purposes of this regulation, will be mainly classified in the financial services sector, instead of credit to the real estate sector. As a result of this change, the ratio of concentration to the construction and real estate fell.

In addition to the regulatory restriction and in order to effectively manage the internal mix of the credit risk, the Bank makes sure to disperse the geographical areas in which the projects are being built according to demand, and between the various sub-sectors.

As at 31 December 2016, the Bank is within the regulatory limit and the internal limits, which conform to the Bank's assessment of risk in the various sub-sectors.

The rate which represents each of the main sub-sectors out of the Bank's overall indebtedness to the real estate area as of the end of 2016 is as follows:

- Initiation of residential construction – 42%
- Activity in real estate (mainly rental property) – 35%

  Of which: rental office property – 10%
- Performance and infrastructure contractors – 12%
- Purchasing groups – 4%
- Infrastructure projects, trade in products for construction and product industry for construction – 7%

Below is the breakdown of credit for construction and real estate in the Bank according to total credit to a single borrower:

Total credit to single borrower (NIS millions		Balance of credit
From-	To-	NIS million
-	10	11
10	20	23
20	40	64
40	80	192
80	150	404
150	300	818
300	600	1,762
600	1200	3,141
1,200	2,000	2,332
2,000	4,000	3,468
4,000	8,000	4,432
8,000	20,000	6,547
20,000	40,000	5,826
40,000	200,000	21,264
200,000	400,000	10,501
400,000	800,000	11,995
800,000	1,200,000	2,787

Below are additional data of total credit

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

Credit ceiling in NIS thousands		**31 December 2016** Percentage of total number of borrowers	Percentage of total balance sheet credit	Percentage of total off-balance sheet credit	31 December 2015 Percentage of total number of borrowers	Percentage of total balance sheet credit	Percentage of total off-balance sheet credit
From	To	%			%		
-	80	**81.0**	**6.0**	**19.8**	81.3	5.8	18.3
80	600	**15.3**	**20.6**	**11.9**	14.9	19.9	10.9
600	1,200	**2.5**	**15.2**	**4.0**	2.5	15.4	3.8
1,200	2,000	**0.7**	**7.2**	**2.4**	0.7	7.2	2.4
2,000	8,000	**0.4**	**9.4**	**5.3**	0.4	9.6	5.3
8,000	20,000	**0.1**	**6.7**	**4.8**	0.1	6.6	4.2
20,000	40,000	**0.04**	**6.2**	**5.3**	0.04	6.3	5.3
40,000	200,000	**0.04**	**17.3**	**18.5**	0.04	15.7	18.3
200,000	800,000	**0.01** (a)	**8.6**	**22.4**	0.01 (a)	10.8	23.7
Above 800,000		**0.001** (b)	**2.8**	**5.6**	0.001 (b)	2.7	7.8
Total		**100.00**	**100.0**	**100.0**	100.00	100.0	100.0

(a) In 2016 - 128 borrowers and 2014 – 154 borrowers
(b) In 2016 - 12 borrowers and 2014 – 13 borrowers
For additional information on the allocation of credit by size – see Note 30B.

The following is a summary of balances of credit to the public and off-balance sheet credit whose scope to a single borrower exceeds NIS 800 million in a more detailed cut-off of the size of credit and in the cut-off of market sectors at 31 December 2016.

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

		31 December 2016			31 December 2015		
		Number of borrowers	Balance sheet credit	Off-balance sheet credit risk	Number of borrowers	Balance sheet credit	Off-balance sheet credit risk
Credit ceiling in NIS millions		Total	Total	Total	Total	Total	Total
From-	To-		NIS million			NIS million	
800	1,200	**9**	**3,849**	**4,690**	8	1,926	5,226
1,200	1,600	**1**	**869**	**432**	2	2,205	615
1,600	2,000	**2**	**2,895**	**789**	1	35	1,613
2,000	2,185	-	-	-	2	3,065	1,193
Total		**12**	**7,613**	**5,911**	13	7,231	8,647

There are no related parties in respect of which the credit and off-balance sheet credit exceeds NIS 800 million.

Groups of borrowers [1]

The Bank maintains a designated monitoring of the exposure of large groups of borrowers in all their components for the purposes of reporting to the Bank of Israel and for examining compliance of the scope of obligation with the regulatory limitations and for the purposes of internal monitoring. In addition, there is an internal process, in the framework of which a central official in the bank ("the Group head") is appointed for each of the large groups and there is coordination and information flow regarding the group components, between the various units in Leumi, with the objective of reinforcing the control on credit exposure and concentration risk deriving therefrom.

Moreover, regarding the small number of the largest groups of borrowers, the head of the group is required, once a year, to provide the Board of Directors of the Bank with a comprehensive review of the group.

With regard to the management of the credit portfolio of the Bank as a whole, the Bank implements an internal process of estimating concentration risk inherent in the exposure to all the large groups of borrowers, and the effect of that risk on the overall risk level of the portfolio. The above process enables both the quantification of the allocation of adequate equity according to the Proper Conduct of Banking Business Directive, and the performance of follow-up and ongoing monitoring of trends within the concentration component as part of the development trends of the entire portfolio.

The Bank is prepared to meet all the requirements of the update of Proper Conduct of Banking Business Directive No. 313, an update which came into effect on 1 January 2016, and the main point of which is the transition to Tier 1 capital and gradually by 31 December 2018 in relation to which the restriction is defined.

Limits on indebtedness of a borrower or group of borrowers

1. As at 31 December 2016, the Group had no exposure to a group of borrowers whose indebtedness exceeds 15% of the Bank's capital (as defined in Proper Conduct of Banking Business Directive No. 313).
2. As of 31 December 2016, the Group has no credit exposure to large borrowers, groups of borrowers and banking groups of borrowers whose debt exceeds 10% of the Bank's capital. The regulatory limit is 120% of the Bank's capital**.**

Geographic dispersal

Mapping of exposure data of the activity of borrowers to countries/regions:

Geographic dispersal is defined as one of the potential credit concentration risks in a portfolio (in addition to sector dispersal and exposure to large borrowers and to groups of borrowers and concentrations of collateral). Geographic risk means: economic/political/security deterioration in countries to which the borrower is exposed is likely to lead to impairment in the financial position of its company and its ability to meet its liabilities.

As part of borrower rating questionnaires, which are used for estimating the internal rating of corporate borrowers, questions relating to geographic exposure, are included. This refers to the mix of revenues and/or the mix of the firm's cash flows, the location of the material assets being used to create its activity (assets used in generating revenue, such as plant, logistical center, warehouse, head offices, rental property, etc.), as well as assets used as collateral for the company's debts.

These data enable the Bank to conduct an examination from the perspective of the entire portfolio of the exposure of the borrowers to the various countries, for the purposes of monitoring and risk management.

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[1] A group of borrowers is defined as all the following together: the borrower, a person controlling it or anyone controlled thereby. When a corporation is controlled by more than one individual, it is required to include in one group of borrowers those controllers for which the controlled corporation is material (e.g., from a capital perspective), including the controlled corporation and anyone controlled by them; an investee corporation which is material for a holder who has no control and anyone controlled by them; borrowers related in such a way that the impairment in the financial stability of any of them is likely to have implications for the financial stability of the other, or that those factors are likely to have implications for the financial stability of both of them.

Exposure to foreign countries

In accordance with the Directive of the Supervisor of Banks, exposure to foreign countries is shown on an end-risk basis, as follows:

1. The accounting balance of a debt is to be dealt with as the amount of exposure to the legal country of residence of the debtor bearing the end risk, after the effect of guarantees, liquid collateral and credit derivatives.
2. The accounting balance of an investment in shares is to be dealt with as the amount of exposure to the country of residence of the issuer of the security.
3. Off-balance sheet credit risk is shown as an off-balance sheet exposure to the country of residence of the counterparty to the transaction, as calculated for the purpose of single borrower debt limitations.

From the aspect of determining end-risk, collateral is to be considered as follows:

a. Third party guarantees - according to the country of residence of the guarantor.

b. Securities - the country of residence is that of the issuer of the security.

c. The directive makes it clear that real estate and debtors' balances do not represent collateral for purposes of determining end-risk.

d. For purposes of determining end-risk, only specific collateral was taken into account.

The exposure by country is divided as follows: United States 51%, Europe (Germany, France, Italy, Spain and the Benelux countries) 15%, United Kingdom 19%, and other countries, 15%.

Part A – Information on total exposure to foreign countries and on exposure to countries whose total individual exposure exceeds 1% of total assets or exceeds 20% of total equity for the purpose of calculating capital ratios, whichever the lower.

	31 December 2016						
	Balance sheet exposure (a)						
	Cross-Border Balance Sheet Exposure				Balance sheet exposure of foreign offices of the banking corporation to local		
	To governments (c)	To banks	To others		Balance sheet exposure before deducting local liabilities	Deduction for local liabilities	Net balance sheet exposure after deducting local liabilities
	NIS millions						
Country							
United States	**10,013**	**2,003**	**9,193**	**-**	**26,847**	**13,879**	**12,968**
United Kingdom	**252**	**2,534**	**3,656**	**-**	**6,838**	**1,567**	**5,271**
France	**810**	**1,350**	**304**	**-**	**-**	**-**	**-**
Switzerland	**-**	**576**	**888**	**-**	**62**	**29**	**33**
Germany	**-**	**2,201**	**354**	**-**	**-**	**-**	**-**
Others	**2,726**	**5,232**	**4,637**	**-**	**1,164**	**633**	**531**
Total exposure to foreign countries	**13,801**	**13,896**	**19,032**	**-**	**34,911**	**16,108**	**18,803**
Total exposure to LDC countries	**397**	**1,227**	**679**	**-**	**1,146**	**633**	**513**
Total exposure to GIIPS countries (d)	**372**	**10**	**328**	**-**	**-**	**-**	**-**

	31 December 2016						
	Balance sheet exposure (a)			Off-balance sheet exposure (a) (b)			
						Cross-Border Balance Sheet Exposure	
						Repayment period	
	Total balance sheet exposure	Balance sheet problem credit risk	Of which: Balance of impaired debts	Total off-balance sheet exposure	Of which: Off-balance sheet problem credit risk	Up to one year	Over one year
	NIS millions						
Country							
United States	**34,177**	**703**	**297**	**7,180**	**-**	**5,198**	**16,011**
United Kingdom	**11,713**	**230**	**229**	**3,609**	**-**	**2,501**	**3,941**
France	**2,464**	**6**	**6**	**1,214**	**-**	**1,434**	**1,030**
Switzerland	**1,497**	**-**	**-**	**358**	**-**	**726**	**738**
Germany	**2,555**	**-**	**-**	**81**	**-**	**1,806**	**749**
Others	**13,126**	**172**	**165**	**2,779**	**-**	**5,195**	**7,400**
Total exposure to foreign countries	**65,532**	**1,111**	**697**	**15,221**	**-**	**16,860**	**29,869**
Total exposure to LDC countries	**2,816**	**127**	**119**	**1,878**	**-**	**397**	**1,906**
Total exposure to GIIPS countries(d)	**710**	**-**	**-**	**174**	**-**	**511**	**199**

Part A – Information on total exposure to foreign countries and on exposure to countries whose total individual exposure exceeds 1% of total assets or exceeds 20% of total equity for purposes of calculating capital ratios, whichever the lower (cont'd).

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

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

(a) Balance sheet and off-balance sheet risk, problem commercial credit risk and impaired debts are stated before the effect of a credit loss allowance and before the effect of collateral permitted for deduction for the purpose of indebtedness of a borrower and a group of borrowers and before the effect of a bilateral offset in respect of derivatives.

(b) Before the effect of a bilateral offset in respect of derivatives.

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

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

Notes:
1. The line "Total exposure to LDC countries" includes the total exposure to countries defined as less developed countries (LDC) in Proper Conduct of Banking Management Directive no. 315 "Supplementary Allowance for Doubtful Debts".
2. Balance sheet exposure to a foreign country includes balance sheet exposure beyond the border and balance sheet exposure of offices of the banking corporation in Israel for residents of the foreign country and balance sheet exposure of the overseas offices of the banking corporation for residents who are not residents of the country in which the office is located. Balance sheet exposure of the office of the banking corporation in a foreign country for local residents include balance sheet exposure of the office of the banking corporation in that foreign country for its residents, net of the liabilities of those offices. (The deduction is made up to the height of the exposure.)

Part B – On 31 December 2016 and 31 December 2015, there was no aggregate amount of balance sheet exposure to foreign countries whose total individual exposure was between 0.75% and 1% of the total consolidated assets or between 15% and 20% of equity, whichever the lower.

Part C – The amount of exposure to foreign countries with liquidity problems as defined by the Bank of Israel (a country receiving financial aid from the IMF or whose obligations are rated with a credit rating of CCC or lower) amounts to NIS 656 million and relates to 31 countries (at 31 December 2015, this amounted to NIS 722 million and related to 11 countries).

The following table presents the exposure to countries according to the countries' credit rating as rated by the World Bank, in NIS millions, as at 31 December 2016:

	Balance sheet exposure	Off-balance sheet exposure	Total exposure	Percentage of exposure in relation to total	Of which problem commercial credit risk
High-income countries	**62,716**	**13,343**	**76,059**	**94.2%**	**984**
Mid-high income countries	**2,573**	**1,477**	**4,050**	**5.0%**	**123**
Mid-low income countries	**242**	**400**	**642**	**0.8%**	**4**
Low-income countries	**1**	**1**	**2**	**-**	**-**
Total	**65,532**	**15,221**	**80,753**	**100%**	**1,111**

The countries are rated according to national income per capita as follows:

High income - exceeding US$ 12,746 per capita.

Mid-high income - from US$ 4,036 to US$ 12,475 per capita.

Mid-low income - from US$ 1,026 to US$ 4,035 per capita.

Low income – Up to US$ 1,025 per capita.

Following are the names of the principal countries in each of the categories:

1. Countries with high income:

USA, Italy, Australia, Austria, Ireland, Belgium, Canada, Czech Republic, Denmark, Finland, Israel, Hungary, France, United Kingdom, Japan, Spain, Switzerland, Luxembourg, Slovenia, the Netherlands, Sweden, Poland, Germany, South Korea, Hong Kong, Monaco, Singapore, Cayman Islands and Russia.

2. Countries with mid-high income:

Argentina, Brazil, Bulgaria, Mexico, Panama, Romania, Russia, South Africa, Turkey, Venezuela, Uruguay, Columbia and Peru.

3. Countries with mid-low income:

Egypt, India, the Philippines, Thailand and the Ukraine.

4. Countries with low income:

Several African countries, Haiti and Nepal.

Credit exposure to foreign financial institutions

The following table sets out the credit exposure to overseas financial institutions[(a)]:

	31 December 2016		
	Balance sheet credit risk (b)	Current off-balance sheet credit risk (c)	Current credit exposure
	NIS millions		
External credit rating (d)			
AAA to AA-	**15,338**	**2,508**	**17,846**
A+ to A-	**1,985**	**12**	**1,997**
BBB+ to BBB-	**571**	**395**	**966**
BB+ to B-	**4**	**27**	**31**
Below B-	**18**	**-**	**18**
Unrated	**347**	**-**	**347**
Total current credit exposure to foreign financial institutions	**18,263**	**2,942**	**21,205**
Problem debt balances	**-**	**-**	**-**

	31 December 2015		
	Balance sheet credit risk (b)	Current off-balance sheet credit risk (c)	Current credit exposure
	NIS millions		
External credit rating (d)			
AAA to AA-	13,048	2,789	15,837
A+ to A-	2,323	54	2,377
BBB+ to BBB-	440	241	681
BB+ to B-	1	2	3
Below B-	35	-	35
Unrated	173	8	181
Total current credit exposure to foreign financial institutions	16,020	3,094	19,114
Problem debt balances	-	-	-

(a) Overseas financial institutions include banks, investment banks, dealers/brokers, insurance companies and institutional bodies.
(b) Deposits in banks, credit to the public, securities that were borrowed or purchased in the context of buy-back (resale) agreements and other assets in respect of derivatives (fair value of derivatives) and investments in debentures including subordinated bank debentures amounting to NIS 478 million at 31 December 2016 and NIS 597 million at 31 December 2015.
(c) Mainly guarantees and undertakings for the provision of credit (excluding off-balance sheet derivatives).
(d) The bank only uses the rating of Moody's and S&P credit rating agencies to rate the foreign financial institutions to which there is a credit exposure.

Notes:
1. Credit exposures do not include investments in asset-backed securities. (See Note 12)
2. Some of the banks have received government support of various types, including direct investment in the Bank's capital, government guarantees of certain asset portfolios of the banks, guarantees enabling the banks to raise sources of financing, etc.
3. For further information regarding the composition of the credit exposure in respect of derivatives *vis-à-vis* banks and broker/dealers (local and overseas), see Note 28B to the financial statements.

Credit exposure to foreign financial institutions refers to commercial banks, bank holding companies, investment banks, insurance companies and institutional bodies.

The exposure includes mainly deposits in overseas banks for short periods of up to one week, and debentures, usually for a period of up to five years. The Bank closely monitors the condition of banks worldwide, and makes frequent analyses of their financial stability. The Bank maintains a shortlist of quality banks with which the Bank and its overseas subsidiaries make deposits.

The management of exposure and credit lines to foreign financial institutions takes into consideration, *inter alia*, the following:

- Their size as reflected, *inter alia*, in the size of their shareholders' equity.
- Their strength, as reflected in capital adequacy ratios (especially Tier 1 capital), analysis of the quality of their assets, and the stability of their profitability.
- The market's valuation, as reflected in the market value of their shares and their risk, as estimated with the help of their credit derivatives (CDS).
- The ratings assigned to them by the international rating agencies.
- The financial strength of the country where the Bank's center of activity is located.
- Additional considerations, such as the level of support, including direct investment in the banks' capital by governments, for the purpose of insuring the stability of these banks and of other banks in their countries.
- The policy for managing the exposure to overseas financial institutions includes, *inter alia*, limits on the amounts of exposure at bank and country level per risk.

Risks in the housing loan portfolio

Developments in credit risks

Against a backdrop of increasing demand for housing units, both for residential purposes and for the purpose of investment and against a backdrop of a trend of increasing housing prices, in addition to the low interest environment, the extent of housing credit in Israel has increased.

As a result of these developments and in order to ensure effective risk management, it was decided to tighten the administrative limits, particularly for the following features: financing rates, monthly repayment ability and credit rating according to the Bank's internal statistical model.

The housing loan port is routinely monitored, with trends analyzed for risk features and focal points, comparing to data from the whole system.

The Bank adheres closely to a balance underwriting policy which takes into consideration the borrower's ability to repay, the rate of financing, the linkage basis and the interest rate, etc., meeting all of the requirements of the Banking Supervision Department.

As part of extending housing loans, individual loans were made to participants in a purchasing group. Financing in the context of a purchasing group provides a solution to the market demands of private organizations, associations, historical land-owners, etc. From the aspect of risk, financing is provided to various populations in a geographical dispersal, and after each borrower has undergone a review of their ability to repay the loan.

It should be noted that in 2016, two transactions involving collaboration with institutional entities were entered into in connection with housing loans. For further information, see Chapter "Capital and Capital Adequacy".

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

	2015	2014	
	Annual total	Annual total	Change
	NIS millions		%
From Bank funds	**9,730**	16,548	(41.2)
From Ministry of Finance funds:			
Directed loans	**16**	11	45.5
Bullet loans	**21**	10	110.0
Total new loans	**9,767**	16,569	(41.1)
Refinanced loans	**1,871**	5,107	(63.4)
Total performance	**11,638**	21,676	(46.3)

Disclosure of housing loans

The following are data relating to the risk characteristics of housing loans, the developments in credit risk and how they are managed, including consideration of steps taken by the Bank to contend with these risk characteristics.

Development of credit balance for housing, net, in Israel:

	Balance of credit portfolio	Rate of growth
	NIS millions	%
December 2014	73,919	8.5
December 2015	80,616	9.1
December 2016	**78,656**	**(2.4)**

In 2016, the volume of housing credit fell, owing to a decrease in the volume of loans extended, sharing in the extension of loans with an institutional entity and the sale of credit to an institutional entity.

Development of credit balance, net by linkage basis:

	Unlinked	Percentage of credit portfolio	Index-linked	Percentage of credit portfolio	Foreign currency	Percentage of credit portfolio	Total portfolio
	NIS millions	%	NIS millions	%	NIS millions	%	NIS millions
December 2014	36,727	49.7	35,447	48.0	1,745	2.3	73,919
December 2015	44,649	55.4	34,511	42.8	1,456	1.8	80,616
December 2016	**45,247**	**57.8**	**31,986**	**40.7**	**1,243**	**1.5**	**78,656**

Development of balance of housing credit portfolio, at variable and fixed interest:

	Fixed		Variable			Total credit portfolio
	Unlinked	Index-linked	Unlinked	Index-linked	Foreign currency	
	NIS millions					
December 2014	7,232	11,659	29,495	23,788	1,745	73,919
December 2015	13,062	12,477	31,587	22,034	1,456	80,616
December 2016	**14,178**	**11,792**	**31,249**	**20,194**	**1,243**	**78,656**

Development of new housing credit balance by interest track in Israel:

The development of new credit according to variable and fixed interest tracks (a variable interest loan is a loan where the interest that it bears is likely to change over the life of the loan) is as follows:

	2016				2015	2014
	Fourth quarter	Third quarter	Second quarter	First quarter	Annual average	Annual average
	Percentage of loans granted					
	%					
Fixed – linked	**18.3**	**17.6**	**18.9**	**19.4**	18.6	22.9
Variable every 5 years and above – index-linked	**14.2**	**13.4**	**12.1**	**13.9**	13.3	17.2
Variable up to 5 years – index-linked	**0.3**	**0.3**	**0.6**	**1.2**	1.2	2.0
Fixed – unlinked	**29.4**	**29.7**	**32.1**	**29.0**	32.1	21.5
Variable every 5 years and above – unlinked	**8.3**	**8.1**	**7.7**	**6.8**	6.0	6.6
Variable up to 5 years – unlinked	**29.0**	**30.5**	**28.3**	**29.4**	28.3	28.5
Variable – foreign currency	**0.5**	**0.4**	**0.3**	**0.3**	0.5	1.3

The percentage of new credit extended by the Bank in variable interest housing loans during 2016 stood at 51%, compared with 49% in 2015. The figures relate to all of the various interest paths and linkage segments, including loans in which the interest varies each period of five years and more. Excluding the effect of loans in which the rate of interest is variable, which varies each period of five years and more, which the directive of the Banking Supervision Department excludes from the definition of variable interest loans, the percentage of housing credit at variable interest which stood at 30% during 2016, similar to 2015.

The balance of the past due portfolio in housing loans more than 90 days in arrears is as follows, in Israel:

	Balance of recorded debt	Amount in arrears	Percentage of amount in arrears
	NIS millions		%
December 2014	74,410	800	1.1
December 2015	80,402	768	1.0
December 2016	**78,667**	**749**	**1.0**

The allowance for credit losses as at 31 December 2016, including the collective allowance on housing loans (hereinafter: "the overall allowance") was NIS 463 million, representing 0.59% of the housing credit balance, compared with the balance of the allowance as at 31 December 2015, amounting to NIS 497 million, representing 0.62% of the housing credit balance.

Data relating to new housing credit:

In 2016, the Bank extended new housing loans amounting to NIS 9.8 billion of the Bank's funds.

The average loan extended by the Bank in 2016 was NIS 555 thousand, compared with NIS 623 thousand in 2015 and NIS 585 thousand in 2014.

Development of the rate of financing, in new credit, above 60%, in Israel:

The development of new credit extended by Leumi Mortgage Bank at a rate of financing higher than 60% is as follows: (The rate of financing is the ratio between the rate of credit approved for a borrower, (even if all or part thereof has not yet been actually extended) and the value of the asset mortgaged, at the time of extending the credit facility.)

	2016				2015	2014
	4th quarter	3rd quarter	2nd quarter	1st quarter	Annual average	Annual average
Rate of financing	%					
Between 60% and 70%	**15.6**	18.4	16.3	15.5	18.8	18.5
Between 70% and 80%	**14.7**	17.8	12.7	13.5	16.7	14.5
Above 80%	**0.1**	0.1	0.1	0.2	1.1	0.4

Development of the rate of financing, balance of credit portfolio, in Israel:

The average rate of financing of the credit portfolio balance at 31 December 2016 was 47.0%, compared to 47.1% in 2015.

Development of new credit, in which the repayment ratio is lower than 2.5:

Loans made in 2016 in which the repayment ratio is lower than 2.5 at the date of approval of the credit, stood at 1.3% of the total new extensions of new credit.

This calculation complies with the Bank of Israel directives for the purposes of reporting pursuant to Proper Conduct of Banking Business Management Regulation no. 876.

Development of new credit, in which the repayment dates extend beyond 25 years:

The percentage of the new credit of housing loans in 2016, in which repayment dates according to loan contracts longer than 25 years, stood on average at 36% of the total of new credit extended, compared to 30% in 20154 and 29% in 2014.

Credit risk to private persons (excluding housing loans)

Total credit to private persons (hereinafter: "private credit"), as well as the credit mix, is derived from household activity in Israel. The key indicator reflecting the level of household activity is the level of private consumption which, in recent years, has been on a trend of significant expansion.

Private credit, the repayment ability of which is chiefly based on household's earnings capacity, is characterized by an extremely wide dispersal of borrowers, a range of credit products (various types of loans, current accounts, credit cards) and (on average) a low level of credit to a single customer.

The activity of private customers is concentrated in the Banking Division, to which the branches of the former Arab Israel Bank were merged at the beginning of 2016.

The Division, which operates through branches dispersed throughout the country and through online channels, provides a varied service, adapted to the various customer sectors.

In order to contend with the growth in the levels of private credit and with the wide extent of control which is necessary to manage it and in order to implement proper corporate governance, a number of functions were expanded and strengthened, both in the first line in the Banking Division and in the Risk Management Division, which constitutes the second line of defense. Designated specialist units have been operating in the Banking Division for a number of years, chief of which include:

Credit management and risk centers – coordinate the handling of all applications which are beyond the authority of the branches, creating a separation between the customer manager and the factor testing the provision of credit; constitute a professional anchor for the credit personnel in the branches; maintain a routine of monitoring and control, the results of which are mirrored both in branches and in the divisional management.

Early collection units and problem debt centers – coordinate the handling of debts for which a delay in payments is detected prior to the classification of the borrower as problematic, and of customers which have been classified as problematic. These units provide a professional service for the processes of dealing with the debts, arrangements and collection procedures, including through the use of outside law firms.

Monitoring and control of the second line are conducted; they include, inter alia, testing trends and segments in the private credit portfolio, monitoring the predictive quality of the models for estimating the risk of borrowers, examining the quality and completeness of the control procedures of the business factors, testing samples of individual portfolios, as necessary, etc.

Private credit policy, formulated by the Risk Management Division in collaboration with the Banking Division, represents a crucial layer in outlining risk appetite and directing routine management of this activity. The following are a number of principles from the private credit policy:

- The credit policy of each borrower is estimated by an internal rating, by means of a statistical model, which is regularly revised and which is based on the information from the customer's account in the Bank. This internal rating is used in a number of key process in managing the credit.

The statistical model and the uses derived therefrom receive independent approval and validation by the Risk Management Division prior to their introduction into use. In addition, the predictive indices of the model are regularly monitored, in order to ensure their long-term quality and correctness. Whenever the need arises, revisions and improvements are made.

- The array of credit authorities is based on a number of central principles, including the power which diminishes, the higher the borrower's risk level. The use of this authority is contingent on the relevant rules as provided in the policies and procedures.
- Adopting cautionary procedures in granting credit to new customers, checking against external databases and information supplied by the customer, such as salary payslips, statements from another bank, banking identity card, etc.
- The Bank attaches paramount importance to fair business behavior, stressing the values of honesty, transparency and safeguarding the best interests of the customer on the part of the Bank, in initiating and supporting the customer, and on appropriate pricing of the risk level. The various aspects of fair business behavior are underlined and refreshed before customer managers and private credit officers. In this context, a number of tools arte put to use, both by training, by specific procedural directives, and by the working processes in the automated systems.
- As a part of maintaining the principles of fair business conduct, the credit is adapted to the needs and ability of the customer.

  Attention is paid to the credit period, currency and linkage segment, which can have implications on the repayment ability.

  The Company is implementing the provisions of the Banking Supervision Department on the subject of the rules regarding initiated offers of private credit.
- The Bank must not initiate and must not encourage a speculative transaction or transactions to purchase securities.
- Increased awareness and strictness with regard to aspects of compliance which are liable to arise from credit, with an emphasis on an examination on the economic rationale of the transaction and the sources of finance.

In view of the increase in the level of leverage which has occurred among households in Israel, and because it is expected that this trend will continue, the underwriting process was recently tightened, on two central planes:

a. Expanding and refining the examination of applications to provide new or additional credit to a borrower, such that it will include a wider analysis of the borrower's debt servicing capacity:

b. Reducing the powers of the business for approving credit in certain segments with a relatively high level of leverage.

In addition to strictness regarding the processes of underwriting, management and control at the single borrower level, the routine monitoring of the provision credit was also extended and increased at the aggregative level. See below the development of the credit balances in the past three years. Once a quarter, the Banking Division produces monitoring reports, which are also tested by the Risk Management Division. This monitoring includes reference to a number of key aspects:

- A distribution of the borrowers' risk ratings, distinguishing between new customers and the whole of the existing population, paying attention to a specified internal limit in relation to the maximum rate of the credit in respect of high risk borrowers. The Bank complies with the limit, which is also tightened during the year.
- Specific risk features (such as loans in arrears, return of cheques, etc.).
- Distribution of amounts and outputs See below a breakdown by size of credit to a single borrower.
- Level of leverage.

On 31 December 2015, the branches of the former Arab Israel Bank were merged in the Banking Division, a process accompanied by administrative attention and monitoring of the changes that were made in some of the working processes and in trends in the credit portfolio.

In view of the expectation of the trends in the Israeli economy in the level of private consumption continuing and, as a consequence, in the level of household leverage, as reflected also, inter alia, in an increase in the total and percentage of problem debts in Leumi (see table above) and in light of decisions taken by management and the Board of Directors not to increase the risk appetite in this segment, the increased close monitoring of developments in this portfolio will also continue in 2017.

The development of private credit risk balances in the Bank (activity in Israel, excluding housing loans) in the past three years is as follows:

	Credit risk balance
	NIS millions
December 2014	44,672
December 2015	46,461
December 2016	**49,987**

The breakdown of private credit risk in the Bank as of 31 December 2016 by size of credit to a single borrower is as follows:

Size of credit risk			
From -	To (NIS millions)	NIS millions	Percentage of portfolio
-	25,000	5,062	10.13%
25,000	50,000	7,489	14.98%
50,000	75,000	7,023	14.05%
75,000	100,000	6,221	12.45%
100,000	150,000	8,817	17.64%
150,000	200,000	5,356	10.71%
200,000	300,000	5,423	10.85%
300,000 and above		4,596	9.20%

The breakdown of private credit risk in the Bank (activity in Israel, excluding housing loans) as of 31 December 2016 is as follows:

	Credit risk balance	%
	NIS millions	Overall credit risk
Current accounts and balance utilized in credit cards	7,956	15.9
Loans to purchase motor vehicles (on liens)	2,585	5.2
Loans and other	21,213	42.4
Total balance sheet credit risk	**31,754**	**63.5**
Unutilized current account facility	6,992	14
Unutilized credit card facility	10,905	21.8
Other off balance sheet credit risk	335	0.7
Total off-balance sheet credit risk	**18,232**	**36.5**
Overall total credit risk	**49,986**	**100**

Breakdown of debts and problem credit risk from the total of debts to private individuals in the Bank (activity in Israel, excluding housing loans)

	31 December	
	2016	2015
	NIS millions	
Non-problem credit	**31,369**	28,166
Unimpaired credit	**294**	161
Impaired problem credit	**91**	44
Total balance sheet credit risk	**31,754**	28,371

For further information, including relating to problem debts and expenses in respect of credit losses, see Note 13 Credit risk, Note 30 and Chapter "Exposure to Risks – Overall credit risk to the public by sector of the economy".

Exposure of the Bank to leveraged finance

Proper Conduct of Banking Business Directive 311 provides that a bank's credit policy should relate, *inter alia*, to leveraged finance. The Bank operates according to unique principles in a credit policy for this segment, including from the aspect of financial parameters, authorities, etc.

On 1 January 2016, Proper Conduct of Banking Management Directive no. 323 (Restrictions on the Financing of Capital Transactions) and Proper Conduct of Banking Management Directive no. 327 (Leveraged Loan Management) came into force. The Bank complies with the provisions of these new directives.

As of 31 December 2016, leveraged financing is defined by the Bank complying with and expanding the updated directives, including loans / borrowers meeting one of the following criteria:

1. Credit for the purpose of a capital transaction, as defined for the purpose of the limitation in Proper Conduct of Banking Management Directive. no. 323, with credit to finance the purchase the means of control or against the means of control held without the right of recourse included in any rate of financing (even if lower than that defined in the directive)
2. Financing holding companies, whose activity is entirely or mainly the holding of subsidiaries (without significant independent activity) as defined in the Bank's policy.

Financing a borrower in the various segments of the defined industry sectors, characterized in significant exceptional values of certain parameters in relation to norms in the area of the relevant market sector, such as the ability to service an insufficient debt compared to norms established by the Bank, a low shareholders' equity to total assets ratio.

In view of the revision of leveraged credit pursuant to the Proper Conduct of Banking Management directive which came into force on 1 January 2016, it is not possible to make a precise quantitative comparison to the balance at the end of 2015. However, we would point out that, generally, the volume of leveraged credit in the Bank has been on a decreasing trend for some years.

As of 31 December 2016, the balance of gross indebtedness of the leveraged credit according to the Bank's definition, stands at NIS 4.6 billion, a decrease of NIS 0.24 billion since the end of last year.

The following table presents the aggregate balances of credit to leveraged borrowers*:

	31 December	
	2016	2015
Market sector	NIS millions	
Supply of electricity	**601**	258
Mining and quarrying	**377**	394
Information and communication	**-**	184
Commerce	**862**	636
Real estate	**699**	1,434
Financial services	**596**	621
Transport and storage	**434**	705
Industry	**1,029**	606
Total	**4,598**	4,838

* The balance stated is according to the revised definition in compliance with the Proper Conduct of Banking Management Directive which came into force on 1 January 2016.

Market Risk

For further information, see in the Report on Risks on the Bank's website.

The Bank applies the directives of the Supervisor of Banks on the subject of the Group's market and liquidity risk management, pursuant to which basic principles for the method of risk management and control are provided, including the responsibility of the management and the Board of Directors, the definition of the means of control and the tools for measuring the risks and the means of control and supervision of these risks, implementing corporate governance which includes the three "lines of defense".

The Bank adheres closely to practice of regular and up-to-date reporting to management factors, the Board of Directors and the Banking Supervision Department.

Market risk management policy

Market risk management reflects the Group's market risk strategy, alongside the existing procedures for detecting, measuring monitoring developing and controlling the market risks. The policy for managing market risks is intended, on the one hand, to support the achievement of business goals by assessing the risks and the prospects that can result from , in comparison with the forecast profit from them, and on the other hand, to reduce the level of risk deriving from the Bank's ongoing activity, including maintaining a high liquidity level.

The policy represents an important tool in defining the Bank's risk appetite in the *nostro* field, dealing rooms and market exposure, in the whole Bank Leumi Group. The policy defines the corporate governance, the allocation of organizational responsibility and escalation mechanisms. As part of the market risk management policy, restrictions of the Board of Directors have been determined for every material market risk factor. In addition, restrictions have been set at the level of the Chief Risk Officer and additional restrictions which complement these restrictions. These restrictions are intended to limit the damage that could be incurred as a result of unforeseen changes in the existing various risk factors in the markets, such as, interest rates, inflation, exchange rates, tradable credit margins and share prices.

Exposures to market risks are routinely managed at the Group level. The overseas subsidiaries determine policy for the management of market risk corresponding to the Group policy and the risk framework approved therein. Information on the actual state of exposure according to the frameworks so determined is received from the subsidiaries and taken into account in the overall management of the Group exposure.

Market risk management is handled by two main risk centers – the banking portfolio and the trading portfolio. Definition of the trading portfolio is derived from the Basel directives and includes the securities trading portfolio of the Bank and derivative transactions in trading activity. The banking portfolio includes transactions that are not included in the trading portfolio.

For further information regarding activity according to portfolio, see Report on Risks on the Bank's website.

Obligations regarding employee rights –

The Bank implements United States generally accepted accounting principles regarding employee rights, as stipulated by the Bank of Israel. Market risk management in respect of the commitment to employees is executed partly within the framework of the banking portfolio and partly managed separately and independently as a part of the "plan assets", which are intended to carry a yield over the long-term, with the aim of servicing the liability value. The actuarial commitment for employees has a long duration, and is significantly affected by changes in the capitalization interest. The rate of capitalization used in computing the actuarial liability for employee rights is made on the basis of the Government of Israel debenture curve with the addition of an AA United States corporate debenture margin. The effect of these changes on the Bank is high. On 12 July 2016, the Bank received specific approval from the Bank of Israel, according to which, for the measuring capital adequacy, the capitalization of the obligation for employee rights will be made according to a moving average curve of eight quarters of market yields, which, as aforesaid, are affected by the Government of Israel debenture curve and the AA united debenture margin. This approval significantly of the regulatory capital deriving from the changes in capitalization interest.

Against part of the actuarial liability, there is an investment in the "plan assets", which is intended to service this commitment, by investing in diverse and dispersed assets, such as shares and debt assets. The investment is subject to regulatory restrictions and limitations set by the funds.

A. Interest risk

Interest risk is the risk of a loss as a result of changes in risk-free interest rates in the various currencies, due to differences between the dates of changes in interest rates or the repayment date of the assets and liabilities in each of the linkage segments, whichever is earlier.

The interest exposure policy restricts the extent of exposure to possible changes in interest on the potential erosion of economic value[1] and financing profit for the coming year. Exposure of the profit to interest is also influenced by the activity in derivative transactions and the trading security portfolio.

The interest risk is actually measured and managed on the basis of various behavioral assumptions with regard to the repayment times of the assets and liabilities. In accordance with past experience the Bank considers part of the current account balances as a long-term liability. In addition, there are assumptions relating to early repayments in mortgages. These assessments are crucial in interest risk management, due to the significant increase in balances in recent years.

The measurement of exposure to changes in interest is carried out for both an increase and a decrease in interest rates in each linkage segment. This measurement is intended to examine the sensitivity of the existing asset and liability structure to changes in interest, and therefore, the computation is made without altering the asset and liability structure. In the event that interest rates are significantly negative, the structure of the assets and liabilities will essentially change.

The summary of exposures to unexpected changes in interest at Group level (before tax and in NIS millions) * - the potential change in economic value as a result of the scenario - is as follows:

	31 December 2016			31 December 2015		
Scenario	Increase of 1%	Decrease of 1%	Change of 0.1%	Increase of 1%	Decrease of 1%	Change of 0.1%
In Israeli currency:						
Banking portfolio	**(12)**	**(227)**	**10**	(641)	708	(66)
Trading portfolio	**37**	**(45)**	**4**	(87)	111	(7)
In foreign currency:						
Banking portfolio	**(42)**	**(143)**	**-**	(32)	(74)	(3)
Trading portfolio	**52**	**(49)**	**5**	7	(33)	2

	Potential erosion in annual profit of 1% **		
	31 December 2016		31 December 2015
	Israeli currency	Foreign currency	Total
Total	**523**	**215**	379

* The extent of exposure does not take into account the existence of an interest rate floor of 0% on the deposits. The further the interest falls and approximates to zero, the higher the impairment in financial margin – as all of the interest reduction by the Bank of Israel is reflected only in the lowering of the interest rate on the credit and therefore, in the reduction of margins and the erosion of profits in the Bank.

** With the fall in interest rates, a loss of a similar amount is expected.

1 The economic value of the capital is defined as the difference between the current value of assets and liabilities. In calculating present value, cash flows are deducted from the risk-free credit yield curve and the foreign currency LIBOR flows.

The exposure of capital to an immediate increase/decrease in interest (before the effect of tax) is as follows:

	Exposure in Israeli currency			Exposure in foreign currency		
	31 December 2016					
	Increase of 1%	Decrease of 1%	Change of 0.1%	Increase of 1%	Decrease of 1%	Change of 0.1%
Exposure of capital to an immediate increase/decrease in interest*	**1,537**	**(1,978)**	**176**	**(435)**	**268**	**(40)**
	31 December 2015					
	Increase of 1%	Decrease of 1%	Change of 0.1%	Increase of 1%	Decrease of 1%	Change of 0.1%
Exposure of capital to an immediate increase/decrease in interest*	1,472	(1,895)	145	(292)	182	(25)

* This index includes the exposure to an immediate change in the interest of the nostro portfolios which have been remeasured at market value and the actuarial commitment to employees. This does not include the effect of the sensitivity of the plan assets to changes in interest which is estimated as of 31 December 2016 as a decrease in the value of the assets amounting to NIS 117 million in the scenario of a 1% increase in interest. In addition, the measurement does not include the effects of the transitional provisions of the standard on employee rights, according to which the capital adequacy ratio is computed.

During 2016, the Group complied with all of the interest exposure restrictions set by the Board of Directors.

For further information, see the Report on Risks on the Bank's website.

Sensitivity of the fair value of assets and liabilities to interest

The effect of potential changes in interest rates on the fair value of the financial instruments of the Bank and its consolidated subsidiaries, except for non-monetary items, according to accounting principles, is as follows:

The net fair value of financial instruments, before the effect of changes in interest rates:

	31 December 2016					
	Israeli currency		Foreign currency, including Israeli currency linked to			
	Unlinked	CPI-linked	Dollar	Euro	Others	Total
	NIS millions					
Financial assets	**278,940**	**48,232**	**69,263**	**8,061**	**8,561**	**413,057**
Amounts receivable in respect of derivative financial and off-balance sheet instruments	**252,169**	**6,790**	**214,767**	**55,373**	**28,222**	**557,321**
Financial liabilities (a)	**231,563**	**55,451**	**91,577**	**15,107**	**7,038**	**400,736**
Amounts payable in respect of derivative financial and off-balance sheet instruments	**276,575**	**8,526**	**193,704**	**48,587**	**30,473**	**557,865**
Net fair value of financial instruments	**22,971**	**(8,955)**	**(1,251)**	**(260)**	**(728)**	**11,777**
	31 December 2015					
	Israeli currency		Foreign currency, including Israeli currency linked to			
	Unlinked	CPI-linked	Dollar	Euro	Others	Total
	NIS millions					
Financial assets	257,444	52,070	64,294	7,598	9,709	391,115
Amounts receivable in respect of derivative financial and off-balance sheet instruments	258,434	7,256	193,030	57,823	24,915	541,458
Financial liabilities	211,447	59,362	87,666	13,889	9,199	381,563
Amounts payable in respect of derivative financial and off-balance sheet instruments	283,626	8,796	170,470	52,076	26,125	541,093
Net fair value of financial instruments	20,805	(8,832)	(812)	(544)	(700)	9,917

(a) Including the fair value of actuarial liabilities to employees and does not include the value of the plan assets.

The effect of potential changes in interest rates on the net fair value* of financial instruments

	31 December 2016							
	Fair value, net, of financial instruments after the effect of changes in interest rates (a)						Change in fair value	
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency					
	Unlinked	CPI-linked	Dollar(b)	Euro	Others	Total	Total	Total
	NIS millions						NIS millions	%
Immediate corresponding increase of 1%	**22,574**	**(7,363)**	**(1,820)**	**(281)**	**(720)**	**12,390**	**613**	**5.21**
Immediate corresponding increase of 0.1%	**22,937**	**(8,771)**	**(1,304)**	**(262)**	**(728)**	**11,872**	**95**	**0.81**
Immediate corresponding decrease of 1%	**23,260**	**(11,050)**	**(849)**	**(239)**	**(736)**	**10,386**	**(1,391)**	**(11.81)**

	31 December 2015							
	Fair value, net, of financial instruments after the effect of changes in interest rates (a)						Change in fair value	
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency					
	Unlinked	CPI-linked	Dollar(b)	Euro	Others	Total	Total	Total
	NIS millions						NIS millions	%
Immediate corresponding increase of 1%	**19,963**	**(7,086)**	**(1,079)**	**(550)**	**(692)**	**10,556**	**639**	**6.44**
Immediate corresponding increase of 0.1%	**20,721**	**(8,657)**	**(839)**	**(545)**	**(699)**	**9,981**	**64**	**0.65**
Immediate corresponding decrease of 1%	**21,643**	**(11,061)**	**(675)**	**(537)**	**(708)**	**8,662**	**(1,255)**	**(12.66)**

* Excluding the estimated income value in respect of early repayment fee.

(a) This exposure includes the exposure to an immediate change in the interest of the nostro portfolios which have been remeasured at market value and the actuarial commitment to employees. This does not include the effect of the sensitivity of the plan assets to changes in interest which is estimated at 31 December 2016 as a decrease in the value of the assets amounting to NIS 120 million in the scenario of a 1% increase in interest. In addition, the measurement does not include the effects of the transitional provisions of the standard on employee rights, according to which the capital adequacy ratio is computed.

(b) Of this, the effect of compound financial assets: immediate corresponding increase of 1% - NIS (345) million (31 December 2015 NIS (250) million), and an immediate corresponding decrease of 1% - NIS 171 million (31 December 2015 - NIS 144 million).

See expansion of the assumptions used in the calculation of the fair value of financial instruments in Note 1G.

Exposure to interest rate fluctuations

	31 December 2016				
	On demand up to one month	Over one month to three months	Over three months to one year	Over one year to three years	Over three years to five years
	NIS millions				
Israeli currency - unlinked					
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments					
Financial assets (a)	**203,151**	**10,810**	**27,888**	**18,901**	**9,437**
Derivative financial instruments (excluding options)	**43,658**	**88,634**	**40,136**	**31,262**	**20,043**
Options (in terms of the underlying asset) (c)	**1,321**	**644**	**1,151**	**1,205**	**754**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fair value	**248,130**	**100,088**	**69,175**	**51,368**	**30,234**
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments					
Financial liabilities (a)	**183,173**	**2,970**	**11,954**	**23,004**	**8,150**
Derivative financial instruments (excluding options)	**56,074**	**85,893**	**50,152**	**32,913**	**25,087**
Options (in terms of the underlying asset) (c)	**373**	**493**	**1,043**	**995**	**-**
Off-balance sheet financial instruments	**-**	**-**	**24**	**-**	**-**
Total fair value	**239,620**	**89,356**	**63,173**	**56,912**	**33,237**
Exposure to interest rate changes in the segment	**8,510**	**10,732**	**6,002**	**(5,544)**	**(3,003)**
Accumulated exposure in the sector	**8,510**	**19,242**	**25,244**	**19,700**	**16,697**
Israeli currency – linked to the CPI					
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments					
Financial assets (a)	**1,333**	**2,547**	**10,666**	**14,132**	**10,092**
Derivative financial instruments (excluding options)	**202**	**350**	**1,341**	**2,432**	**1,081**
Options (in terms of the underlying asset) (c)	**-**	**-**	**-**	**-**	**-**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fair value	**1,535**	**2,897**	**12,007**	**16,564**	**11,173**
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments					
Financial liabilities (a)	**737**	**1,118**	**10,937**	**7,945**	**13,185**
Derivative financial instruments (excluding options)	**793**	**499**	**1,585**	**2,491**	**1,308**
Options (in terms of the underlying asset) (c)	**-**	**-**	**-**	**-**	**-**
Off-balance sheet financial instruments	**-**	**-**	**135**	**-**	**-**
Total fair value	**1,530**	**1,617**	**12,657**	**10,436**	**14,493**
Financial instruments, net					
Exposure to interest rate changes in the segment	**5**	**1,280**	**(650)**	**6,128**	**(3,320)**
Accumulated exposure in the sector	**5**	**1,285**	**635**	**6,763**	**3,443**

Notes:

(a) Except for book balances of derivative financial instruments, fair value of off-balance sheet financial instruments and fair value of compound financial instruments in the "without maturity period" column the non-discounted book balances are presented including balances whose repayment date has exceeded NIS 843 million.

(b) Weighted average according to fair value of effective duration.

(c) Duration less than 0.05 years.

Exposure to interest rate fluctuations (contd.)

Over five years to ten years	Over ten years to twenty years	Over twenty years	Without fixed maturity	Total fair value	Internal rate of return	Average effective duration (b)	31 December 2015 Total fair value	Internal rate of return	Average effective duration (b)
					%	Years		%	Years
6,474	**1,550**	**112**	**617**	**278,940**	**3.30**	**0.56**	257,444	2.87	0.70
22,951	**361**	**48**	**-**	**247,093**	**-**	**1.50**	252,647	-	1.44
-	**1**	**-**	**-**	**5,076**	**-**	**-**	5,787	-	-
-	**-**	**-**	**-**	**-**	**-**	**-**	-	-	-
29,425	**1,912**	**160**	**617**	**531,109**	**3.30**	**0.99**	515,878	2.87	1.06
2,269	**43**	**-**	**-**	**231,563**	**1.00**	**0.42**	211,447	0.93	0.41
22,979	**524**	**24**	**-**	**273,646**	**-**	**1.44**	279,269	-	1.35
-	**1**	**-**	**-**	**2,905**	**-**	**-**	4,328	-	-
-	**-**	**-**	**-**	**24**	**-**	**0.50**	29	-	0.50
25,248	**568**	**24**	**-**	**508,138**	**1.00**	**0.97**	495,073	0.93	0.94
4,177	**1,344**	**136**							
20,874	**22,218**	**22,354**							
5,624	**2,118**	**1,697**	**23**	**48,232**	**2.44**	**3.82**	52,070	2.00	3.29
1,384	**-**	**-**	**-**	**6,790**	**-**	**2.65**	7,256	-	3.05
-	**-**	**-**	**-**	**-**	**-**	**-**	-	-	-
-	**-**	**-**	**-**	**-**	**-**	**-**	-	-	-
7,008	**2,118**	**1,697**	**23**	**55,022**	**2.44**	**3.68**(b)	59,326	2.00	3.26(b)
4,082	**884**	**-**	**-**	**38,888**	**0.82**	**2.91**	43,990	0.67	3.06
1,655	**60**	**-**	**-**	**8,391**	**-**	**2.78**	8,671	-	2.93
-	**-**	**-**	**-**	**-**	**-**	**-**	-	-	-
-	**-**	**-**	**-**	**135**	**-**	**-**	125	-	-
5,737	**944**	**-**	**-**	**47,414**	**0.82**	**2.88** (b)	52,786	0.67	3.03(b)
1,271	**1,174**	**1,697**							
4,714	**5,888**	**7,585**							

Exposure to interest rate fluctuations

	31 December 2016				
	On demand up to one month	Over one month to three months	Over three months to one year	Over one year to three years	Over three years to five years
	NIS millions				
Foreign currency and foreign currency linked (e)					
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments					
Financial assets (a)	**45,829**	**14,940**	**6,880**	**6,684**	**5,002**
Of which; compound financial instruments	**3,049**	**1,146**	**763**	**1,289**	**1,201**
Derivative financial instruments (excluding options)	**91,208**	**82,718**	**76,296**	**14,872**	**8,767**
Options (in terms of the underlying asset) (d)	**(1,559)**	**1,550**	**6,873**	**98**	**(13)**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fair value	**135,478**	**99,208**	**90,049**	**21,654**	**13,756**
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments					
Financial liabilities (a)	**83,846**	**10,821**	**14,702**	**3,501**	**391**
Derivative financial instruments (excluding options)	**57,488**	**75,070**	**82,882**	**16,158**	**11,873**
Options (in terms of the underlying asset) (d)	**(1,598)**	**1,743**	**6,937**	**1,172**	**796**
Off-balance sheet financial instruments	**-**	**-**	**14**	**-**	**-**
Total fair value	**139,736**	**87,634**	**104,535**	**20,831**	**13,060**
Financial instruments, net					
Exposure to interest rate fluctuations	**(4,258)**	**11,574**	**(14,486)**	**823**	**696**
Accumulated exposure in the sector	**(4,258)**	**7,316**	**(7,170)**	**(6,347)**	**(5,651)**
Total exposure to interest rate fluctuations					
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments					
Financial assets (a) (c)	**250,313**	**28,297**	**45,434**	**39,717**	**24,531**
Derivative financial instruments (excluding options)	**135,068**	**171,702**	**117,773**	**48,566**	**29,891**
Options (in terms of the underlying asset) (d)	**(239)**	**2,194**	**8,024**	**1,303**	**741**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fair value	**385,142**	**202,193**	**171,231**	**89,586**	**55,163**
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments					
Financial liabilities (a) (c) (f)	**267,756**	**14,909**	**37,593**	**34,450**	**21,726**
Derivative financial instruments (excluding options)	**114,355**	**161,462**	**134,619**	**51,562**	**38,268**
Options (in terms of the underlying asset) (d)	**(1,225)**	**2,236**	**7,980**	**2,167**	**796**
Off-balance sheet financial instruments	**-**	**-**	**173**	**-**	**-**
Total fair value	**380,886**	**178,607**	**180,365**	**88,179**	**60,790**
Financial instruments, net					
Exposure to interest rate fluctuations	**4,256**	**23,586**	**(9,134)**	**1,407**	**(5,627)**
Accumulated exposure in the sector	**4,256**	**27,842**	**18,708**	**20,115**	**14,488**
In addition, exposure to interest rates in respect of liabilities for employee rights' gross - pension and severance pay	**86**	**172**	**774**	**2,063**	**1,190**

Notes:

(a) Except for book balances of derivative financial instruments, fair value of off-balance sheet financial instruments and fair value of compound financial instruments in the "without maturity period" column the non-discounted book balances are presented including balances whose repayment date has exceeded NIS 843 million.

(b) Weighted average according to fair value of effective duration.

(c) Including non-monetary items shown in the "Without maturity period" column.

(d) Duration less than 0.05 years.

(e) Including Israeli currency linked to foreign currency.

(f) Including fair value of actuarial liability to employees – not including the value of plan assets.

Over five years to ten years	Over ten years to twenty years	Over twenty years	Without fixed maturity	Total fair value	Internal rate of return	Average effective duration (b)	31 December 2015 Total fair value	Internal rate of return	Average effective duration (b)
					(%)	(Years)		(%)	(Years)
5,439	**772**	**130**	**209**	**85,885**	**2.48**	**1.26**	81,601	1.81	1.32
1,783	**703**	**95**	**-**	**10,029**	**2.83**	**3.44**	10,317	-	2.62
17,108	**471**	**3**	**-**	**291,443**	**-**	**0.96**	266,812	-	1.00
(30)	**-**	**-**	**-**	**6,919**	**-**	**-**	8,956	-	-
-	**-**	**-**	**-**	**-**	**-**	**-**	-	-	-
22,517	**1,243**	**133**	**209**	**384,247**	**2.48**	**1.01**	357,369	1.81	1.05
21	**44**	**1**	**10**	**113,337**	**1.08**	**0.18**	110,362	0.99	0.28
19,379	**597**	**213**	**-**	**263,660**	**-**	**1.19**	238,694	-	1.30
(21)	**61**	**-**	**-**	**9,090**	**-**	**-**	9,963	-	-
-	**-**	**-**	**-**	**14**	**-**	**0.50**	14	-	0.50
19,379	**702**	**214**	**10**	**386,101**	**1.08**	**0.87**	359,033	0.99	0.95
3,138	**541**	**(81)**							
(2,513)	**(1,972)**	**(2,053)**							
17,537	**4,440**	**1,939**	**4,093**	**416,301**	**2.78**	**1.09**	395,236	2.31	1.17
41,443	**832**	**51**	**1,681**	**547,007**	**-**	**1.23**	527,633	-	1.24
(30)	**1**	**-**	**138**	**12,132**	**-**	**-**	14,743	-	-
-	**-**	**-**	**-**	**-**	**-**	**-**	-	-	-
58,950	**5,273**	**1,990**	**5,912**	**975,440**	**2.78**	**1.15**	937,612	2.31	1.19
6,372	**971**	**1**	**1,350**	**385,128**	**0.93**	**0.60**	366,647	0.80	0.69
44,013	**1,181**	**237**	**1,470**	**547,167**	**-**	**1.34**	527,933	-	1.36
(21)	**62**	**-**	**-**	**11,995**	**-**	**-**	14,291	-	-
-	**-**	**-**	**180**	**353**	**-**	**0.06**	347	-	0.08
50,364	**2,214**	**238**	**3,000**	**944,643**	**0.93**	**1.02**	909,218	0.80	1.06
8,586	**3,059**	**1,752**							
23,074	**26,133**	**27,885**							
3,103	**5,036**	**4,524**	**-**	**16,948**	**2.23**	**15.49**			

General notes:

1. In this table, the data by periods represent the present value of future cash flows, discounted at the internal rate of return used for discounting to the fair value included in respect of the financial instrument, consistent with the assumptions used in calculating the fair value of the financial instrument. For further details regarding the assumptions used in the calculation of the fair value of the financial instruments, see Note 33A in the Annual Financial Report.
2. The internal rate of return is the interest rate for discounting the cash flows expected from a financial instrument to the fair value included in respect of it.
3. The effective duration of a group of financial instruments constitutes an approximation of the percentage change in the fair value of the group of financial instruments that would be caused as a result of a small change (an increase of 0.1%) in the internal rate of return of each of the financial instruments.
4. The effect of hedging transactions is included in total assets or total liabilities, as applicable.
5. In calculating the duration of assets and liabilities in the CPI-linked segment an estimate was taken into account of early redemptions and withdrawals at exit points in savings plans, in accordance with a model estimating expected early redemptions based on the behavior of savers. The duration of total assets according to the original cash flow of the savings plans is higher and reached 4.38 years, the duration of total liabilities reaches 2.93 years, and the gap in the internal rate of return (hereinafter – IRR) amounts to 0.52%. The change in fair value in total assets is a decrease of NIS 1,358 million and in total liabilities, an increase of NIS 18 million.
6. Further details of the exposure to interest rate fluctuations for each segment of financial assets and financial liabilities by the various balance sheet headings, will be supplied on request.

Exposure to interest rates and compliance with limits

The status of exposure to interest changes at the Group level, which is calculated according to accounting principles, is set forth below.

	31 December 2016			31 December 2015		
	Unlinked	CPI-linked	Foreign currency and foreign currency linked	Unlinked	CPI-linked	Foreign currency and foreign currency linked
Average duration in years:						
Average duration of assets (a)	**0.99**	**3.68**	**1.01**	1.06	3.26	1.05
Average duration of liabilities (a)	**0.97**	**2.88**	**0.87**	0.94	3.03	0.95
Duration gap in years	**0.02**	**0.80**	**0.14**	0.12	0.23	0.10
IRR gap (%)	**2.30**	**1.62**	**1.40**	1.94	1.33	0.82

(a) Including forward transactions and options, and based on fair value data of financial instruments.

In calculating the average duration of the liabilities in the index-linked segment and in the unlinked shekel segment, an estimate regarding early repayments and withdrawals at exit points in the savings programs is taken into account, in accordance with a model which estimates the expected early repayments on the basis of the savers' behavior. An average duration of the total liabilities according to the original cash flow of the savings programs is higher, reaching 2.93 years, and the internal rate of return gap (hereinafter "IRR") amounts to 0.52%.

Early repayments of index-linked mortgage loans are taken into account in the figures set forth above, t. The average duration of the assets at the end of 2016, according to the original cash flow which does not take into account early repayments, is longer, reaching 4.38 years, and the IRR gap amounts to 0.52%.

The exposure to changes in interest rates presents current account balances according to the Bank of Israel directives on deposits with demand of up to a month. On the other hand, for the purpose of exposure to interest, a certain rate from the current account balances in shekels and foreign currency was spread for repayment periods up to 10 years. This is in accordance with the model of behavior, the basic assumptions of which are regularly updated. Taking these assumptions into account, the average duration of the liability is higher, reaching in unlinked shekels, 1.21 years, and in foreign currency, 0.85 years, and the difference in the IRR amounts to 1.85% and 0.31% respectively.

A. Basis/ exchange rate risk

According to accounting principles, capital is defined as an unlinked shekel source. Thus, an investment of capital in a segment other than the unlinked shekel segment is defined as basis exposure. Exposure to basis risk is measured as a percentage of the Group's exposed capital.

The exposed capital, at the Bank level, includes shareholders' equity and certain reserves, less fixed assets and investments in investee companies, excluding investments in subsidiaries abroad that are financed from foreign currency sources and are therefore not deducted from capital. At the Group level, the exposed capital includes shareholders' equity and certain reserves, less fixed assets and investments in companies included on equity basis.

Exposure limits approved by the Board of Directors are decided in accordance with considerations of expected return and risk and are allocated among the trading rooms, ALM and subsidiary companies.

The subsidiaries abroad and in Israel generally maintain low levels of basis exposures, on the basis of policies which are anchored in resolutions of the Board of Directors, and in coordination with the Bank in Israel.

Changes in the exchange rate affect the effective tax rate, because the exchange rate differentials in respect of investments abroad are not taken into account in the income basis for calculating the provision for tax, unlike exchange rate differences in respect of sources of financing in respect thereof. The Bank makes hedging transactions against the tax exposure arising from exchange rate differences in respect of investments abroad which are defined as units whose functional currency is identical to the shekel.

The following table sets out the actual economic exposure at Group level, compared with the limits stipulated by the Board of Directors. The data is presented in terms of percentages of the exposed capital:

	Actual position	
	31 December	
	2016	2015
	%	
Unlinked	**(19.0)**	(19.3)
CPI-linked *	**17.7**	19.5
Foreign currency	**1.3**	(0.2)

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

In 2016, the percentage of capital invested on average over the year in the index-linked segment was 14.6%. During the year, the percentage ranged from a surplus of 7% to 22.9% of the exposed capital. Capital was channeled to the foreign currency sector at a relatively low rate, and therefore, the effect of the change in exchange rate on profit was not material.

In 2016, the Group complied with all the basis exposure limits approved by the Board of Directors.

The following table presents sensitivity to changes in the exchange rate of the main foreign currencies as of 31 December 2015. The measurement relates to the effect of the changes in the Bank's capital and includes activity in balance sheet and off-balance sheet instruments:

	Dollar	Euro	Pound sterling	Swiss franc	Yen
	NIS millions				
Increase of 5% in exchange rate	**31**	**(2)**	**6**	**(3)**	**3**
Increase of 10% in exchange rate	**73**	**(7)**	**12**	**(5)**	**7**
Decrease of 5% in exchange rate	**(15)**	**(1)**	**(5)**	**3**	**(2)**
Decrease of 10% in exchange rate	**(34)**	**(7)**	**(9)**	**6**	**(4)**

B. Shares

The Bank has defined the Group's policy for investing including restrictions on the amount of the total investment and in a single company, the investment mix and the various levels of risk between the types of non-banking investments.

Exposure to shares (according to value in the balance sheet) as of 31 December 2016 is as follows:

	31 December	
	2016	2015
	NIS million	
Marketable shares in the available-for-sale portfolio	**981**	1,050
Non-marketable shares in the available-for-sale portfolio	**961**	1,653
Total	**1,942**	2,703

Liquidity and Financing Risk

Liquidity risk

Liquidity risk is the risk created due to the uncertainty relating to the possibility of raising funds and/or unexpectedly realizing assets within a short period, without incurring any material loss. The policy of liquidity risk management constitutes an integral part of the strategic business management of Leumi Group which has been adjusted to the requirements of Proper Conduct of Banking Management Regulation no. 342 regarding liquidity risk management and the requirements Proper Conduct of Banking Management Regulation no. 221 regarding "Liquidity coverage ratio", which adopts the Basel III Committee's recommendations for calculating minimal liquidity ratio liquidity coverage ratio ("LCR"), while making adjustments to the Israeli economy.

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

-The liquidity coverage ratio of the banking corporation is computed on the basis of the average daily observations and the consolidated liquidity coverage ratio is computed on the basis of the average monthly observations for the period.

	Year ended 31 December	
	2016	2015
	%	
a: In consolidated data		
Liquidity coverage ratio	**132**	105
Minimum liquidity coverage ratio required by the Supervisor of Banks	**80**	60
b. In data of the banking corporation		
Liquidity coverage ratio	**130**	103
Minimum liquidity coverage ratio required by the Supervisor of Banks	**80**	60

For further information regarding liquidity risk, see the Report on Risks on the Bank's website and Note 25B.

The Bank has prepared a contingency plan to deal with a liquidity crisis which includes a system of red lights that can indicate a change in the Bank's liquidity position. On the appearance of a warning light, a designated forum is convened to assess the position and examine the need for activating the plan depending on the level of severity. The plan includes detailed operative measures relating to, *inter alia*, the order by which assets are realized, policies for dealing with customers and reporting systems to all the corporate factors, Board of Directors and the Bank of Israel.

Financing Risk

Financing risk is the risk for building an inadequately stable structure of sources in the long term in a way that does not serve the planned use.

For many years, the Bank has managed an extensive and diversified infrastructure of stable financing sources for different terms. The Bank's primary financing source is deposits from retail customers. In addition, the Bank finances its activity through deposits of commercial and business customers and by issuing notes. In 2016, deferred notes amounting to NIS 3.5 billion, and eligible deferred notes to be included in Tier 2 amounting to NIS 0.9 billion, were raised. The management of sources is conducted on a daily basis separately in shekels and in foreign currency. Some 31.6% deposits are raised in foreign currency. The sources from abroad are invested by the offices in credit and liquid assets, mainly in low-risk debentures. The Bank has a broad range of foreign currency sources from foreign resident customers, local retail, business and financial customers, and also severance pay deposits. Last year, the stability of the volume of deposits in this sector of the Bank has been maintained. The surplus of deposits over credit in foreign currency is invested in liquid assets and short time swap transactions.
As stated above, there was a significant increase in shekel deposits. Due to low interest rates, the trend of growth in customers' current accounts balances continued. In order to maintain an infrastructure of stable and diversified financing sources, the Bank markets a variety of attractive deposits for varying time periods.

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

Linkage Status, Repayment Periods and Liquidity Status

A. Linkage Status

In accordance with the policy for the management of assets and liabilities on a linkage basis, the available capital – which is defined as the total of capital sources and certain reserves, less investment in consolidated companies and fixed assets – is invested in unlinked shekel assets, CPI-linked assets and foreign currency and foreign currency-linked assets. The financing of all of the Bank's overseas investments from foreign currency sources, back-to-back, prevents basis exposure in respect thereof.

A summary of the linkage balance sheet position, as it appears in Note 31 to the financial statements, is as follows:

	As at 31 December 2016			As at 31 December 2015		
	Unlinked	CPI-linked	Foreign currency (b)	Unlinked	CPI-linked	Foreign currency (b)
	NIS millions					
Total assets (a)	**293,216**	**48,573**	**119,752**	271,308	51,672	115,182
Total liabilities (a)	**265,263**	**49,057**	**121,733**	245,875	52,305	117,558
Surplus (deficit) of assets in segment	**27,953**	**(484)**	**(1,981)**(c)	25,433	(633)	(2,376)(c)

(a) Includes future transactions and options.

(b) Includes foreign currency linked.

(c) The excess of liabilities in foreign currency derives mainly from a hedging transaction against the tax exposure in respect of investments in overseas units of the Bank, investment in shares and reserves classified as a noninterest-monetary item, and also in respect of hedging future income in foreign currency.

Day-to-day management and reporting of the exposure of the Bank to basis risks is conducted according to the economic approach including adjustments and additions to the accounting approach shown above. The basis exposure, calculated according to the economic approach, is detailed in the chapter, " and Methods of Risk Management".

In 2016, there was an increase of some NIS 19.5 billion in total deposits from the public (including subordinated notes and capital notes). In total credit to the public, there was an increase of NIS 0.5 billion. Investments in securities and debentures increased by some NIS 9.1 billion, and credit to banks increased by some NIS 14.8 billion.

The main changes that occurred in 2016 in the principal activity divided into linkage segments were as follows:

The unlinked shekel segment

The percentage of the financial assets in the unlinked shekel segment to total financial assets is some 63%.

Most of the activity in the segment is for short periods.

Total credit to the public increased by some NIS 13 billion, some 4.1%.

Total cash and deposits in banks, net, increased by NIS 13.3 billion, and the total investment in securities increased by some NIS 3 billion.

In 2016, total shekel deposits increased by NIS 21.3 billion, 10.6%. This increase includes a net increase of NIS 0.6 billion in subordinated notes.

Total net balance of derivative transactions in the segment as at 31 December 2016, was some NIS 24.1 billion, an increase of NIS 1.1 billion compared to December 2015.

The CPI-linked segment

In 2016, credit to the public fell by some NIS 4.8 billion, some 9.8%. Total investment in securities fell by NIS 1.8 billion.

Index-linked deposits, including subordinated notes, contracted by NIS 5.2 billion.

The net balance of derivative transactions in the segment as at 31 December 2016 amounted to some NIS 1.5 billion, an increase of NIS 0.2 billion compared to December 2015.

Foreign currency and foreign currency linked segment

The percentage of financial assets in the foreign currency segment as a percentage of total financial assets was 26%.

Credit to the public in the segment, which constitutes only 34% of the total deposits of the public. In 2016, credit t decreased by NIS 1.6 billion or 4.1%. (Excluding exchange rate changes, the change was not material.)

Investments in securities in foreign currency amounted to NIS 36.2 billion, an increase of NIS 4.4 billion in comparison to December 2015.

Deposits in banks, net, decreased by some NIS 1.8 billion.

From the beginning of 2016, total deposits of the public in foreign currency increased by NIS 2.6 billion, 2.4%.

The balance of future transactions, net, in foreign currency against shekels amounted to some NIS 25.3 billion as of 31 December 2016, an increase of some NIS 1.6 billion, compared with December 2015.

B. Repayment periods

During 2016, as in recent years, the Bank was characterized by a high level of liquidity in shekels. This was partially as the result of a policy directed by the Bank to raise stable and varied sources of funds, by means of raising deposits from a large number of customers for various periods including long-term, and its share of an increase in liquidity surpluses in shekels in the banking system.

Some 31.8% of the Bank's total assets are deposited for short periods in banks and invested in marketable securities, mainly in government debentures.

In 2016, the Bank complied with all liquidity limits for the various scenarios. This was in accordance with the policy whose aim is to ensure stability also in extreme theoretical stress scenarios.

The future cash flow of the assets and liabilities according to repayment periods and according to basis of linkage (including derivative instruments and not including non-monetary items) is set forth below. (For further information, see Note 32 to the financial statements).

Pursuant to Bank of Israel directives, cash flows in respect of liabilities with a number of repayment dates were classified according to management's assessment at its discretion or the earliest forecast repayment date.

According to a Bank of Israel circular from September 2013, a banking corporation is required to present the cash flows in respect of assets and liabilities distinguishing between Israeli currency (including Israeli currency linked to foreign currency) and foreign currency. In addition, cash flows in respect of cleared derivative instruments, net, will be classified to Israeli currency or to foreign currency according to the currency in which the clearing was made. Off-balance sheet amounts of these derivative instruments should not be reported.

Excess of assets over liabilities:

	As at 31 December 2016		
	Israeli currency	Foreign currency	Total
	NIS millions		
Period remaining until maturity:			
Less than 1 month	**(89,319)**	**(48,402)**	**(137,721)**
1 month to 1 year	**(2,336)**	**13,048**	**10,712**
1 year to 5 years	**65,800**	**22,061**	**87,861**
5 years to 10 years	**39,385**	**12,544**	**51,929**
More than 10 years	**47,129**	**5,351**	**52,480**
No maturity date	**3,169**	**1,579**	**4,748**
Total	**63,828**	**6,181**	**70,009**

	As at 31 December 2015		
	Israeli currency	Foreign currency	Total
	NIS millions		
Period remaining until maturity:			
Less than 1 month	(85,457)	(48,488)	(133,945)
1 month to 1 year	3,901	6,971	10,872
1 year to 5 years	59,869	17,225	77,094
5 years to 10 years	36,433	12,126	48,559
More than 10 years	48,438	9,949	58,387
No maturity date	1,070	469	1,539
Total	64,254	(1,748)	62,506

* After offsetting surplus (deficit) balances in respect of derivatives.

For information regarding a description of the key points of the policy, the means of monitoring and implementing the policy, and the limits used in the management of market risks, including basis and liquidity risks, see chapter "Market Risk".

C. Liquidity Position and Funding

Liquidity position and raising funds by the Bank

The surplus liquidity of the Israel banking system continued to be high in 2016. In order to absorb the surpluses, each day, week and month, the Bank of Israel holds monetary tenders.

In 2016, the Bank of Israel purchased foreign currency in the amount of US$ 6.3 billion, of which US$ 1.8 billion was purchased as part of a program to offset the effect of gas royalties on the exchange rate.

The foreign currency purchases of the Bank of Israel have an extensive impact on liquid shekel surpluses in the banking system, as do the surplus redemptions on issues of short-term loans in 2016.

The composition of the Bank's assets and liabilities continues to indicate a high level of liquidity. This is the result of a deliberate policy of raising stable and diversified sources, while placing importance on the raising of sources from a large number of customers, various customer segments, for varying periods, in various currencies.

Leumi monitors, on an ongoing basis, its liquidity status via indices intended to warn of changes in the liquidity position, *inter alia*, by using a regulatory model, and internal models developed in Leumi pursuant to a directive of the Bank of Israel, and pursuant to the standard generally accepted around the world. The various assumptions forming the basis of the internal models are examined and updated regularly according to developments in the major relevant parameters.

The total balances of the banking system (current accounts and monetary deposits) in the Bank of Israel at the end of December 2016 stood at NIS 207 billion, compared with NIS 171 billion at the end of 2015.

The total balances of Leumi (current accounts and monetary deposits) in the Bank of Israel at the end of December 2016 stood at NIS 60 billion, compared with NIS 47 billion at the end of 2015.

At 31 December 2016, the net balance of cash and deposits with banks amounted to some NIS 69.7 billion, compared with NIS 52.2 billion at the end of 2015, an increase of some 34%.

In addition, the Bank has a securities portfolio of some NIS 70 billion, invested mainly in Israeli government debentures, foreign government debentures, and debentures of banks overseas. This is in comparison to the balance as at 31 December 2015 amounting to NIS 64 billion.

During the period under review, the total off-balance sheet monetary assets of the customers increased by NIS 20 billion to NIS 615 billion.

The main regulatory restrictions on the transfer of liquid resources between the Group companies in Israel and abroad are:

1. The Bank of Israel does not restrict the placement of deposits by the Bank in the Group companies in Israel and abroad. However, it imposed restrictions on capital investments and notes by the Bank in overseas companies. The advance confirmation of the Bank of Israel is required for all investments.
2. Directives of authorities in the United States restrict local banks in the extent of exposures of any type vis-à-vis related companies. The maximum rate of exposure to a related company is 10% of the Bank's capital in the United States, and vis-à-vis the Group of which the Bank in the United States is part, the maximum rate is 20% of its capital.
3. Directives of authorities in the United Kingdom restrict local banks in the extent of exposures of any type vis-à-vis related companies. The maximum rate of exposure of the bank in the United Kingdom vis-à-vis the companies of the Group (except Bank Leumi le-Israel Ltd) is 25% of the Bank's capital in the UK. Approval from the regulator in the UK (waiver) was renewed for an increase in the extent of exposure vis-à-vis Bank Leumi le-Israel Ltd., such that the maximum rate of exposure towards it is currently 100% of the Bank's capital in the UK.

The total deposits of the three largest groups of depositors at 31 December 2016 amounted to NIS 14,607 million.

Operational Risks

An operational risk is defined as the risk of a loss resulting from inadequate or failed internal processes, people, systems, or external events. The definition of this risk does not include legal risk, but not strategic risk and reputational risk.

Leumi Group operates in a wide range of financial activity, and, accordingly, is exposed to operating risks, including, *inter alia*, information security and cyber risks, information technology risks, risks of embezzlement and frauds, and business continuity.

Operational risk management in Leumi Group is conducted in a systematic overview by the three lines of defense. The operational risk management is based on a proactive process of identifying, assessing, measuring, monitoring, controlling, mitigating and reporting of material risks which is carried out in all the divisions in the Bank.

The Bank's policy in the area of operational risk

The Group's operational risk management policy is approved annually in the Board of Directors. The policy establishes the perception of operational risk management in Leumi through principles and guidelines, including: risk management adapted to activity in the various business lines, tightening the responsibility of the risk-takes in the first line of defense, an integrative overview and accessibility of the management information, focusing on risk with the potential for significant implications and real-time involvement in risk management in material products and projects.

In order to enable appropriate corporate governance for the Board of Directors and management – a tolerance to the operational risk has been established which is reflected in the form of quantitative restrictions and qualitative declarations. These restrictions define limits to business activities and behaviors, and constitute a support tool for managing the units in making prioritization decisions in the allocation of resources.

Framework for managing operational risk:

The methods and tools for managing operational risks in Leumi are examined and updated regularly while leveraging professional knowhow from Israel and abroad and in accordance with the regulatory directives of Bank of Israel.

The operational risk profile is monitored periodically and reported on a quarterly basis, in the form of a report on risks to the management and the Board of Directors, as a basis for decision-making. In addition, there is an automated system supporting the documentation of risks, controls and mitigation plans, and loss and near-loss events.

The Bank revises the operational risk assessment as a part of a risk survey which lasts throughout a period of three years. The revision is made by the first line units providing guidance, challenging, and assisting the Risk Management Division. The process includes the identification of risks, the assessment of risks and the existing risks and recommendations for minimizing the risks (mitigation plans). The risks are assessed both qualitatively and quantitatively. Bank issues assessed at a high-risk level are tested as part of the work program of the Risk Management Division.

The Bank manages risks in material new projects and products on the basis of a methodology which includes the identification of risks and preparation to minimize them with the aim of complying with Leumi's business and operating goals.

In addition, in order to reduce possible damage when the risk materializes, Leumi Group acquired an array of insurance to cover a range of operational risks, including cyber risks.

Since the operational risks are cross-border organizations and activities, the Bank is taking steps to assimilate an advanced risk management culture, including the reporting of events and drawing conclusions.

During 2016, the structure of the Operational and Cyber Risk Sub-Division in the Risk Management Division was changed in order to adapt it to the accelerated changes in the business-banking environment and the technological operational environment, including the management of cyber and technology risks.

The main risk areas in operational risks

Data security and cyber risks

Developments in cyberspace have led to an increase in the volume and intensity of the threats, the capabilities of attackers and the complexity of the attacks, and in accordance with a significant increase in exposure to cyber risk.

These risks may expose the Bank to business and reputational damage. The increase in the exposure to the risk derives also from:

- Expansion of online business services to customers (PCs, smart phones).
- Increased use of contractors and subcontractors linked to Leumi's network.

In light of the perpetual changes in the business and financial environment and the outline of threats in the area of cyber, the cyber protection and security strategy and policy were updated. The concept of cyber protection is focused on the allocation of protection resources differentially according to the level of the inherent risk, and in relation to the technological, business, human and physical aspect.

In this context, pursuant to the principle of materiality, a process for defining the most sensitive information took place and perceptions in the context of the human factor (authorizations, functions and employees) were established.

Protection of the sensitive data is carried out on a number of plains: in the databases, information systems, in the granting of authorizations to access the systems and their day-to-day management, through physical security means and the raising of awareness among all personnel.

In 2016, no events or embezzlements were found in the area of cyber which affected the Bank's books.

Technological risk

Bank Leumi is a progressive bank and a leader in product technological innovation, with the aim of creating advanced services for its customers. To facilitate these services, the Bank requires advanced digital infrastructures which, on the one hand, create business opportunities, while on the other hand, raises the level of exposure to technological risks in the business and operating processes.

Technological risk has many dimensions: Risks related to project management and in the management of the transition to a complex IT environment, risks related to the ability to manage the information in an efficient and high-quality manner, risks involved in the growing exposure to cybercrime and risks related to the ability to maintain resistance and uninterrupted business continuity.

The IT environment is complex, changes rapidly and dependency on it is ever-increasing. Consequently, it is extremely important that the technology infrastructure is stable, durable and strong.

Leumi is meticulous in maintaining the quality and proper functioning of the information systems, including the necessary working processes and invests numerous resources in the technological infrastructures.

In 2016, the directives of the Bank of Israel regarding online banking were implemented, including customer verification and identification processes, options for taking measures in various channels and strengthening controls over high-risk transactions.

In addition, in recent years, the use of cloud services has increased in the area of computerization, communication infrastructures and systems.

These technologies facilitate effective utilization of computer resources, space, equipment, etc.

Alongside the advantages**,** the realization of the cloud perception is subject to various risks, including operational and regulatory risks emanating from the transfer of data and applications to the centers situated outside the organization, reputational risk as a result of an operational/business failure or insolvency of the supplier, opening to fraud, leakage of information, etc.

Embezzlement and fraud

The digital workplace environment increases the intensity of embezzlement and fraud risks in identity theft and stealing money, as well as from the aspect of information, exposure of customer information and the misuse of information.

As a financial corporation that manages customers' funds and assets, customer trust is the fundamental condition for conducting business. Accordingly, embezzlement and fraud risks in Leumi are managed by investing adequate resources to identify and mitigate them, including developing tools to monitor and prevent them, both in their routine activity, and in focused monitoring activity.

There are designated monitoring centers in the Bank to prevent and uncover embezzlement and fraud**,** which monitor and prevent irregular activities by the Bank's employees and outside factors. As part of dealing with this issue, an additional protection center is planned, which will consolidate the various monitoring units in the matter of embezzlement and fraud.

Conduct risk - Fair conduct with customers

For an explanation, see Chapter "Changes in the Risk Environment and their Effect on the Group"

Business continuity risks

The Bank manages and implements processes for business continuity, pursuant to which it prepares itself for recovering from disaster events and the continuity of its business activity. The processes include:

- A business continuity policy that defines corporate governance, principles, the key processes in emergencies;
- A working framework that includes business continuity plans, business impact analysis, recovery strategies and practice drills'
- Technological infrastructures - the Bank's computer system is based on two computing systems and additional backup center;
- A crisis management system.
- Implementation of exercises according to a three-year plan, while expanding the content and nature of the exercises carried out in the Bank with the aim of improving the level of preparedness and enabling conclusions to be drawn for identifying and minimizing gaps.

Other risks

Regulation and compliance risks

A. Compliance, prohibition of money laundering and the financing of terrorism

For the effective management of the subject, a compliance and enforcement department was set up in Leumi headed by the Chief Compliance Officer.

The Chief Compliance Officer is responsible for fulfilling the obligations pursuant to the legislative directives regarding the prohibition of money laundering and the financing of terrorism.

The Chief Compliance Officer is also in charge of enforcement in the area of securities law and as responsible officer in the area of FATCA, as outlined below.

The activity of the Compliance Department is performed by a professional team with extensive knowledge and understanding in the field of compliance, and based on work processes, control and automated systems.

The Compliance and Enforcement Department is subject to the Chief Legal Counsel.

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

Proper Conduct of Banking Business Directive No. 308 "Compliance and Compliance Function in Banking Corporation" became effective on January 1, 2016. The directive extends the area of responsibility of compliance formally and at the Group level. The directive outlines the definition of compliance regulations and stipulates that "compliance risk" is derived from laws, by-laws, directives, regulation, internal procedures, behavior rules and authority positions. The directive stipulates that it is required to assess the effectiveness of the compliance risk management, and find means for its measurement, while, as stated above, the compliance risk is derived from the overall legislation relevant to the Bank's activity.

The directive provides that the compliance function will be responsible for at least the compliance risk derived from the core regulations (such as: the fairness of the Bank towards its customers, money laundering and the financing of terror, customer advice, a conflict of interests, privacy protection, aspects of taxation relevant to products or services to customers, and so forth). Where the risk is derived from the other regulations applicable to the banking corporation, it can be managed by other functions from the second line of defense.

Pursuant to the directive, a comprehensive policy document, revised and approved by the Board of Directors every year, is prepared. As part of the policy document, corporate governance, including the areas of responsibility of the Bank, the management and Board of Directors and the Chief Compliance Officer and the allocation of responsibility of the three lines of defense from the aspects of compliance is established. A new methodology for risk assessment in regulatory directives (compliance directives as defined by the new regulation) has been stipulated. Pursuant to the directive, the Compliance Department prepares a multi-year and risk-oriented work plan, including time budgeting for tasks and activities.

Retention of a fair compliance culture, throughout the organization, requires the existence of an effective control and enforcement framework, which will be secured in work processes and will enable fulfilment of all the compliance regulations. For this purpose, regulated compliance and enforcement processes have been determined for all work processes and the compliance risks inherent in them. The purpose of the control and enforcement framework is, among other things, to locate existing and potential gaps and exposures in order to examine the need to update the work processes, procedures, training and assimilation. The control processes are based, inter alia, on an analysis of the compliance regulations, internal and external audit findings, complaints of the public considered relevant, legal proceedings against the Bank or other banks that can indicate possible compliance exposures, the analysis of trends and events in Israel and around the world.

The Department is in regular contact with subsidiaries in Israel and overseas, for the purpose of monitoring the implementation of compliance matters, in its entirety and the implementation of the collective compliance policy.

Pursuant to the developing trends around the world, the Bank deals with a range of issues on the matter of compliance, the prohibition of money laundering and the prohibition of the financing of terrorism and aspects of taxation and reporting to the relevant tax authorities and to the customer.

B. Enforcement

In January 2011, the Efficiency of Enforcement Procedures in the Securities Authority Law (Legislative Amendments), 2011, was passed in the Knesset. The object of the law is the improvement of efficiency of enforcement over the legislative provisions in the area of securities laws. In the context of this legislation, it will be possible to impose various sanctions on a corporation, including officers and employees committing violations, and breaches of the relevant provisions.

Further to the law, the Securities Authority published a document of criteria for recognition of an internal enforcement program in the field of securities and investment management (hereinafter: "document of criteria").

In the document of criteria, the Securities Authority instructs the corporation to appoint an officer to be in charge of enforcement. His function, according to the document of criteria, is to be responsible for the implementation of the enforcement program.

The Chief Compliance Officer of the Group acts as the officer in charge of enforcement and coordinates the authorities and means to implement the legislative provisions relevant to these areas.

The Board of Directors has approved the internal enforcement plan, after the plan had been validated by an outside specialist law firm, and after it had reviewed the main enforcement procedures.

C. Foreign Account Tax Compliance Act – FATCA

In March 2010, the Internal Revenue Code in the United States (the U.S. Income Tax Law) was amended, so as to bring into effect a reporting regime, which aims to compel foreign financial institutions (FFI) to transfer information regarding accounts held by U.S. customers.

The Bank implements the FATCA procedure, reflecting the implementation of the FATCA regulations, with all that it implied from the IGA agreement, and the local regulations which have been determined accordingly (Amendment to Income Tax Ordinance no. 227).

In order to ensure the compliance of Leumi Group (hereinafter – Leumi) and individuals therein, with the provisions of the legislation, the Bank is taking steps on a number of levels, the most important which are: the appointment of a compliance officer to assume the function of "responsible officer", the adoption of appropriate policy and work procedures, the development of automated tools supporting the working processes, the formulation of training and assimilation, inspection control and operation mechanisms which are required for complying with the directives and instructing the subsidiaries in the Group towards the appropriate preparedness.

D. OECD – Standards for Automatic Exchange of Financial Account Information

In 2013, the OECD organization published a uniform standard for implementing the Automatic Exchange of Information regarding intergovernmental financial accounts (hereinafter: the "standard"). The standard is formulated in the spirit of the United States FATCA and is intended to increase transparency and supervision of tax reporting by residents of the countries holding financial accounts outside their countries of residence. In July 2016, the Law for the Amendment of the Income Tax Ordinance (no. 227) regarding the implementation of the FATCA and the implementation of the standard was published. The regarding for implementing the standard have not yet been published.

Leumi is prepared for complying with the requirements of the standard, including the adoption of policy, formulation of appropriate work procedures, development of automated tools for supporting the work processes, crystallization of training and assimilation, operation and control mechanisms. The offices of Bank Leumi in the UK and in Romania commenced implementing the standard on 1 January 2016 pursuant to the provisions of local regulation to which they are subject.

Legal risks

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

Areas of legal risk and their treatment

Legal risks derive from five main areas:

- Legislation risks - Risks attributable to the Bank's activity, if it does not comply with a primary or secondary legislative directive, a regulation of the Bank of Israel or a directive of other qualified authorities;
- Contractual communication risks - Risks attributable to the Bank's activity with customers, suppliers and other factors with whom the Bank contracts in various agreements, if it is not backed by an agreement fully regulating the Bank's rights, or that the agreement is not fully enforceable;
- Court ruling risks – Risks deriving from the Bank's activity if it does not comply with a precedential court ruling;
- Risks attributable to legal proceedings conducted against the Bank;
- Risks deriving from changes in enforcement policy.

Treatment of legal risks

The Group implements a program for managing legal risks, which aims to detect, prevent, manage and minimize the legal risks. The program includes policy documents and an interface between the Legal Division and units of the Bank, as well as internal procedures applicable to the Legal Division, the purpose of which is to ensure that legal counseling provided in the Bank is professional and up-to-date. The policy document has been updated periodically over the years, including in 2016.

With regard to the Bank’s subsidiaries in Israel and abroad, a general policy has been determined to manage legal risks in the framework of designated policy documents, according to which the companies has prepared an internal procedure for managing legal risks that correspond with their activity and the Group policy on the subject. The internal procedures have been approved by the Legal Division and in the boards of the subsidiaries. According to the policy documents, the subsidiaries are required to refer certain subjects for appropriate legal advice. In addition, the companies send six-monthly reports to the Legal Risk Officer at the end of the second and fourth quarters each year, as well as immediate reports, as required in the policy documents. The reports were sent in a consistent format prepared in the Legal Division. In 2016, the policy documents for legal risk management in the overseas subsidiaries and a policy document for managing the legal risks in subsidiaries in Israel were updated. In addition, a legal stress scenario was formulated and prepared.

In the context of the legal risk management program, the following points have been emphasized:

- Preventing and minimizing legal risks;
- Identifying sources of material legal risks and their treatment;
- Preparing appropriate agreements, guidelines and procedures;
- Examining statutory provisions (including case law) and regulatory directives, and their implications on the work of the Bank;
- Drawing conclusions on various matters and implementing of these conclusions drawn in legal documents used in the Bank, as well as disseminating opinions on these subjects to the relevant units in the Bank.

In order to conduct the legal risk management program, various officials and committees operate in the Legal Counsel Division, headed by the Chief Legal Counsel (who is the Legal Risk Officer), whose function is to examine legislative matters and legal rulings that have repercussions for the work of the Bank and coordinate and examine the way in which they will be dealt with. The Regulation Sub-Division, which was set up during the period, is engaged in locating and, if necessary, dealing with the new regulatory directives (primary legislation, secondary legislation, directives from authorities), even at the stage of being a relevant proposed law or the regulation.

The activity of each of the abovementioned officials and committees is organized in an internal work procedure of the Legal Division. The procedures stipulate, *inter alia*, the information flow among each of the abovementioned officials and the management of the division and the legal risk team which operates in the division.

General

There is general exposure, which cannot be assessed or quantified, deriving, *inter alia*, from the complexity of the services provided by the Bank and the consolidated companies to their customers. The complexity of these services conceals, *inter alia*, a potential for claims, interpretations and others, relating to several commercial and regulatory conditions. It is impossible to foresee all of the kinds of claims which may be raised in this area and the exposure deriving from these claims and others in connection with the services of the Bank and the consolidated companies which are raised, *inter alia*, via the procedural mechanism provided in the Law for class actions.

In addition, there is exposure due to regulatory changes and directives of the Banking Supervision Department. Engagements with customers are, in part, engagements which last many years, in the course of which changes in policy are likely to occur, in regulations and in trends in the law, including in court rulings. The Bank and the consolidated companies take steps by means of complex automated systems, which, in light of the changes as aforesaid, there is a need to adapt them on a regular basis. All these create an increased operating and legal exposure.

There is also a general exposure deriving from the fact that, from time to time, complaints against the Bank and the consolidated companies are made to the Banking Supervision Department, which, in certain circumstances, are liable to result in legal proceedings against the Bank. When this happens, it is not possible to assess whether there is exposure in respect of these complaints and it is not possible to assess whether a broad decision of the Banking Supervision Department on the matter of the abovementioned complaints and/or whether class or other actions will be brought as a result of such proceedings, and it is not possible to assess the potential exposure for the abovementioned complaints. Accordingly, no provision is included in respect of the said exposure.

The table of severity risk factors set forth below presents an assessment of the severity for each of the various risks, which is derived from an assessment of the impact of the realization of potential stress scenarios which defined on the Bank's capital adequacy. We would point out that none of the exposures to the risk is defined as high, and the distribution of the risks obtained corresponds with the risk appetite of the Group's goals.

For further information, regarding risk management, see chapter "Definition of severity of risk factors".

Table of severity of risk factors:

	Risk	Definition	Degree of severity *
1	Overall credit risk	Risk of a loss as a result of the possibility that a counterparty does not comply with its obligations. With regard to the banking corporation, the reference is to balance sheet and off balance sheet credit	Medium
1.1	Quality of borrower and securities risk	Risk in respect of a borrower/counterparty going into default, resulting in non-fulfilment of contractual monetary obligations. A borrower/counterparty's entering default in derivatives and the residual risk in respect of the inability to realize collateral.	Medium
1.2	Large borrower and group of borrowers concentration risk	Credit risk arising from the relative size of borrowers in the credit portfolio of the Bank.	Low
1.3	Industry and sector concentration risk	Credit risk arising from concentration of credit to borrowers in certain sectors and segments of the economy.	Medium
2	Overall market risk	Risk of exposure of the Group's assets to changes in exchange rates, interest, inflation and asset prices, the correlation between them and their volatility levels.	Low-medium
2.1	Base risk	Risk due to fluctuations of the exchange rate, including inflation (trading portfolio and banking portfolio).	Low
2.2	Interest risk	Risk due to fluctuation in interest rates (trading and banking portfolio)	Low-medium
2.3	Margin and share prices risk	Risk as a result of fluctuations in share and bond prices in the commercial portfolio and in the banking portfolio for assets remeasured at market price.	Low-medium
3	Liquidity risk	The risk of inability to withstand the uncertainty in relation to the possibility of raising funds and/or realizing assets, in an unexpected manner and within a short time-frame, without incurring a material loss.	Low
4	Operating risk	Risk of loss that can arise from weaknesses or failures in processes, large projects, people, systems, or external events, including cyber events.	Medium
5	Regulatory risk	The risk of regulations composed of the three interrelated legal risks, compliance risk and regulation and legislation risk	Medium
6	Reputational risk	The risk that negative publicity will lead to a decrease in customer base, a decrease in income, in liquidity or high legal costs.	Low-medium
7	Pension risk	All of the risks related to various obligations to employees	Low-medium
8	Strategic risk	Business risk, including the current and future implications for capital, profits and goodwill or status emanating from erroneous business decisions. the improper implementation of the decisions or the absence of response to sectoral, economic regulatory and technological changes.	
9	Global systemic risk	The risks caused as a result of global external events that could lead to the materialization of a number of risks simultaneously.	Medium-high
10	Local systemic risk	The risks caused as a result of local events that could lead to the materialization of a number of risks simultaneously.	Medium

* In relation to potential impairment in capital adequacy and the subjective assessment of the impact of risks that are difficult to quantify, the level of risk does not reflect the probability of its realization, but rather the impairment in the Bank if the scenario were to occur.

Accounting Policy and Estimates on Critical Subjects

General

The preparation of consolidated financial statements, in accordance with generally accepted accounting principles and the directives of the Supervisor of Banks, requires Management to make estimates and assessments that affect the reported amounts of assets and liabilities and the amounts of income and expenses.

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

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

The principal accounting policies applied in the Leumi Group are set out in detail in Note 1 to the financial statements.

Set out below is a brief description of the major critical accounting subjects which involve Management's estimates and assessments and which have been discussed by the Board of Directors, Management and the joint auditors:

Allowances for credit losses and classification of problem debts

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

Collective allowance

The collective allowance for credit losses is applied to large groups of relatively small and homogenous debts, and in respect of debts that have been reviewed individually and found to be unimpaired. The measurement of the credit losses is based on the Public Reporting Directive. The collective in respect of off-balance sheet credit instruments is based on the rates of allowance determined for balance sheet credit, taking into account the rate of recovery for the expected credit of off-balance sheet credit risk.

The rate of realization for the credit of the off-balance sheet credit risk is calculated by the Bank based on conversion coefficients, as provided in the Proper Conduct of Banking Business no. 203, Measurement and Capital Adequacy – Credit Risk – the Standardized Approach, with certain adjustments in cases where the Bank has past experience indicating the rates of realization of the credit.

Pursuant to the Public Reporting Directive, which was updated in January 2015, the rates of collective allowance were determined by allocating according to the various market sectors (with one rate being determined in each sector for non-problematic credit, and a separate, higher, rate, for problem credit), on the basis of the average historical rates of loss for doubtful debts in each market sector (rates of allowances/accounting write-offs). In addition, the Bank takes into account relevant environmental factors, including developments in sectoral conditions, macro-economic and sectoral data, changes in credit volume and mix, other factors, including credit concentrations, and expert assessments of the risks and risk management in the Bank. On the basis of the relevant environmental factors, as mentioned above, the Bank determines an increment in the rate of collective allowance in respect of each market segment, in excess of the average of past losses. The average historical rates of loss are the net average rates of deletions on the current year and in the full preceding calendar years, starting from 2011.

In accordance with the said revision to the Public Reporting Directive, published by the Bank of Israel on 19 January 2015, this increment in excess of the average with regard to credit to private individuals which is not problematic – must not be less than 0.75%, with effect from December 2014.

With regard to housing loans, a minimum allowance for doubtful debts is calculated according to the formula set by the Supervisor of Banks, taking into account, *inter alia*, the extent of arrears in current payments of the loans, such that the rates of allowance increase as the arrears deepen. The application of the calculation of the allowance according to the extent of arrears formula refers to all housing loans, except for loans which are not repaid in periodic installments and loans which finance activity of a business nature. In addition, a collective allowance is made on the balance of the housing loans in which there are no arrears, based on past statistics (subject to a minimum rate of 0.35%determined by the Supervisor of Banks).

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

Classification of problem debts and individual allowance

The Bank examines the credit portfolio on an ongoing basis and in accordance with procedures, for the purpose of identifying, as early as possible, those borrowers whose risk level and exposure have risen and who require special management attention and close monitoring, in light of the characteristics of the risk or as a result of the economic/market conditions that are likely to impact the borrowers' condition, so as to improve their position with regard to the corporate and commercial customers. An assessment of the extent of the problem is made while exercising business judgment by the business entities dealing with the borrower, by the credit risk management units in the Risk Management Division, as well as an objective evaluation, as far as possible, of the difficulties that have been identified, in order to determine their risk level.

In the Retail Division, customers with an obligo of more than NIS 1 million are individually identified and reviewed by authorized factors in the division for the purpose of their classification as problem debts, and the remainder is dealt with for this purpose as a group of homogenous and relatively small debts, making a collective allowance.

As part of the measures used by the Bank to manage credit risk, there is a methodology for detecting and identifying problem debts, which is applied in all lines of business (in each, in accordance with its characteristics). The methodology includes a structured quarterly work process in the context of which a thorough review of the credit portfolio is carried out on the basis of a number of criteria that give advance warning of a debt becoming problematic, as part of a process of dealing with customers defined as "sensitive customers". In the Corporate and Commercial Division and in the International Credit and Real Estate Division, which deal with the larger customers of the Bank and medium-sized business corporations, a quarterly credit review process is carried out, in which borrowers whose risk rating is higher than that requiring inclusion in the customer population defined as sensitive.

The methodology for dealing with problem debts requires, *inter alia*, a systematic examination of the appropriateness of the allowance for credit losses in respect of the debts which are classified as "impaired". The allowance is assessed in accordance with the gap between the balance of the debt recorded and the present value of the expected future cash flows for servicing the debt from the customer's activity and the realization of collateral and other assets, discounted at the effective interest rate of debt. With regard to debts where their repayment is supported by collateral (debts conditional on collateral) and there are no other available and reliable sources of repayment, the allowance is determined on the basis of the fair value of the collateral, net of realization costs, and after the activation of security coefficients, in all matters related to the value of the security which will be realizable and from which repayment will be made.

An examination of the accuracy of the allowance is made every quarter, when the credit risk management (CRM) units in the Risk Management Division (or the corporate credit branch in the Banking Division, depending on where the customer belongs) approve the examination of the appropriateness of the allowance which is carried out by the corporate units. In addition, an examination is made of the ability to service the debt of customers classified by other debt indicators (debt under special mention and substandard debt).

The process described above for classifying debts and estimating potential losses in the credit portfolio involves, *inter alia*, subjective assessments which have an implication for the classification of debts and on the extent of the credit loss allowance.

Pursuant to the revisions in the Proper Conduct of Banking Management, the Risk Management Division has overall responsibility for the fairness of the classifications and the allowances, in addition to discussions which are held in the managements of the corporate divisions and representatives of the Risk Management Division. Discussion also takes place each quarter in the Bank's Allowances Committee, headed by the President and Chief Executive Officer, with regard to the aggregate total of allowances required for that quarter, and in relation to the classification of specific allowances (in excess of the stipulated threshold amount).

Derivative instruments

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

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

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

Level 1 data: quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 data: quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or identical liabilities in inactive markets; prices derived from valuation models where all of the significant data is observable in a market or supported by observable market data.

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

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

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

The standard requires that the banking corporation reflects the credit risk and the risk of non-performance risk in measuring the fair value of the debt, including derivative instruments, which were issued by it and measured at fair value. Non-performance risk includes the credit risk of the banking corporation, but not solely limited to this risk.

Specific directives regarding the methodology and data to be used in calculating the fair value of derivative instruments have been determined. The Bank computes the allowance in respect of credit risk at customer level, using a credit quality index, based on internal models or on market data.

In the 2016 Annual Report, the computation of the credit risk allowance using a complex model, including various scenarios of potential exposure.

In a few cases where the Bank does not have a mathematical model for revaluing a derivative, the fair value is determined on the basis of price quotations received from traders in such derivatives. Although these quotations are received from reliable brokers with whom the Bank has chosen to work, it is not certain that the price quoted reflects the price obtainable in an actual transaction in any amount, and especially a transaction in a large amount.

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

Securities

Securities, other than debentures held to maturity, are presented in the balance sheet at fair value. Shares in respect of which the fair value is not available are presented at cost.

The fair value of Israeli securities is based primarily on prices quoted on the Tel Aviv Stock Exchange, and of overseas securities, on prices received from external sources. With regard to foreign securities, most of the portfolio is calculated on a daily basis by a reputable international body which is engaged in the business of calculating the fair value of financial assets for their disclosure in the financial statements. This organization is not dependent on the issuing houses or the marketing bodies. The calculation is based mainly on the transaction prices in active markets, and the revaluation of similar transactions. The calculation reflects the price that a willing buyer in the market would pay for securities, based on current information available in the market. Due to the fact that only a small part of the securities is traded worldwide on a daily basis, the organization makes use the following valuation method:

The appraiser bases his data for determining a price, using a pricing algorithm of transactions actually executed, indications for prices from global and local banks, brokers and stock exchanges. In the event that the market data is small or do not exist, the appraiser employs sophisticated valuation models, taking into account the identity of the issuer and the relevant sub-division.

In non-tradable securities of companies in Israel, fair value is based on data received from the "Mirvach Hogen" company. The Bank has validated the model and ensured with a reasonable degree of security the accuracy of the fair value.

Sometimes, for reasons of prudence, when there are indicators, the Bank adjusts the model and/or market price in order to establish a more accurate value.

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

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

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

The Bank’s policy is to recognize a decline in value as being non-temporary in nature if one or more of the following conditions are met:

1. A security that was sold before the date of the publication of the Report to the public.

2. A security that the Bank intends to sell, as of a time close to the date of the publication of the Report to the public, within a short time frame.

3. A debenture whose rating was significantly downgraded between the rating at the date of its purchase by the banking corporation and the rating at the date of the publication of the Report. Reduction of the rating below BBB- only is considered a significant downgrading for purposes of this section.

4. A debenture which, after its purchase, was classified as problematic by the Bank.

5. A debenture for which there was a credit failure that was not corrected within a short period of time.

6. A security, the fair value of which is lower than the value at which it was purchased for a period of at least nine months to the end of the period of the financial statements and at the end of the report period, as well as the date immediately prior to the publication date of the report, it is 35% or more of the cost (with regard to debentures, the amortized cost). For this purpose, an exception is permitted, if the Bank has firm objective evidence that there are special circumstances.

Exceptions are allowed in such cases, if the Bank has objective and solid evidence and a cautious analysis of all relevant factors, which establishes, to a high degree of certainty that the decline in value is of a temporary nature. The objective evidence and relevant factors include parameters such as: a rise in value after the date of the financial statement, a high credit rating (group A or above), analysis of stability in stress scenarios by an external professional body or by the Bank, its backing including direct government investment in the equity for the purpose of ensuring the strength of the issuing bank.

These principles conform to the guideline issued by the Supervisor of Banks. The definitions of "significant downgrading" and "significant impairment" have been determined by the Bank.

Obligations regarding employee rights

The amounts of the obligations for pension are calculated using actuarial models. The discount rate used to calculate the actuarial liability of the Bank's employees' pension rights was used based on market yields in accordance with the method selected by the Bank from a number of alternatives provided by the Bank of Israel, in which the curve comprises Israel government bond yields in addition to the margin curve of corporate bonds rated internationally as AA and above.

In the examination of the methodology over time, selected by the Bank, repeated anomalies, which were unreasonable from an economic perspective, were discovered. Accordingly, the Board of Directors of the Bank, on the basis of the recommendation of the Audit Committee, decided to adopt an alternative discounting methodology, which adds to the curve based on government bonds in Israel, a fixed margin with an international AA rating, which corresponds to the duration of the obligations for employee rights.

For further information regarding the discounting rate used for calculating the actuarial obligation for employee rights, see Note 1.A.b.

The change was treated prospectively as a change in estimate. The effect of the change in estimate was a decrease in the obligation in respect of employee rights of NIS 432 million, after the effect of tax which was recorded in other comprehensive income.

In addition, the actuarial calculations take into account the forecast of the inflation-adjusted increase on the basis of past experience which varies with the age of the employee.

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

A decrease of 1.0% in the rate of capitalization of the abovementioned liabilities will result in an increase of NIS 2.7 billion in total liabilities. A decrease of 1.0% in the increase of salary will result in a reduction of NIS 581 million in total liabilities. An increase of 5.0% in the life expectancy will result in an increase of NIS 267 million in total liabilities. All amounts are before the effect of tax.

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

The actuary’s valuation of the employees’ rights may be found on the Israel Securities Authority’s website: www.magna.isa.gov.il.

As of 31 December 2016, the balance of accumulated other comprehensive income in respect of employee benefits amounted to NIS 2,169 million, after the effect of tax, a decrease of NIS 679 million after the effect of tax compared with 31 December 2015.

On 12 July 2016, the Bank received specific approval from the Bank of Israel regarding the method of calculating the capitalization interest to be used in computing the liability for employee rights for the purpose of measuring regulatory capital. Pursuant to the approval, capitalization interest will be calculated according to a moving average of the market yield for a period of eight quarters ended on the reporting date. The change is being implemented from the financial statements for the period ended 30 June 2016 and through the financial statements for 31 December 2020 (inclusive). The change in the method has significantly moderated the fluctuations arising from changes in capitalization interest. The change in the method of calculation increased regulatory capital as of 30 June 2016, amounting to NIS 380 million.

On 15 November 2016, the Board of Directors of the Bank resolved, based on the recommendation of the Audit Committee, to calculate the pension liability to employees, a fixed margin of international AA-rated debentures. The effect of the change on regulatory capital as of 30 September 2016 totaled NIS 296 million.

For further information, see Note 1L.

The balance of the liability for employee benefits as of 31 December 2016 at the discounting rate on the basis of corporate debentures in Israel ("deep market for the approach of the Israel Securities Authority") is NIS 709 million less than the actual liability balance.

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

Obligations in respect of legal claims

Among the Bank’s other obligations, there are provisions for various legal claims against the Bank, including applications for class actions. The provisions were determined in a conservative manner in accordance with Management’s assessments, based on legal opinions.

A quarterly discussion is held in the Bank's Allowance Committee, headed by the President and CEO, and in the Board of Directors in respect of provisions for claims above a certain amount that have been filed against the Bank.

To assess the risks in legal proceedings filed against the Bank, the Bank’s Management relies on the opinions of the outside counsel representing the Bank in these claims.

These opinions were given by the outside counsel in accordance with their most considered opinion on the basis of the facts presented to them by the Bank and on the basis of the known legal position (laws and case law) as at the date of the assessment, and which are often open to possible conflicting interpretations and claims.

The assessment of risks inherent in requests for the approval of class actions is complex, since this is a field, the legal doctrine relating to which, even on important matters of principle, is still being formed and not yet entirely settled. There are also claims in respect of which, due to the stage of the proceedings, counsel is unable to estimate their inherent risk, even under the above-mentioned limitations.

In light of the above, it is possible that the actual results of claims may differ from the provisions made.

Buildings and Equipment

The Bank's buildings and equipment are presented in the financial statements at cost, less accumulated depreciation and a provision for a decline in value.

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

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

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

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

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

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

From time to time, the management of the Bank examines the need for provisions for a decrease in value of the assets owned by the Bank. The test for a decrease in value of the assets is made by comparing the book value of the asset with its recoverable amount. Recoverable value is the higher of the realization price of the asset and its usage value (which is the present value of an estimate of the forecasted future cash flows from the use of the asset).

Intangible assets

On 22 October 2015, a circular was published regarding "Reporting of banking corporations and credit card companies in Israel according to U.S. GAAP regarding intangible assets". Pursuant to the circular, a banking corporation shall apply U.S. GAAP applicable to banks in the United States on this topic, inter alia, the rules of presentation, measurement and disclosure set forth in the provisions of the Codification Topic 350 regarding "Intangible Assets – Goodwill and Other Assets".

Below are the main points of the directive:

Impairment of intangible assets with a finite useful life – the test will be made at the level of a group of assets (a very limited level of a group of assets that generates cash flow separately).

It should be examined whether the book value of the asset group is higher than the sum of non-discounted cash flows expected from it. If so, impairment is to be recognized equal to the difference between the book value and the fair value of the asset group. The impairment will be allocated proportionally between the Group's assets as long as the value of an individual asset shall not drop below its fair value.

Impairment of intangible assets with an indefinite useful life – the test will be made at least annually. If the book value exceeds its fair value, impairment is to be recognized in the amount that the book value exceeds the fair value.

Reversal of impairment loss - as a general rule, losses cannot be cancelled from impairment of intangible assets.

Capitalization of costs in creating an intangible asset – as a general rule, these will be recognized as an expense when incurred except in cases where there are other specific guidelines such as regarding software development costs for internal use which will be capitalized during the development phase, see Note1N above.

The Bank has implemented the directive with effect from 1 January 2016 by way of retroactive application. The implementation did not have a material effect on the financial statements.

Taxes on income

The Group has implemented the International Standard IAS 12, as provided in the Public Reporting Directive "Taxes on Income" with effect from 1 January 2012.

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

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

Deferred taxes

The recognition of deferred taxes receivable/payable is with regard to temporary differences between the book value of assets and liabilities for financial reporting purposes and their value for tax purposes. Deferred taxes are measured at the tax rates expected to be applicable to the temporary differences at the date they are realized, based on the laws enacted until the balance sheet date.

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

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

Reporting on taxes on income according to United States principles

On 22 October 2015, a circular was published by the Bank of Israel regarding the reporting of banking corporations and credit card companies in Israel in conformity with United States generally accepted accounting principles regarding taxes on income. According to the circular, a banking corporation and a credit card company are required to adopt U.S. GAAP regarding taxes on income. A banking corporation implemented generally accepted accounting principles on this topic. The provisions determined in accordance with the circular will apply from 1 January 2017 and thereafter.

On 13 October 2016, a circular was published regarding the reporting of banking corporations and credit card companies according to U.S. GAAP. The circular includes, among other things, certain clarifications regarding the reporting of taxes on income according to U.S. GAAP. The main points of the amendments to the Public Reporting Directives are as follows:

- The transitional provisions have been updated so that temporary differences in respect of prior periods will continue to be treated in accordance with the provisions that applied before 31 December 2016.
- It has been clarified that fines to the tax authorities and interest income and expenses in respect of taxes on income, shall be classified under "taxes on income ".
- It has been clarified that a law shall be considered as "enacted" only upon its publication in the Official Gazette.
- The disclosure requirements in the Public Reporting Directives, as well as the disclosure format regarding "Provision for taxes on profit", have been adjusted to the requirements of the new directives.
- The requirement for a note on information based on historical nominal data for tax purposes has been cancelled.

The new directives are to be applied as of 1 January 2017 and thereafter. The comparative figures must be reclassified to correspond with the restatement according to the new directives.

A review of the main points of the new directives in implementing the provisions of the U.S. standards regarding taxes on income, as adopted in the Public Reporting Directives are as follows:

- **Investments in local subsidiaries and temporary differences after 1 January 2017**

  Deferred tax liabilities are to be recognized unless the tax laws allow tax-exempt recovery of the investment (for example, through liquidation or tax-exempt statutory merger) with no significant cost and the parent company expects to make an eventual recovery in this way (ability and intention).

- **Investment in foreign subsidiaries**

  Deferred tax liabilities are to be recognized unless the following conditions are fulfilled:

  - The investor can control the date of reversal and;
  - Undistributed profits will be re-invested indefinitely or they can be distributed tax-free.

- **Recognition of a deferred tax asset**

  A deferred tax asset will be recognized only if it appears that the temporary difference will be reversed in the foreseeable future. On recognition of the asset, it should be determined whether there is a future taxable income against which it will be possible to deduct the difference, in order to determine whether there is a need for a provision for a tax asset, which will reduce the deferred tax asset.

- **Tax asset in respect of deductible temporary differences**

  A deferred tax asset is recognized for the whole amount of the temporary difference. If it is more likely than not that the asset will not be realized, because then a provision for a tax asset will be recognized.

- **Changes in deferred taxes from items recognized at first outside the profit and los**s.

  Current taxes and deferred taxes in respect of items recognized in the current period outside the profit and loss, will be recognized outside the profit and loss. There are specific instructions for allocating tax expenses between the various components of the report. Usually, subsequent changes in the provision for a tax asset deriving from a change in the assessment of the possibility the deferred tax asset created or from a change in the tax rate will be recognized in the profit and loss in the current period, even if the provision was initially recognized in capital.

- **Changes in tax rates**

  Current tax assets and liability are usually measured using the enacted tax rates. Deferred tax assets and liabilities are usually measured at the tax rates expected to apply in the period of recovery. Subsequent changes in deferred taxes arising as a result of changes in the tax rates are usually carried to profit and loss in the current period, even if the provision was initially recognized in capital.

- **Deferred taxes in respect of share-based payment arrangements**

  Temporary differences arising in share-based payment arrangements over the amount of the cost of compensation recognized in profit and loss without additional adjustments up to the realized benefit. It should be noted that there are further differences in relation to the tax effects in respect of share-based payments.

- **Non-monetary liabilities and non-monetary assets measured in a functional currency other than the currency according to which their tax base is determined**

  Non-monetary liabilities and non-monetary assets measured in a functional currency other than the currency according to which their tax base is determined are not to be recognized, with the differences arising in respect of changes in the exchange rate or in respect of linkage for tax purposes.

  These instructions are to be applied as of 1January 2017 and thereafter, including a retroactive correction of comparative figures. The reapplication is unlikely to have a substantial impact on the financial statements.

Controls and Procedures regarding Disclosure in the Financial Statements

The directives of the Supervisor of Banks apply the requirements of Sections 302 and 404 of the SOX Act to banking corporations. With regard to these sections, the SEC and the Public Company Accounting Oversight Board have provided directives as to management's responsibility for the determination and existence of controls and procedures with regard to disclosure and existence of internal control over financial reporting and the external auditors' opinion with regard to the audit of the internal control over financial reporting.

The Supervisor's directives provide that:

- Banking corporations shall apply the requirements of Sections 302 and 404 and also the SEC's directives that were published by virtue thereof.
- Proper internal control requires the existence of a control system in accordance with a defined and recognized framework, and the COSO (Committee of Sponsoring Organizations of the Treadway Commission) 1992 model meets the requirements and can be used to assess the internal control.

The Bank implements the directives in the Leumi Group.

In 2016, the Bank carried out a validation and update of material control processes and checks of the effectiveness of the entire internal control system on financial reporting.

Assessment of controls and procedures with regard to disclosure

The management of the Bank, together with the President and Chief Executive Officer, the Head of the Finance Division and the Chief Accounting Officer, has evaluated, as at the end of the period covered by this report, the effectiveness of the disclosure controls and procedures of the Bank. On the basis of this evaluation, the President and Chief Executive Officer of the Bank, the Head of the Finance Division and the Chief Accounting Officer have concluded that, as at the end of the said period, the disclosure controls and procedures of the Bank are effective for the recording, processing, summarizing and reporting of the information that the Bank is required to disclose in its financial statements, in accordance with the directives of the Supervisor of Banks on reporting to the public and at the time required in these directives.

As a result of the introduction into use of the Nahal system which manages the Bank's impaired debts in the first quarter of 2016, there were changes in the automation of the process of classifying problem debts and the calculation of the expense for credit losses, and accordingly, there was change in the Bank's internal control of financial reporting. In the course of preparing the financial for this quarter, key compensating controls related to the completeness of the data and the reasonableness of the results were implemented. In cases where deficiencies are discovered, the Bank takes steps to correct them as soon as possible.

Changes in internal control

Apart from the abovementioned, during the quarter ended 31 December 2016, no material change to the internal control over financial reporting of the Bank occurred which had a material effect, or which could reasonably be expected to have a material effect, on the Bank's internal control over the financial reporting.

Board of Directors

During 2016, the Board of Directors held 42 plenary meetings and 92 committee meetings.

At the Meeting of the Board of Directors that took place on 29 March 2017, it was decided to approve and publish the audited consolidated financial statements of the Group as at 31 December 2016 and for the period ended on that date.

The Board of Directors of the Bank expresses its appreciation and gratitude to the employees and managers of the Bank and Group companies in Israel and abroad for their dedicated work and their contribution to the promotion of the Group's business.

David Brodet
Chairman of the Board of Directors

Rakefet Russak-Aminoach
President and Chief Executive Officer

29 March 2017

Certification

I, Rakefet Russak-Aminoach, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2016 (the "Report").

2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact that is necessary so that the statements included therein, in light of the circumstances under which such statements were included, are not misleading with reference to the period covered by the Report.

3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity and cash flows of the Bank for the dates and periods covered by the Report.

4. I and the Bank's other certifying officers are responsible for establishing and maintaining controls and procedures with regard to the Bank's disclosure and internal control of financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"), and also:

   (a) We have established such controls and procedures, or caused such controls and procedures to be determined under our supervision, so as to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and in those corporations, particularly during the period of preparation of the Report;

   (b) We have established such internal control over financial reporting, or caused such internal control to be established under our supervision, so as to provide a reasonable level of confidence regarding the reliability of financial reporting and that the financial statements for external purposes are prepared in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions;

   (c) We have evaluated the effectiveness of the Bank's disclosure controls and procedures and presented our conclusions regarding the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report, based on our evaluation; and

   (d) We have disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during the fourth quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and

5. I and the Bank's other certifying officers have disclosed to the Joint Auditors, the Board of Directors, and the Audit Committee of the Board of Directors of the Bank, based on our most recent evaluation of internal control over financial reporting:

   (a) All significant deficiencies and material weaknesses in the establishment or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether material or immaterial, in which Management was involved or in which other employees were involved who have a significant role in the Bank's internal control over financial reporting.

The above does not derogate from my responsibility or the responsibility of any other person, pursuant to any law.

29 March 2017

Rakefet Russak-Aminoach
President and Chief Executive Officer

Certification

I, Omer Ziv, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2016 (the "Report").

2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact that is necessary so that the statements included therein, in light of the circumstances under which such statements were included, are not misleading with reference to the period covered by the Report.

3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity and cash flows of the Bank for the dates and periods covered by the Report.

4. I and the Bank's other certifying officers are responsible for establishing and maintaining controls and procedures with regard to the Bank's disclosure and internal control of financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"), and also:

   (a) We have established such controls and procedures, or caused such controls and procedures to be determined under our supervision, so as to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and in those corporations, particularly during the period of preparation of the Report;

   (b) We have established such internal control over financial reporting, or caused such internal control to be established under our supervision, so as to provide a reasonable level of confidence regarding the reliability of financial reporting and that the financial statements for external purposes are prepared in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions;

   (c) We have evaluated the effectiveness of the Bank's disclosure controls and procedures and presented our conclusions regarding the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report, based on our evaluation; and

   (d) We have disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during the fourth quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and

5. I and the Bank's other certifying officers have disclosed to the Joint Auditors, the Board of Directors, and the Audit Committee of the Board of Directors of the Bank, based on our most recent evaluation of internal control over financial reporting:

   (a) All significant deficiencies and material weaknesses in the establishment or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether material or immaterial, in which Management was involved or in which other employees were involved who have a significant role in the Bank's internal control over financial reporting.

The above does not derogate from my responsibility or the responsibility of any other person, pursuant to any law.

29 March 2017

Omer Ziv
Executive Vice President,
Head of Finance Division

Certification

I, Shlomo Goldfarb, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2016 (the "Report").

2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact that is necessary so that the statements included therein, in light of the circumstances under which such statements were included, are not misleading with reference to the period covered by the Report.

3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity and cash flows of the Bank for the dates and periods covered by the Report.

4. I and the Bank's other certifying officers are responsible for establishing and maintaining controls and procedures with regard to the Bank's disclosure and internal control of financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"), and also:

   (a) We have established such controls and procedures, or caused such controls and procedures to be determined under our supervision, so as to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and in those corporations, particularly during the period of preparation of the Report;

   (b) We have established such internal control over financial reporting, or caused such internal control to be established under our supervision, so as to provide a reasonable level of confidence regarding the reliability of financial reporting and that the financial statements for external purposes are prepared in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions;

   (c) We have evaluated the effectiveness of the Bank's disclosure controls and procedures and presented our conclusions regarding the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report, based on our evaluation; and

   (d) We have disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during the fourth quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and

5. I and the Bank's other certifying officers have disclosed to the Joint Auditors, the Board of Directors, and the Audit Committee of the Board of Directors of the Bank, based on our most recent evaluation of internal control over financial reporting:

   (a) All significant deficiencies and material weaknesses in the establishment or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether material or immaterial, in which Management was involved or in which other employees were involved who have a significant role in the Bank's internal control over financial reporting.

The above does not derogate from my responsibility or the responsibility of any other person, pursuant to any law.

29 March 2017

Shlomo Goldfarb
Executive Vice President
Chief Accounting Officer
Head of Accounting Division

Report of the Board of Directors and Management on Internal Control over Financial Reporting

The Board of Directors and Management of Bank Leumi le-Israel B.M. (henceforth: "the Bank"), are responsible for establishing and maintaining appropriate internal control over financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"). The internal control system of the Bank has been designed to provide a reasonable level of confidence to the Board of Directors and Management of the Bank concerning the preparation and appropriate presentation of financial statements published in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions. Irrespective of the quality level of their design, all internal control systems have inherent limitations. Therefore, even if it is determined that they are effective, they can only provide a reasonable level of confidence with reference to the preparing and presentation of a financial statement.

The Management, under the supervision of the Board of Directors, maintains a comprehensive internal control system designed to ensure that transactions are executed in accordance with the authorizations of Management, that assets are protected, and that accounting entries are reliable. Furthermore, Management, under the supervision of the Board of Directors, takes steps to ensure that channels of information and communication are effective and monitor performance, including performance of internal control procedures.

The Management of the Bank, under the supervision of the Board of Directors, has evaluated the effectiveness of internal control of the Bank over financial reporting as at 31 December 2016, based on the criteria determined in the internal control model of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, the Management believes that as at 31 December 2016, the Bank's internal control over financial reporting is effective.

The effectiveness of the Bank's internal control over financial reporting as at 31 December 2016 was audited by the Bank's Auditors, Kost Forer Gabbay & Kasierer and Somekh Chaikin, as stated in their Report on page 120, which includes an unqualified opinion regarding the effectiveness of the Bank's internal control over financial reporting as at 31 December 2016.

29 March 2017

David Brodet
Chairman of the Board of Directors

Rakefet Russak-Aminoach
President and Chief Executive Officer

Omer Ziv
Executive Vice President
Head of Finance Division

Shlomo Goldfarb
Executive Vice President
Chief Accounting Officer
Head of Accounting Division

Report of the Joint Auditors to the Shareholders of Bank Leumi le-Israel B.M. in accordance with Public Reporting Directives of the Supervisor of Banks regarding Internal Control over Financial Reporting

We have audited the internal control of Bank Leumi le-Israel B.M. and subsidiaries (hereinafter together: "the Bank") over financial reporting as of 31 December 2016, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Bank's Board of Directors and Management are responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of the Board of Directors and Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Bank's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) in the United States regarding the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A bank's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and with the directives and guidelines of the Supervisor of Banks. A bank's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and transfers of the assets of the company (including dispositions); (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in Israel (Israeli GAAP), and the directives and guidelines of the Supervisor of Banks, and that receipt and payment of funds of the Bank are being made only in accordance with authorizations of the Management and Board of Directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Bank maintained, in all material respects, effective internal control over financial reporting as at 31 December 2016, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with generally accepted auditing standards in Israel, and certain auditing standards, of which implementation in audit of banking institutions was required in directives and guidelines of the Supervisor of Banks, the consolidated balance sheets of the Bank and its subsidiaries as at 31 December 2016 and 2015, the consolidated statements of profit and loss, the consolidated statements of comprehensive income, the consolidated statements of changes in equity, and the consolidated statements of cash flows for each of the three years ended 31 December 2016, and our report of 29 March 2017 included an unqualified opinion on those financial statements, as well as drawing attention to that stated in Notes 26C, paragraphs 2 and 4.

Somekh Chaikin
Certified Public Accountants (Isr.)

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Joint Auditors

29 March 2017

Report of the Joint Auditors to the Shareholders of Bank Leumi le-Israel B.M.
Annual Financial Statements

We have audited the accompanying consolidated balance sheets of Bank Leumi le-Israel B.M. ("the Bank") and its consolidated companies ("the Group") as at 31 December 2016 and 2015, and the related consolidated statements of profit and loss, statements of changes in shareholders' equity and the consolidated statements of cash flows for each of the three years, the last of which ended 31 December 2016. These financial statements are the responsibility of the Bank's Board of Directors and of its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors (Manner of Auditor's Performance) Regulations, 1973 and certain auditing standards implementation of which in audit of banking institutions was required in directives and guidelines of the Supervisor of Banks. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management of the Bank, as well as evaluating the appropriateness of the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as at 31 December 2016 and 2015, and the results of operations, changes in shareholders' equity and cash flows of the Bank for each of the three years the last of which ended 31 December 2016, in conformity with generally accepted accounting principles (Israeli GAAP). Furthermore, the above financial statements have, in our opinion, been prepared in accordance with the directives and guidelines of the Supervisor of Banks.

Without qualifying our above opinion, we draw attention to that stated in Note 26C, paragraph 2, regarding claims made against the Bank including petitions for their approval as class actions. The Bank is unable to estimate the implications of the above-mentioned matters on the Bank, if any, on its financial position and operating results, and whether or not they will be material.

We have also audited, in accordance with the standards of the PCAOB (Public Company Accounting Oversight Board) in the United States regarding the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel, internal control over financial reporting of the Bank as of 31 December 2016, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report of 29 March 2017 included an unqualified opinion on the effectiveness of internal control on financial reporting by the Bank.

Somekh Chaikin
Certified Public Accountants (Isr.)

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Joint Auditors

29 March 2017

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Profit and Loss for the year ended 31 December 2016

	Note	2016	2015	2014
		NIS millions		
Interest income	**2**	**9,552**	8,784	10,012
Interest expenses	**2**	**2,026**	1,666	2,649
Interest income, net	**2**	**7,526**	7,118	7,363
Expenses (income) in respect of credit losses	**13,30**	**(125)**	199	472
Net interest income after expenses in respect of credit losses		**7,651**	6,919	6,891
Non-interest income				
Non-interest financing income	**3**	**1,282**	1,610	795
Commissions	**4**	**3,967**	4,092	4,167
Other income	**5**	**159**	595	179
Total non-interest income		**5,408**	6,297	5,141
Operating and other expenses				
Salaries and related expenses	**6**	**5,422**	5,544 (a)	5,253 (a)
Building and equipment maintenance and depreciation	**16**	**1,697**	1,678 (a)	1,631 (a)
Amortization and impairment of intangible assets and goodwill	**17**	**-**	5	58
Other expenses	**7**	**1,461**	1,609 (a)	2,429 (a)
Total operating and other expenses		**8,580**	8,836	9,371
Profit before taxes		**4,479**	4,380	2,661
Provision for taxes on profit	**8**	**1,717**	1,691	1,278
Profit after taxes		**2,762**	2,689	1,383
Share of the banking corporation share in profits of companies included on equity basis, after tax	**15**	**66**	177	42
Net profit:				
Before attributing to non-controlling interests		**2,828**	2,866	1,425
Attributed to non-controlling interests		**(37)**	(31)	(12)
Attibuted to shareholders of the banking corporation		**2,791**	2,835	1,413
Basic and diluted earnings per share (in NIS):				
Net profit attibuted to shareholders of the Bank	**9**	**1.85**	1.92	0.96
Diluted net profit attibuted to shareholders of the Bank	**9**	**1.84**	1.92	0.96

(a) Reclassified

The accompanying notes are an integral part of these consolidated financial statements.
For the condensed financial statements of the Bank only – see Note 35.

David Brodet
Chairman of the Board of Directors

Rakefet Russak-Aminoach
President and Chief Executive Officer

Omer Ziv
Executive Vice President,
Head of Finance Division

Shlomo Goldfarb
Executive Vice President,
Chief Accounting Officer,
Head of Accounting Division

Date of approval of the financial statements: 29 March 2017

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Comprehensive Income for the year ended 31 December 2016

	2016	2015	2014
	NIS millions		
Net profit before attribution to non-controlling interests	**2,828**	2,866	1,425
Less net profit attributed to non-controlling interests	**37**	31	12
Net profit attributed to shareholders of the Bank	**2,791**	2,835	1,413
Other comprehensive income (loss), before taxes:			
Adjustments for showing securities available for sale at fair value, net	**(281)**	(423)	355
Adjustments for translation of financial statements, net (a), after the effect of hedges (b)	**(11)**	(9)	192
Adjustments for liabilities in respect of employee benefits (c)	**(928)**	683	(1,384)
Share of the banking corporation in other comprehensive income of companies included on equity basis	**(20)**	11	(108)
Other comprehensive income (loss), before taxes	**(1,240)**	262	(945)
Relevant tax effect	**376**	(161)	447
Other comprehensive income (loss) before attribution to non-controlling interests, after taxes	**(864)**	101	(498)
Less other comprehensive income attributed to non-controlling interests	**-**	-	-
Other comprehensive income (loss) attributed to shareholders of the banking corporation, after taxes	**(864)**	101	(498)
Comprehensive income before attribution to non-controlling interests	**1,964**	2,967	927
Comprehensive income attributed to non-controlling interests	**37**	31	12
Comprehensive income attributed to shareholders of the Bank	**1,927**	2,936	915

(a) Adjustments for translation of financial statements of foreign operations whose functional currency is different from the functional currency of the Bank.

(b) Hedges – profits (losses) net in respect of hedging a net investment in foreign currency.

(c) Reflects mainly adjustments in respect of actuarial estimates at year end of defined benefit pension plans and amortization of amounts recorded in the past in other comprehensive income. See also Note 23.

See also Note 10 on accumulated other comprehensive income.

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Balance Sheet as at 31 December 2016

	Note	31 December 2016	31 December 2015
		NIS millions	
Assets			
Cash and deposits with banks	**11**	**74,757**	60,455
Securities (a) (b)	**12**	**77,201**	69,475
Securities borrowed or purchased under agreements to resell		**1,284**	1,764
Credit to the public	**13,30**	**265,450**	265,070
Allowance for credit losses	**13,30**	**(3,537)**	(3,671)
Credit to the public, net		**261,913**	261,399
Credit to the Government	**14**	**642**	453
Investments in companies included on equity basis	**15**	**901**	924
Buildings and equipment	**16**	**3,147**	3,095
Intangible assets and goodwill	**17**	**17**	18
Assets in respect of derivative instruments	**28A,B**	**10,654**	11,250
Other assets (a)	**18**	**8,087**	7,666
Total assets		**438,603**	416,499
Liabilities and equity			
Deposits of the public	**19**	**346,854**	328,693
Deposits from banks	**20**	**3,394**	3,859
Deposits from governments		**900**	750
Securities lent or sold under agreements to repurchase		**539**	938
Debentures, bonds and subordinated notes	**21**	**22,640**	21,308
Liabilities in respect of derivative instruments	**28A,B**	**10,677**	11,098
Other liabilities (a) (c)	**22,30D**	**21,885**	20,746
Total liabilities		**406,889**	387,392
Equity attributable to shareholders of the Bank	**25A**	**31,347**	28,767
Non-controlling interests		**367**	340
Total equity		**31,714**	29,107
Total liabilities and equity		**438,603**	416,499

(a) For details on amounts measured at fair value, see Note 33A.
(b) For details on securities pledged to lenders, see Note 12.
(c) Of which: allowance for credit losses in off-balance sheet credit instruments, NIS 488 million (31 December 2015 – NIS 482 million).

The accompanying notes are an integral part of these consolidated financial statements.
For the condensed financial statements of the Bank only – see Note 35.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Statement of Changes in Equity for the year ended 31 December 2016

		Capital reserves		
	Share capital	Premium	Share-based payment transactions and others (a)	Total share capital and capital reserves
	NIS millions			
Balance as at 1 January 2014	7,059	1,129	33	8,221
Net profit	-	-	-	-
Adjustments in respect of companies included on equity basis, net	-	-	-	-
Other comprehensive loss, net after the effect of tax	-	-	-	-
Loans to employees for purchase of the Bank's shares	-	-	-	-
Dividend paid by consolidated companies	-	-	-	-
Changes in non-controlling interests	-	-	-	-
Balance as at 31 December 2014	7,059	1,129	33	8,221
Net profit	-	-	-	-
Adjustments in respect of companies included on equity basis, net	-	-	-	-
Employee benefit from share-based payment transactions	-	-	10	10
Other comprehensive income, net after the effect of tax	-	-	-	-
Loans to employees for purchase of the Bank's shares	-	-	-	-
Dividend paid by consolidated companies	-	-	-	-
Changes in non-controlling interests	-	-	-	-
Balance as at 31 December 2015	7,059	1,129	43	8,231
Net profit	**-**	**-**	**-**	**-**
Adjustments in respect of companies included on equity basis, net	**-**	**-**	**-**	**-**
Other comprehensive loss, net after the effect of tax	**-**	**-**	**-**	**-**
Issue of shares	**50**	**593**	**(7)**	**636**
Dividend paid by consolidated companies	**-**	**-**	**-**	**-**
Balance as at 31 December 2016	**7,109**	**1,722**	**36**	**8,867**

(a) Including NIS 10 million of other capital reserves.

(b) Including NIS 2,389 million not available for distribution as a dividend (31 December 2015 – NIS 1,849 million, 31 December 2014 – NIS 2,257 million). The balance of the amount for allocation is subject to Bank of Israel directives and the limitations set out in Proper Conduct of Banking Business Directives. See Note 25E.

The accompanying notes are an integral part of these consolidated financial statements.

Accumulated other comprehensive profit (loss)	Retained earnings (b)	Loans to employees for purchase of the Bank's shares	Total	Non-controlling interests	Total capital
(1,051)	17,680	(43)	24,807	340	25,147
-	1,413	-	1,413	12	1,425
-	75	-	75	-	75
(498)	-	-	(498)	-	(498)
-	-	1	1	-	1
-	-	-	-	(10)	(10)
-	-	-	-	(2)	(2)
(1,549)	19,168	(42)	25,798	340	26,138
-	2,835	-	2,835	31	2,866
-	(19)	-	(19)	-	(19)
-	-	-	10	-	10
101	-	-	101	-	101
-	-	42	42	-	42
-	-	-	-	(10)	(10)
-	-	-	-	(21)	(21)
(1,448)	21,984	-	28,767	340	29,107
-	**2,791**	**-**	**2,791**	**37**	**2,828**
-	**17**	**-**	**17**	**-**	**17**
(864)	**-**	**-**	**(864)**	**-**	**(864)**
-	**-**	**-**	**636**	**-**	**636**
-	**-**	**-**	**-**	**(10)**	**(10)**
(2,312)	**24,792**	**-**	**31,347**	**367**	**31,714**

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows
for the year ended 31 December 2016

	2016	2015	2014
	NIS millions		
Cash flows from operating activities			
Net profit for the year	**2,828**	2,866	1,425
Adjustments:			
Group share in undistributed losses (profits) of companies included on equity basis (a)	**(28)**	666	15
Depreciation of buildings and equipment (including impairment)	**663**	655	602
Amortization	**-**	45	58
Expenses (income) in respect of credit losses	**(125)**	199	472
Losses (profits) from assets transferred to group ownership	**-**	3	(3)
Profit on sale of loan portfolios	**(44)**	(11)	(28)
Net profit on sale of available-for-sale securities	**(856)**	(1,075)	(659)
Realized and unrealized profit (loss) from adjustment to fair value of securities held for trading	**116**	(62)	(456)
Gain on realization of investments in companies included on equity basis	**(7)**	(522)	-
Gain on sale of buildings and equipment	**(66)**	(485)	(83)
Provision for impairment of shares available for sale	**5**	283	12
Expenses deriving from share-based payment transactions	**10**	10	- (b)
Deferred taxes, net	**43**	(278)	(174) (b)
Severance pay and pension - increase in surplus of provision over fund	**288**	469	355
Interest received (and not yet received) in excess of interest accrued in the period in respect of debentures available for sale	**312**	(b) 118	(b) (67)
Unpaid interest in respect of debentures and subordinated notes	**782**	722 (b)	1,000
Effect of exchange rate differentials on cash and cash equivalents	**591**	6	(839)
Other, net	**-**	13	(139) (b)
Net change in current assets:			
Deposits in banks	**(207)**	888 (b)	(1,215) (b)
Credit to the public	**(2,942)**	(9,345) (b)	(11,029)
Credit to the Government	**(189)**	76	35
Securities borrowed or purchased under agreements to resell	**480**	236	(640)
Assets in respect of derivative instruments	**595**	5,664	(3,845)
Securities held for trading	**3,322**	1,112	(1,633)
Other assets	**(223)**	(807)	203
Net change in current liabilities:			
Deposits from banks	**(447)**	(708)	191
Deposits of the public	**18,358**	24,931	15,184
Deposits of the Government	**156**	275	39
Securities lent or sold under agreements to repurchase	**(399)**	(300)	614
Liabilities in respect of derivative instruments	**(314)**	(4,538)	2,086
Other liabilities	**369**	(869)	525
Net cash from operating activities	**23,071**	20,237	2,006

(a) Less dividend received.
(b) Reclassified.

The accompanying notes are an integral part of these condensed consolidated interim financial statements.
For the condensed financial statements of the Bank only – see Note 35.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows (cont'd)
for the year ended 31 December 2016

	2016	2015	2014
	NIS millions		
Cash flows from investment activities			
Acquisition of available-for-sale securities	**(92,212)**	(81,408)	(33,427)
Proceeds from sale of available-for-sale securities	**35,438**	33,513	22,673
Proceeds from redemption from available-for-sale securities	**45,457**	30,366	26,347
Proceeds of sale of loan portfolios	**2,723**	317 (a)	344 (a)
Acquisition of shares in companies included on equity basis	**-**	(20)	(341)
Proceeds from realization of investment in companies included on equity basis	**73**	711	-
Acquisition of buildings and equipment	**(634)**	(627)	(683)
Proceeds from realization of buildings and equipment	**99**	562	94
Proceeds from realization of assets transferred to group ownership	**2**	3	3
Central fund for severance pay	**173**	22(a)	(297)(a)
Net cash from investment activities	**(8,881)**	(16,561)	14,713
Cash flows from financing activities			
Issue of debentures and subordinated notes	**4,442**	2,606 (a)	-
Redemption of debentures and subordinated notes	**(3,892)**	(5,698) (a)	(2,763)
Dividend paid to minority shareholders in consolidated companies	**(10)**	(10)	(10)
Additional acquisition of shares in consolidated companies	**-**	(41)	(2)
Repayment of loans to employees	**-**	42	1
Net cash from financing activities	**540**	(3,101)	(2,774)
Increase (decrease) in cash and cash equivalents	**14,730**	575	13,945
Balance of cash and cash equivalents at beginning of year	**58,130**	57,561	42,777
Effect of changes in the exchange rate of cash balances	**(591)**	(6)	839
Balance of cash and cash equivalents at end of year	**72,269**	58,130	57,561

Interest and taxes paid and/or received and dividends received

	2016	2015	2014
	NIS millions		
Interest received	**9,864**	9,830	9,922
Interest paid	**(3,041)**	(3,209)	(3,455)
Dividends received	**48**	1,013	67
Taxes paid on income	**(1,629)**	(1,419)	(1,604)

(a) Reclassified.

The accompanying notes are an integral part of these condensed consolidated interim financial statements.
For the condensed financial statements of the Bank only – see Note 35.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows (cont'd)
for the year ended 31 December 2016

Appendix A – Non-cash investment and financing transactions in the reporting period:

2016:

During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 119 million.
During the year, shares were issued against the conversion of rights that accumulated to the benefit of the employees in the amount of NIS 636 million.
See Note 23L.

2015:

During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 37 million.

2014:

During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 49 million.

The accompanying notes are an integral part of these condensed consolidated interim financial statements.
For the condensed financial statements of the Bank only – see Note 35.

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Note 1 – Significant Accounting Policies

A. General

The financial statements have been prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and the directives and guidelines of the Supervisor of Banks relating to the preparation of annual financial statements of a banking corporation.

Publication of the financial statements is on the basis of the consolidated statements only. Condensed financial statements of the Bank on a single-entity basis appear in Note 35.

The financial statements were approved for publication by the Board of Directors of the Bank on 30 March 2017.

B. Definitions

In these financial statements –

The Bank- Bank Leumi le-Israel B.M
The Group – the Bank and its subsidiaries.

Consolidated companies - companies of which the financial statements are fully consolidated, directly or indirectly, in the statements of the Bank.

Companies included on equity basis - companies, other than consolidated companies including a partnership or joint enterprise, in which the Bank's investment is included, directly or indirectly, in the financial statements on equity basis.

Investee companies - consolidated companies and companies included on equity basis.

Overseas units - representative offices, agencies, branches or consolidated companies of the Bank outside Israel.

Functional currency - the currency of the main economic environment in which the Bank generally operates. This is the currency of the environment where the corporation produces and spends most of its cash funds.

Reporting currency - the currency in which the financial statements are reported.

Related parties - as defined in Section 80 of the Public Reporting Directives.

Interested parties - as defined in Section 80 of the Public Reporting Directives.

Index - the Consumer Price Index in Israel published by the Central Bureau of Statistics.

Adjusted amount - historical nominal amount adjusted to the December 2003 CPI, in accordance with the provisions of Opinions 23 and 36 of the Institute of Certified Public Accountants in Israel.

Reported amount - amount adjusted to the transition date (31 December 2003) with the addition of amounts in nominal values that were added after the transition date and less amounts that were eliminated after the transition date.

Nominal financial reporting - financial reporting based on reported amounts.

Adjusted financial reporting - financial reporting in values adjusted according to the changes in the general purchasing power of the Israeli currency in accordance with the provisions of the opinions of the Institute of Certified Public Accountants in Israel.

Cost – cost in reported amount.

Fair value - the amount that would be received from the sale of an asset or that would be paid to transfer a liability in a transaction between a willing seller and a willing buyer at the measurement date.

Recorded debt balance – the recorded debt balance is defined as the outstanding debt after deducting accounting write-offs, but before deducting an allowance for credit losses in respect of that debt. The recorded balance of debt does not include accumulated interest that was not recognized.

C. Basis for preparation of the financial statements

1. Reporting principles

The financial statements of the Bank have been prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and the directives and guidelines of the Supervisor of Banks. In most matters, these directives are based on US GAAP. In other subjects that are less material, the directives are based on certain International Financial Reporting Standards (IFRS), interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and Israeli GAAP.

When International Financial Reporting Standards (IFRS) allow a number of alternatives, or do not include a specific reference to a certain situation, specific instructions for implementation have been determined in the directives of the Supervisor of Banks that are based mainly on US GAAP.

For details of the new accounting standards, accounting standards updates and new directives of the Banking Supervision Department that were implemented for the first time see paragraph V below.

2. Functional currency and reporting currency

The financial statements are reported in new shekels rounded to the nearest million, unless stated otherwise.

The shekel is the currency representing the principal economic environment in which the Bank operates.

For information on the functional currency of banking units operating overseas, see paragraph (D) below.

3. Basis of measurement

3.1 General

The financial statements are shown in reported amounts in accordance with the accounting standards of the Israeli Accounting Standards Board and the directives of the Supervisor of Banks.

3.2 Balance Sheet

- Non-monetary and equity items (mainly buildings and equipment; investments in non-quoted shares; amortizable expenses relating to issuance of debentures, bonds and subordinated notes, deferred taxes, assets and liabilities in respect of employee benefits and non-current assets held for sale) are shown in reported amounts.

- Monetary items are shown in the balance sheet at historical nominal values as at the balance sheet date, except for derivative financial instruments and other financial instruments that are measured at fair value.

- An investment in companies included on equity basis is determined based on the financial statements of these companies in reported amounts or translated to new Israeli shekels.

3.3 Profit and Loss Statement

- Income and expenses that arise from non-monetary items (for example, depreciation and amortization and prepaid income and expenses) or from provisions included in the balance sheet are derived from the difference between the reported amount of the opening balance and the reported amount of the closing balance.

- The Bank's share in the operating results of investee companies and the share of external shareholders in the results of consolidated companies are determined based on the financial statements in reported amounts of these companies.

- Other components of the profit and loss statement are shown at their nominal values (for example, net interest income, and commissions).

4. Use of estimates

When preparing the financial statements, in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and directives and guidelines of the Supervisor of Banks, management is required to use estimates, evaluations and their discretion affecting the reported amounts of assets and liabilities, the disclosure relating to contingent assets and liabilities and amounts of income and expenses during the reporting period. It should be made clear that actual results may differ from such estimates.

When formulating accounting estimates used in preparing the Bank's financial statements, Bank management has to make assumptions concerning circumstances and events which involve significant uncertainty. In its consideration of the estimates, Bank management bases itself on past experience, various facts, external factors, and on reasonable assumptions in accordance with circumstances appropriate to each estimate.

Changes in estimates

The estimates and the assumptions on which they are based are reviewed on a routine basis. Changes in accounting estimates are recognized in the period in which the estimates were amended and for each period affected in the future.

Remuneration of Office-Holders in Financial Corporations Law

Against the background of the enactment of the limitation of salaries, the Bank's management conducted a reevaluation of the probability of the realization of exposure to payment of rights granted to office-holders and key officers in connection with the termination of employee-employer relations under conditions of dismissal, in light of the new legal situation created and based on different parameters examined.
Due to significant growth of the likelihood and the change in dates for the end of tenure for members of Management and other managers employed under personal contracts with the Bank, the Bank decided to update the estimate of the provision for the termination of employee-employer relations.

The effect of the change in the estimate at 31 March 2016 amounted to NIS 117 million before tax and was charged to other comprehensive income. See also Note 23 below on Employee Rights.

The discount rate of the pension liability

The discount rate used to calculate the actuarial liability of the Bank's employees' pension rights was used based on market yields in accordance with the alternative chosen by the Bank out of the alternatives set by the Bank of Israel, in which the curve comprises Israel government bond yields in addition to the margin curve of corporate bonds rated internationally as AA and above.

In the examination over time of the methodology chosen by the Bank, repeat anomalies were discovered, which are economically unreasonable. These anomalies mostly stemmed from extreme and unreasonable changes in forward interest rates that are derived from the margin curve, which bring about extreme changes in the margin curve and, additionally, from discrepancies in adjusting the margin to the corresponding cash flow outlook. After analyzing the reasons for the anomalies, the Bank believes that the discrepancies found in the existing methodology, prevent the Bank from its continued application. Therefore, on 15 November 2015, the Board of Directors of the Bank, based on the recommendation of the Audit Committee, decided to adopt the alternate discount methodology presented by the Bank of Israel in its directives, which adds to the curve that is based on government bonds in Israel, a fixed margin with an international AA rating. In order to apply the alternate methodology, the Bank uses data published by Bank of America Merrill Lynch regarding the margin, which is consistent with the average duration of the liabilities for employee rights. The Bank is of the opinion that the change is expected to lead to a more appropriate measurement and which reflects better the liabilities for employee rights.

The change was treated prospectively as a change in estimate. The effect of the change in the estimate was a reduction in the liabilities in respect of employee rights, net of tax, of NIS 432 million, which was recorded in other comprehensive income.

D. Foreign currency and linkage

Transactions in foreign currency

Assets and liabilities denominated in foreign currency or linked thereto are stated according to the representative rates of exchange published by Bank of Israel at the balance sheet date, or other appropriate date, as follows:

- Assets and liabilities denominated in foreign currency or linked thereto are translated to the functional currency at the rate of exchange prevailing on the reporting date.

- Non-monetary assets and liabilities in foreign currency or linked thereto that are measured at fair value, are translated into the functional currency at the rate of exchange prevailing on the date on which the fair value is determined. Non-monetary assets and liabilities denominated in foreign currency or linked thereto and measured at historical cost, are translated at the rate of exchange prevailing on the date of the transaction.

Income and expenses in foreign currency are included in the statement of profit and loss at current representative exchange rates at the transaction dates and exchange rate differentials on the assets and liabilities in respect of which the above income and expenses arose.

Exchange rate differentials resulting from translation to the functional currency are recognized in profit and loss except for the following differences recognized in other comprehensive income resulting from the translation of:

- Equity financial instruments classified as available for sale (except in the event of impairment when the translation differences recognized in other comprehensive income are reclassified to profit and loss).

- Financial liabilities hedging investments in a foreign operation in respect of the effective part of the hedge.

The functional currency of offices operating overseas

The Bank applies IAS 21 – "The Effects of Changes in Foreign Exchange Rates" as of 1 January 2011, except for the provisions of the Standard with regard to the classification of banking offices operating overseas as foreign operations whose functional currency is not the shekel.

Until 1994 certain foreign banking offices were considered as a foreign operation whose functional currency is different from the shekel, and exchange rate differentials were charged directly to equity, as part of the translation reserve. From 1995, pursuant to the directives of the Supervisor of Banks, foreign banking offices were classified as a foreign operation whose functional currency is the same as the functional currency of the Bank.

On 14 February 2012, a circular was published by the Supervisor of Banks as to the manner of determining the functional currency of banking offices operating overseas. When determining the functional currency, the Bank is required to examine the range of criteria listed below, and document the results:

- If the primary environment in which the office generates and expends cash is a foreign currency and the activity of the office in shekels is marginal.

- If recruiting customers for the office is carried out independently, such that the activity of the office vis-à-vis the customers of the banking corporation or related parties is not significant.

- If the activity of the office vis-à-vis the banking corporation and related parties is not significant, and, inter alia, the office has no dependence on sources of funding from the banking corporation or its related parties.

- If the activity of the office is essentially independent and stands alone, and is not an extension of or supplementary to the local activity of the banking corporation.

When one of the said criteria is clearly not fulfilled, this indicates that the office is to be treated as a foreign operation whose functional currency is the shekel. In any other situation, the determination is to be made according to an examination of a range of criteria.

The Bank has reexamined the classification of its overseas banking offices in accordance with the new criteria, and has reclassified the banking offices in the US and Switzerland as foreign operations whose functional currency is other than the shekel.
The change in classification was dealt with prospectively as a change in the functional currency of the offices, so that exchange rate differences from translation are recognized from 1 January 2012 as other comprehensive income, and shown under "Adjustments for translation of foreign operations".

Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments generated in an acquisition, have been translated to NIS at the exchange rate prevailing at the date of the transactions. Income and expenses of foreign operations have been translated to NIS at the exchange rates prevailing at the dates of the transactions.

Exchange rate differentials in respect of the translation are recognized in comprehensive income, and are shown in equity under "Adjustments for translation of financial statements".

On realization, including liquidation of a foreign operation leading to loss of control or substantial influence, the cumulative amount in the translation reserve resulting from the foreign operation is reclassified to profit and loss as part of the profit or loss on the realization.

In addition, when there are changes in the percentage of the Bank's holdings in a subsidiary company that includes foreign operations while retaining control of the subsidiary company, a proportionate part of the accumulated amount of exchange rate differences recognized in other comprehensive income is reattributed to non-controlling interests.

When the Group realizes part of the investment that is a subsidiary company that includes foreign operations while retaining material influence, the proportionate part of the accumulated amount of exchange rate differences is reclassified to profit and loss.

Hedging a net investment in a foreign operation

The Group applies hedge accounting in respect of exchange rate differences between the functional currency of a foreign operation and the functional currency of the Bank (NIS), whether the investment in a foreign operation is held directly by the Bank or through a holding company.

Exchange rate differences arising from translation of a financial liability hedging a net investment in a foreign operation are charged to other comprehensive income and shown as equity under "Adjustments for translation of foreign operations". The ineffective part is charged to profit and loss. When the investment for which the hedging was made is realized, the relevant amount accrued in "Adjustments for translation of financial statements" is transferred to profit and loss as part of the profit and loss from realization of the investment.

Index-linked assets and liabilities not measured at fair value

Assets and liabilities linked to the Consumer Price Index are included in accordance with the linkage terms determined for each balance.

Details of representative exchange rates and the CPI and the rate of change therein:

	31 December			Rate of change in		
	2016	2015	2014	**2016**	2015	2014
	NIS			**%**		
Exchange rate of:						
U.S. dollar	**3.845**	3.902	3.889	**(1.5)**	0.3	12.0
Euro	**4.044**	4.247	4.725	**(4.8)**	(10.1)	(1.2)
Pound Sterling	**4.725**	5.784	6.064	**(18.3)**	(4.6)	5.6
Swiss franc	**3.767**	3.925	3.929	**(4.0)**	(0.1)	0.8
Consumer Price Index:	(Points)					
November – known index	**98.9**	99.2	100.1	**(0.3)**	(0.9)	(0.1)
December – index for the month	**98.9**	99.1	100.1	**(0.2)**	(1.0)	(0.2)

E. Basis of consolidation

1. Business combinations

The Group applies the acquisition method with regard to all business combinations. The acquisition date is the date when the acquirer achieved control over the acquiree. The Group controls the acquiree when it has the ability to direct policy and management in the acquiree. When considering control, potential rights are not taken into account.

The Group recognizes goodwill at the acquisition date at the fair value of the proceeds paid, including amounts recognized in respect of any rights not conferring control over an acquiree, as well as the fair value at the acquisition date of equity rights in the acquiree that were held prior to then by the acquirer, after deducting the net amount attributable on acquisition to identifiable assets that were acquired and liabilities that were assumed.

The Bank recognizes a contingent liability assumed in a business combination at the date of acquisition if there is a liability at the date of acquisition deriving from past events whose fair value can be measured in a reliable manner.

In the event the Group carries out an acquisition at an advantageous price (an acquisition that includes negative goodwill), it recognizes the profit generated as a result in the profit and loss statement at the acquisition date, after carrying out an additional examination of the amounts attributed to the assets and liabilities of the entity acquired.

The proceeds transferred include the fair value of the assets transferred to the previous owners of the acquiree, liabilities assumed by the acquirer vis-à-vis the previous owners of the acquiree, and equity rights issued by the Group. In a business combination achieved in stages, the difference between the fair value at the date of acquisition of the equity rights in the acquiree held previously by the Group, and the book value at the same date, is charged to the statement of profit and loss under "Non-interest financing income – profits or losses from investment in shares" as part of activities not for trading purposes. Furthermore, the proceeds transferred include the fair value of the conditional proceeds. Subsequent to the date of acquisition, the Group recognizes changes in the fair value of the conditional proceeds classified as a financial liability in the statement of profit and loss, while the conditional proceeds classified as a capital instrument is not remeasured.

Costs of a transaction resulting from a business combination transaction are charged immediately to profit and loss.

2. Subsidiary companies

Subsidiary companies are entities controlled by the Bank.

The consolidated financial statements include the financial statements of the Bank and of entities in which the Bank has control. The financial statements of subsidiary companies are included in the consolidated financial statements from the date control is obtained until the date control ceases. The accounting policy of subsidiary companies was amended as necessary in order to adapt it to the accounting policy adopted by the Bank, except in those cases when the Supervisor of Banks otherwise permitted.

Intercompany balances and transactions between consolidated companies are eliminated in the consolidated financial statements.

The financial statements of two wholly-owned real estate and service companies are consolidated in the financial statements of the Bank only.

Non-controlling interests

Non-controlling interests are the part of the equity of subsidiary companies, directly or indirectly, which are not attributable to the parent company. These rights, which grant the holder part of the net assets of the acquiree, are measured for fair value on the date of acquisition.

Profit or loss and any element of other comprehensive income are attributable to the shareholders of the Bank and to non-controlling interests. The amount of profit, loss, and other comprehensive income attributable to the owners of the Bank and to non-controlling interests even if, as a result of this, the balance of non-controlling interests would be negative.

Transactions with non-controlling interests, while maintaining control, are treated as equity transactions. Any difference between the proceeds paid or received in the change of non-controlling interests is charged to the owners' share of the Bank, directly to retained earnings.

The amount for which non-controlling interests are adjusted is calculated as follows:

- When the holding percentage increases, according to the relative part acquired from the balance of the non-controlling interests in the consolidated financial statements prior to the transaction.

- When the holding percentage decreases, it is calculated according to the relative part realized by the owners of the bank in net assets of the subsidiary company including goodwill.

- When there are changes in the holding percentage in a subsidiary company, while retaining control, the Bank reapportions the aggregate amounts recognized under other comprehensive income, between the owners and the non-controlling interests.
- When there is a loss of control, the Bank deducts the assets and liabilities of the subsidiary company and other components of the capital attributed to the subsidiary company. If the Bank remains with some investment in the former subsidiary company, the balance of the investment is measured at fair value at the date of loss of control. The difference between the proceeds received and the fair value of the balance of the investment in the former subsidiary company and the balances deducted are recognized in profit and loss. The amounts that were recognized in equity by way of other comprehensive income relating to that subsidiary are reclassified to profit or loss.

3. Companies included on equity basis

Companies included on equity basis are entities in which the Group has significant influence on financial and operational policy, without having achieved control over them. It is assumed that holding between 20% and 50% of an investee grants material influence. In addition, for purposes of determining material influence, qualitative criteria are examined which often supersede this quantitative assumption. When examining whether there is material influence, potential voting rights that are exercisable or immediately convertible to shares in the investee company, are to be taken into consideration.

The investment in shares of companies included on equity basis is dealt with according to the equity method and recognized initially at cost. The cost of the investment includes transaction costs. When the Bank achieves significant influence for the first time in an investment dealt with as an asset available for sale until the date significant influence is achieved, the equity method is applied retroactively.

Investments include goodwill calculated at the date of acquisition and shown after deducting accrued losses from impairment. The accounting policy of companies included on equity basis which is implemented by them is in accordance with generally accepted accounting principles in Israel or international accounting principles if the company included on equity basis is in a foreign country or is otherwise permitted by the Supervisor of Banks.

The financial statements of a company included on equity basis are prepared using a uniform accounting policy with the banking corporation with regard to similar transactions and events under similar circumstances; except for adjustments to accounting policy referring to subjects that are a core part of the banking business, that were implemented by a non-banking company included on equity basis.

The Bank's share in the operating results of the said companies is shown after amortization of the cost generated on their acquisition. Excess cost attributed to the assets and liabilities is amortized over the useful life of the asset. Positive goodwill is not amortized and is included in the book value of the investment, and negative goodwill is recognized in profit and loss at the acquisition date with the approval of the Supervisor of Banks.

The statement of changes in shareholders' equity includes the Bank's share in "translation adjustments" of units held by companies included on equity basis, as units whose activity is in a functional currency differing from the functional currency of the Bank.

Profits or losses from the realization of companies included on equity basis are charged to profit and loss under "Non-interest financing income – profits or losses from investment in shares" as part of activities not for trading purposes.
When the Group share in losses exceeds the value of the rights of the Group in the company dealt with under the equity method, the book value of those rights is reduced to zero.

The Group does not recognize additional losses of the investee company unless the Group has an additional obligation to the investee company. When there is an increase in the percentage of the holding in the company included on equity basis that is being dealt with under the equity method while retaining significant influence, the acquisition method is applied only with respect to the additional percentages held, while the previous holding remains unchanged.

When there is a reduction in the percentage of the holding in the company included on equity basis that is being dealt with under the equity method while retaining significant influence, the Group reduces a relative portion of its investment and recognizes it in profit and loss on the sale. In addition, on the same date the relative portion of the amounts recognized in capital reserves through other comprehensive profit in reference to the said company included on equity basis, is reclassified to profit and loss or retained earnings.

When there is a loss of significant influence, the Group ceases to use the equity method as of the date it lost significant influence, and deals with the remaining investment as a financial asset. At this date it will recognize in other comprehensive income the difference between the fair value of the balance of the investment and the book value of the investment.

In addition, at the same date a relative part of the amounts recognized in capital reserves by way of other comprehensive income, with reference to that company included on equity basis, is reclassified to the statement of profit and loss or to retained earnings.

The Bank reviews, in each reporting period, the need to record impairment of its investment in companies included on equity basis - see paragraph U.3 below.

F. Basis of recognition of income and expenses

Income and expenses are included on an accrual basis, except for the following:

- Income and expenses from securities held for trading and derivative financial instruments are recognized according to the changes in fair value.

- Interest accruing on problematic debts that were classified as non-accrual loans is recognized on a cash basis when there is no doubt with regard to collection of the remaining recorded debt balance of an impaired debt. In these situations, an amount collected on account of the interest that is recognized as interest income, is limited to the amount that would be accumulated in the reporting period on the remaining recorded balance of the debt according to the contractual interest rate. Interest income on a cash basis is classified in the statement of profit and loss as interest income under the relevant heading. When there is doubt as to collection of the remaining recorded balance of debt, all payments collected serve to reduce the loan principal. In addition, interest on past-due amounts in respect of housing loans is recognized in the profit and loss statement on an actual collection basis.

- Credit origination commissions - Commissions charged for originating credit, excluding loans for a period up to three months, are not recognized immediately as income in the statement of profit and loss, but are deferred and recognized over the life of the loan as an adjustment of the return. Income from the said commissions will be charged under the effective interest rate method and reported as part of interest income.

- Early repayment commissions – Income from Commissions charged for early repayment, performed before 1 January 2014 and not yet amortized, are recognized over a period of three years or the remaining term of the loan, whichever is shorter. Commissions that were charged for early repayment performed after 1 January, 2014, are immediately recognized as part of interest income.

- Change in the terms of a debt - In cases of refinancing or restructuring of debts that are not problematic, the Bank considers whether the loan terms were changed significantly. In such cases all commissions not yet amortized and early repayment commissions collected from the customer due to change in credit terms are included as part of the net investment in the new loan and recognized as adjustments to the return as stated above.

- Credit allocation commissions are accounted for in accordance with the likelihood of the realization of the obligation to provide credit. If this is remote, the commission is recognized on a straight line basis over the term of the commitment, or the Bank defers recognition of income from such commissions until the date of exercise of the commitment or the date of expiry, whichever the earlier. If the commitment fee is recognized, then the commissions are recognized by way of adjusting the yield over the life of the loan as stated above. If the commitment expires unexercised, the commissions are recognized on the date of expiration and reported as part of income from commissions. For this purpose, the Bank assumes that the probability of realizing the commitment is not remote.

- Operating commissions for granting services are charged to profit and loss when the service is granted.

- In subsequent periods to an impairment which is other than of a temporary nature, interest income from investments in debt instruments will be recognized based on the excess of the amount of expected cash flows of the debt instrument.

G. Fair value of financial instruments

Effective 1 January 2011, the Bank implements the rules set out in FAS 157 (ASC 820) that defines fair value and establishes a consistent working framework for the measurement of fair value by defining fair value assessment techniques with regard to assets and liabilities, and by establishing a fair value hierarchy and detailed instructions for implementation. In addition, as of 1 January 2012, the Bank applies the directive of the Banking Supervision Department on Fair Value Measurement that integrates the principles set out in Accounting Standards Update ASU 2011-04 on Fair Value Measurement in the Public Reporting Directives.

The Standard requires, *inter alia*, for purposes of fair value valuation, making optimum use of observable inputs, and minimizing the use of unobservable inputs. Observable inputs provide information available to the market received from independent sources, whereas unobservable inputs reflect assumptions by the banking corporation.

FAS 157 stipulates a hierarchy of measurement techniques based on the determination if the inputs used for purposes of determining fair value are observable or unobservable. These types of input create a fair value hierarchy detailed as follows:

- Level 1 inputs: quoted prices (not adjusted) in active markets for identical assets or liabilities.

- Level 2 inputs: prices quoted for similar assets or liabilities in active markets; prices quoted for identical assets or liabilities in inactive markets; prices derived from evaluation methods in which all the significant inputs are observable in the market, or are supported by observable market data.

- Level 3 inputs: unobservable inputs for the asset or the liability deriving from evaluation model for which one or more of the significant inputs are not observable.

This hierarchy requires the use of observable market data, where such exist. When this is possible, the Bank considers relevant observable data in its evaluation, the scope and frequency of the transactions, the size of the bid-ask margin, and the size of adjustment required when comparing similar transactions, are all factors taken into account when determining the level of market liquidity and the degree of relevance of observable prices in those markets.

The level in the scale of fair value to which the fair value measurement of the financial instrument belongs is to be determined on the basis of the lowest level of the figure that is significant for the fair value measurement as a whole.

Methods of assessment implemented by the Bank for measuring fair value are evaluated taking into consideration the relevant circumstances for the various transactions, including prices of recent transactions in the market, indicative prices of assessment services, and the results of back-testing of similar types of transactions.

Evaluation of credit risk and non-performance risk

The Standard requires the banking corporation to reflect credit risk and non-performance risk in the measurement of the fair value of debt, including derivative instruments, issued by the banking corporation and measured at fair value. Non-performance risk includes the credit risk of the banking corporation, but is not limited to this risk only.

For further details regarding the methods and main assumptions used for purposes of assessing the fair value of financial instruments, see Note 33A below, under the subject of balances and fair value measurements of financial instruments.

Securities

The fair value of securities held for trading and securities available for sale is determined based on market prices quoted in the principal market. In those cases, where a quoted market price is not available, the fair value is based on the best available information with maximum use of observable data and taking into account the risks inherent in the financial instrument. Fair value is determined using generally accepted pricing models, based on evaluations obtained from experts in valuing financial instruments or based on an independent system of the Bank. Evaluation methods include the use of various parameters, such as interest curves, currency rates and standard deviations, taking into account the risks inherent in the financial instrument (market risk, credit risk, non-marketability, etc.).

Most of the portfolio is calculated each month by a well-known international institution which is engaged in the calculation of fair value and is independent of the issuing entities and the marketing entities. The calculation is based mainly on the prices of transactions in active markets. The balance of the portfolio is revalued based on quotes from brokers or from the makers of the instruments, or based on the Bank's system.

Derivative financial instruments

The fair value of derivative financial instruments that have an active market is determined based on market prices quoted in a principal market.
In those cases, where a quoted market price is not available, a fair value estimate is made by using models that take into account the risks inherent in the derivative instrument.

Non-derivative financial instruments

For most financial instruments in this category there is no active market in which they are traded. Accordingly, fair value is estimated using generally accepted pricing models, such as the present value of future cash flows discounted at an interest rate reflecting the level of risk inherent in the financial instrument. For this purpose, pursuant to Banking Supervision Department instructions, future cash flows for impaired debts and other debts have been calculated after deducting the effect of accounting write-offs and allowances for credit losses in respect of the debts.

The Fair Value Option for Financial Assets and Financial Liabilities

FAS 159 (ASC 825-10) allows a banking corporation to elect, on defined dates, to measure financial instruments and certain other items (the eligible items) at fair value, which under the Public Reporting Directives are not required to be measured at fair value. Unrealized profits and losses in respect of changes in the fair value of the items for which the fair value alternative is selected, shall be reported in the statement of profit and loss for each consecutive reporting period. In addition, prepaid costs and fees related to the items for which the fair value alternative is selected, shall be recognized in profit and loss on the date of creation, rather than deferred. The election to apply the fair value alternative, as noted above, shall be made instrument by instrument, and cannot be cancelled. In addition, FAS 159 establishes presentation and disclosure requirements aimed at facilitating comparisons between banking corporations that choose different bases for measurement of similar types of assets and liabilities.

Notwithstanding the above, it is clarified by the Banking Supervision Department that a banking corporation shall not elect the fair value alternative unless it has developed prior know-how, systems, procedures, and controls at a high level, which will enable it to measure the item to a high degree of reliability. Thus, a banking corporation shall not elect the fair value alternative with regard to any asset requiring classification as Level 2 or Level 3 of the fair value hierarchy, or with regard to any liability, unless it receives prior approval to do so from the Banking Supervision Department. The Bank did not designate financial instruments under the fair value option.

H. Impaired Debts, Credit Risk and Allowance for Credit Losses

As of 1 January 2011, in accordance with the Directive of the Supervisor of Banks on Measurement and Disclosure of Impaired Debts, Credit Risk, and the Allowance for Credit Losses, the Bank applies the ASC310 (US Accounting Standards Codification), the positions of the US banking supervisory authorities and the Securities and Exchange Commission as adopted by the Supervisor of Banks in the Public Reporting Directives.
In addition, the Bank implements the directives of the Banking Supervision Department on updating the disclosure on credit risk and on the allowance for credit losses as of 1 January 2012.

The Directive has been implemented with regard to all debt balances such as deposits in banks, bonds, securities borrowed or purchased under repurchase agreements, credit to the public, credit to the government, etc. Credit to the public and other debt balances for which no specific rules were made in the Public Reporting Directives regarding the measurement of the allowance for credit losses (such as credit to the government, deposits in banks, etc.) are reported in the books of the Bank according to the recorded debt balance. A recorded debt balance is defined as the balance of a debt after deducting accounting write offs but before deducting an allowance for credit losses in respect of that debt.

The Bank has decided on the procedures required to maintain an allowance for credit losses at a level appropriate to cover expected credit losses relating to its loan portfolio, including in respect of off-balance sheet credit risk. The allowance to cover expected credit losses in the loan portfolio is estimated in one of the following tracks:

- Individual allowance for credit losses – The allowance is made based on the measurement of the impairment of the debt, based on the present value of future expected cash flows, discounted at the effective rate of interest of the debt; or, when a debt is dependent on collateral (debt in which the repayment is expected to be made exclusively from the pledged collateral or other asset held by the borrower), or when an asset is expected to be seized, according to the fair value of the collateral pledged to secure such credit (less costs of sale). The need for an individual allowance is assessed for each debt whose contractual balance (without deducting: accounting write-offs not involving a legal waiver, interest not recognized, allowances for credit losses, and collateral) is NIS 1 million or more, and any other debt identified for individual assessment by the Bank. In some of the consolidated subsidiary companies, the assessment is made also for lower amounts. The individual allowance is calculated for each debt classified as impaired (see below).

  • Collective allowance for credit losses – This is implemented for large groups of relatively small and homogeneous debts, and in respect of debts that have been assessed individually and found not to be impaired. Measurement of credit losses is based on the principles set out in FAS 5 (ASC 450) – Accounting for Contingencies and the directives of the Supervisor of Banks, based on historical loss rates in the various sectors of the economy, divided between problem debts and non-problem debts in the years ranging from1 January 2011 up to the reporting date. In addition, for purposes of determining the appropriate rate of the provision, the Bank, for purposes of determining the appropriate rate of the provision, takes into account adjustment in respect of environmental factors such as: conditions of the sector, macroeconomic data, a general assessment of the quality of credit to sectors of the economy, changes in volume and the trend of balances in arrears and impaired balances, and the effect of the changes on credit concentrations.

  Regarding consumer credit to private individuals, the rate of adjustment in respect of environmental factors shall not be less than 0.75% of the balance of unimpaired consumer credit. From the aforesaid was excluded the credit risk deriving from receivables in respect of banking credit cards without interest charge.

- The allowance assessed on a group basis for off-balance sheet credit instruments is based on the rates of allowance determined for balance sheet credit, taking into account the percentage of off-balance sheet credit risk expected to be realized. The credit realization percentage is calculated by the Bank based on credit conversion coefficients as set out in Proper Conduct of Banking Business Directive No. 203 – Measurement and Adequacy of Capital – Credit Risk – Standardized Approach, with certain adjustments in cases where the Bank has prior experience indicating percentages for the realization of credit.

  The minimum provision for doubtful debts in respect of housing loans is calculated according to a formula determined by the Supervisor of Banks, taking into account the extent of arrears, whereby the rates of the provision increase as the arrears grow. The application of the calculation of the provision according to the formula of the extent of arrears refers to all housing loans, except for loans not payable in regular installments and loans financing activity of a business nature. Similarly, a provision is made on the balance of housing loans not in arrears based on past statistics.

In addition, the Bank implemented the provisions of an update of Proper Conduct of Banking Business Directive 329 on "Restrictions on Granting Housing Loans". The Bank formulated a policy designed to ensure that it complies with the new requirements that, as of 30 June 2013, the balance of the collective allowance for credit losses for housing loans will not be less than 0.35% of the balance of the said loans at the reporting date.

The Bank examines the overall appropriateness of the allowance for credit losses based on management's judgment, taking into account the risks inherent in the loan portfolio.

The Bank also calculates a supplementary and general provision under the policy for the provision for doubtful debts before the implementation of the directives on impaired debts, credit risk, and the allowance for credit losses.

These provisions are used only as an indicator for the collective allowance such that if the total collective allowance is less than the supplementary and general provision, the allowance is to be made using the higher of the two calculations.

Classification of problem debts

The Bank determined procedures for identifying problem credit and classifying debts as impaired. In accordance with these procedures, the Bank classifies the balance of its various troubled debts as follows: special mention, substandard, or impaired.

Special mention credit

Special mention balance sheet credit is a debt which has potential weaknesses in respect of which special attention is required by the management of the corporation. Off-balance sheet credit is classified as special mention credit if realization of the liability contingent on this item is "possible", and if the debts which may be recognized as a result of the contingent realization are suitable for classification in this category.

Substandard credit

Substandard balance sheet credit is credit which is insufficiently protected by the current established value and the debtor’s repayment ability, or by the pledged collateral, if any. Balance sheet credit risk classified as such has a well-defined weakness or weaknesses that put the realization of the debt at risk. Credit for which an allowance for credit losses is recognized on a collective basis will be classified substandard when it becomes a debt with arrears of 90 days or more.

Impaired credit

Identifying and classifying impaired credit

Impaired debt is credit of which the banking corporation, based on current information and events, will probably not be able to collect the entire amount due (principal and interest), according to the contractual terms of the loan agreement. In particular, a debt is classified as impaired when its principal or interest is in arrears of more than 90 days, except if the debt is well secured or in collection proceedings. In addition, an impaired debt is also considered as a debt whose terms were changed due to troubled debt restructuring, unless prior to and after the restructuring a minimum allowance was made for credit allowance by extent of arrears.

Reversing an impaired debt back to non-impaired status
An impaired debt reverts to being classified as a non-impaired debt if one of the following conditions is met:

- There are no components of principal or interest in regard thereof repayment has become due but have not been paid, and the Bank expects repayment of the remaining principal and interest in full under the terms of the contract (including accounting write-offs or amounts that have been provided for).
- When the debt has become well-secured debt and is in process of collection.
- A troubled debt which has been restructured and thereafter the banking corporation and the debtor entered into an additional restructuring agreement (subsequent restructuring), the banking corporation is not required any longer to regard the debt as a restructured troubled debt anymore, provided that the debtor no longer has financial difficulties at the time of the restructuring and that, in accordance with the subsequent restructuring terms, the banking corporation has not granted a waiver to the debtor. This paragraph applies to restructurings to be performed or renewed from 31 December 2016.

The rules for reversing an impaired debt will not apply to debts classified as impaired as a result of troubled debt restructuring, except for subsequent restructuring as mentioned above.

Changing an impaired debt back to an impaired accrual status
A debt for which after restructuring there is reasonable certainty that it will be repaid in accordance with its new terms, is changed back for treatment as a debt accruing interest income under terms of restructuring, and any accounting write-off carried out in the debt is supported by an updated appraisal as to the financial condition of the debtor, based on continuous repayments of at least six months and only after payments are received that significantly reduce (at least 20%) the recorded balance of debt determined after restructuring.

Troubled debt restructuring
A debt which formally underwent a troubled debt restructuring is defined as a debt in respect of which, for economic or legal reasons related to the debtor's financial difficulties, the Bank granted a waiver by way of modification of the terms of debt, in order to alleviate the burden for the debtor of near-term cash payments or by way of receipt of other assets as payment of the debt. For purposes of determining whether a debt agreement executed by the Bank comprises a troubled debt restructuring, the Bank performs a qualitative examination of the totality of the terms of the arrangement and the circumstances under which it was made, in order to determine whether (1) the debtor is in financial difficulties and (2) the Bank granted a waiver under the arrangement to the debtor.

In order to determine whether the debtor is in financial difficulties, the Bank examines whether there are signs that point to the fact that the borrower is in difficulties at the time of the arrangement or the existence of a reasonable possibility that the borrower would get into financial difficulties if not for the arrangement.

The Bank examines, inter alia, the existence of one or more of the following circumstances:

- At the time of the debt arrangement the borrower is in default, including when any other debt of the borrower is in default;

- With regard to debts which at the time of the arrangement are not in arrears, the Bank estimates if according to the current repayment ability it is likely that in the foreseeable future the borrower will get into a default situation, and will not meet the original contractual terms of the debt;

- The debtor was declared bankrupt, is under receivership, or there are significant doubts as to the borrower's continued existence as a going concern;

- And that without changing the terms of the debt, the debtor will not be able to raise debt from other sources at market rates of interest for debtors not in default.

The debtor was granted a waiver, even if under the arrangement an increase was made in the contractual interest rate, if one or more of the following situations exist:

- As a result of restructuring, the Bank is not expected to collect all amounts outstanding (including accrued interest according to the contractual terms);

- The updated fair value of the collateral, in respect of debts conditional on collateral, does not cover the contractual balance of the debt and indicates the inability to collect all amounts due;

- The debtor has no possibility of raising resources at the rate prevailing in the market for a debt with terms and characteristics such as those of the debt granted under the arrangement.

In addition, the Bank will not classify debt as a restructured troubled debt if, under the arrangement, the debtor was granted a stay of payments that is not material, given the frequency of the payments in the contractual repayment period and the expected duration of the original debt. In this regard, if several arrangements were made involving changes in the terms of the debt, the Bank takes into account the cumulative effect of the previous arrangements for the purpose of determining whether the stay of payments is not material.

Restructured debts, including those that prior to the restructuring were examined on a group basis, will be classified as impaired debt and will be evaluated on an individual basis for purposes of making an allowance for credit losses, or an accounting write-off. As a rule, a troubled debt which has been restructured will continue to be measured and classified as an impaired debt, until it is repaid in full, unless it met the conditions of reversal or impairment, as mentioned above.

However, recognition of income at the time the debt is classified as impaired, the Bank defines the debt as a debt not accruing interest income, and ceases accruing interest income on it, except that stated above regarding certain impaired debts after restructuring. In addition, at the time the debt is classified as impaired, the Bank cancels all the interest income accrued but not yet collected, which was recognized as income in profit and loss. The debt remains classified as a debt not accruing interest income, as long as the impaired debt classification is not canceled. A debt that underwent a formal troubled debt restructuring, and after the restructuring there is reasonable certainty that the debt will be repaid and will perform in accordance with its new terms, will be treated as an impaired debt accruing interest income. For details regarding recognition of income on a cash basis for debts classified as impaired, see paragraph F above.

Regarding debts assessed and provided for on a collective basis, which are in arrears of 90 days or more, the Bank continues to accrue interest income. These debts are subject to methods of evaluation for the allowance for credit losses that ensure that the profit of the Bank is not overstated. Late-payment commissions for these debts are included as income on the date the Bank becomes entitled to receive them from the customer, provided that collection is reasonably secured.

Accounting write-off

The Bank makes an accounting write-off in the cases set out below:

- Any debt or part thereof examined on an individual basis that is considered uncollectible, or a debt which the Bank has made efforts to collect over an extended period (defined generally as a period exceeding two years) to collect the debt and for which individual allowances for credit losses have been made.

- In the event of a debt whose collection in collateral-contingent, any part of a debt which exceeds the value of the collateral, which is identified as uncollectible will be written off immediately against the allowance for credit losses.

- Troubled debts in respect of which the allowance is measured based on a collective allowance for credit losses when the period of arrears exceeds 150 days.

It should be explained that accounting write-offs do not involve a legal waiver, and they reduce the reported balance of debt for accounting purposes only, while creating a new cost base for the debt in the Bank's books.

I. Securities

1. Securities in which the Bank invests may be classified in three portfolios as follows:

a. Debentures held to maturity

Debentures which the Bank intends and is able to hold until redemption date. Debentures held to maturity are stated at cost with the addition of accrued interest, linkage and foreign currency differences, taking into consideration the proportion of the premium or discount and less provision for impairment in their value which is not of a temporary nature.
The Bank did not classify debentures in the held to maturity portfolio.

b. Securities held for trading

Securities which were acquired and are held with the aim of selling them in the near future, and securities for which the banking corporation chose to make fair value measurement through the statement of profit and loss. Securities held for trading are stated at fair value at the reporting date. Realized and unrealized gains and losses are included in the statement of profit and loss.

c. Securities available for sale

Securities not classified as debentures held to redemption or as securities held for trading. Securities available for sale are stated in the balance sheet at their fair value on the reporting date, except for shares, and venture capital funds in respect of which the fair value is not available, in which case they are stated at cost.

Differences between the fair value and the amortized cost, less a reserve for tax, are shown in a separate item within shareholders' equity, under other comprehensive profit. Impairment in value which is not of a temporary nature is charged to the profit and loss statement as detailed in paragraph 6 below.

Unrealized gains or losses from adjustments to fair value of securities available for sale designated as being hedged by fair value hedges, are charged to the statement of profit and loss over the period of hedging the hedged risk.

2. Dividend income, accumulated interest, linkage and price differences, amortization of premium or discount (in accordance with the effective interest method), as well as losses from impairment in value not of a temporary nature, are recorded to the profit and loss statement.

3. Interest income in respect of beneficial interests which have been acquired, such as asset-backed financial instruments, e.g., MBS, CLO, SCDO and CMO (except for high-quality loan instruments) is recognized using the prospective interest method (future interest that also anticipates future changes), adjusting the interest rate used for recognizing interest for changes in the estimate of future cash flows. High quality loan beneficial interests are beneficial interests issued under the guarantee of the United States government or agencies of the U.S. government, and asset-backed securities whose international credit rating is at least AA.

4. The Bank's investments in venture capital funds are dealt with according to fair value. If no rate is published, they will be shown at cost less losses from impairment of a nature other than temporary. Profits from venture capital investments are credited to the profit and loss statement when the investment is realized.

5. Fair Value

With regard to the determination of fair value, see paragraph G above.

6. Impairment

The Bank examines the necessity, in each reporting period, for making a provision for impairment of securities, in the available for sale portfolio, which is not of a temporary nature. The examination is carried out if there are indications that the value of the securities might be impaired. The criteria for determining if the impairment is not of a temporary nature are based on the following considerations and tests:

- Intention and ability to hold the security until the forecasted recovery of the cost in full.
- The assets and collaterals backing up the security.
- The percentage of impairment from the cost of the security.
- Duration of period in which the fair value of the security is lower than cost.
- Evaluation of repayment ability and rating.
- An adverse change in the situation of the issuer or in the state of the market as a whole.

The Bank's policy is to recognize the impairment of a security as having a nature other than temporary, at least in respect of the impairment of any security that fulfils one or more of the following conditions:

- A security which was sold before the publication of the report to the public.
- A security which the Bank intended to sell within a short period of time before the publication of the report to the public.
- A debenture for which there was a significant rating decrease between the rating of the debenture at the date of acquisition by the Bank and the rating of the debenture at the date of publication of the report. Only a rating decrease below BBB- is considered a significant rating decrease for purposes of this paragraph.
- A debenture which was classified as problematic by the Bank after its acquisition.
- A debenture in respect of which there was a credit failure which was not rectified within a reasonable period of time.
- A security whose fair value was lower than the purchase value for a period of time of at least nine months before the end of the period of the financial statement, and at the end of the statement period as well as at a date shortly before publication of the report was lower by 35% or more than the cost (in the case of a debenture – the depreciated cost).

  In this matter an exception is possible if the Bank has concrete objective evidence and a conservative analysis of all the relevant factors, to show with a high degree of certainty that the impairment is of a temporary nature. The objective evidence and the relevant factors include parameters such as: an increase in value after the date of the financial report, a high credit rating (group A or above), an analysis of stability in stress scenarios carried out by an independent external party or by the Bank, backing and direct government investment in shareholders' equity for purposes of ensuring the strength of the issuer.

These principles are in accordance with the guideline issued by the Supervisor of Banks, except for the definitions of "significant rating" and "significant impairment" which were determined by the Bank.

When impairment in value occurs not of a temporary nature, the cost of the security is reduced to the fair value and serves as a new cost basis. Losses from securities which are not of a temporary nature are charged to the statement of profit and loss. Increases in value over the new cost basis in subsequent reporting periods, are included in a separate item in shareholders' equity under total other accumulated profit and is not charged to profit and loss.

J. Derivative financial instruments including hedge accounting

The Bank holds derivative financial instruments for purposes of hedging foreign currency risks and interest rate risks, and also carries out activity in derivatives not for hedging purposes, including embedded derivatives that have been separated.

Hedge accounting

The Bank, at the date the hedge is made, formally documents the hedging relationships between the hedging instrument and the hedged item, including the purpose of risk management and the Bank's strategy in creating the hedging transaction, and the manner in which the Bank will evaluate the effectiveness of hedging relationships. The Bank evaluates the effectiveness of hedging relationships both at the beginning of the hedge and also on an ongoing basis. In addition, the Bank applies hedge accounting in the "shortened" version which assumes full effectiveness in accordance with the provisions of the standard.

1. **Fair value hedging**

Changes in the fair value of derivative financial instruments designated to hedge fair value are charged to the profit and loss statement. The hedged item is also shown at fair value with reference to the risks hedged, and changes in fair value are charged to the profit and loss statement.

If the hedging instrument no longer fulfills the criteria of an accounting hedge, or expires, is sold, cancelled or realized, or the Bank cancels the designation of a fair value hedge, the Bank ceases utilization of hedge accounting.

Hedging a net investment in a foreign operation – see paragraph D above.

2. **Assets and liabilities**

Hedge accounting is not applied with regard to derivative instruments serving as part of the Bank's asset and liability management system (ALM). Changes in the fair value of these derivatives are recognized in the statement of profit and loss when incurred.

3. **Other derivatives**

Changes in the fair value of derivatives not used for hedging or covering exposures are charged immediately to profit and loss.

4. **Embedded derivatives**

Embedded derivative instruments are separated from the host contract and dealt with separately if: (a) there is no clear and close relationship between the economic characteristics and risks of the host contract and of the embedded derivative instrument, including credit risks attributable to certain embedded credit derivatives; (b) a separate instrument with the same conditions as the embedded derivative instrument would fulfill the definition of a derivative; and (c) the hybrid instrument is not measured according to fair value through profit and loss.

An embedded derivative that was separated is included in the balance sheet together with the host contract, and changes in fair value of separated embedded derivatives are charged on a current basis to profit and loss.

In certain cases, (such as in cases when the Bank is not able to separate the embedded derivative from the host contract), pursuant to US Accounting Standard FAS 155 (ASC 815-15), Accounting Treatment of Certain Hybrid Financial Instruments, the Bank elects not to separate the embedded derivative and to measure the hybrid instrument as a whole for fair value while reporting on changes in the fair value in the statement of profit and loss when they occur. The above election is made at the date of purchase of the hybrid instrument or on the occurrence of certain events when the instrument is subject to re-measurement (a re-measurement event), such as a result of business combinations or material changes in the debt instrument. Such fair value election is irrevocable.

5. **Fair value**

With regard to the determination of fair value, see paragraph G above.

K. Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

The Bank applies the measurement and disclosure principles prescribed in US Accounting Standard FAS 140 (ASC 860-10) - Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, amended by FAS 166 (ASC 860-10) - Transfers and Servicing of Financial Assets, for the purpose of dealing with transfers of financial assets and extinguishment of liabilities. In accordance with these principles, the transfer of a financial asset will be accounted for as a sale, if and only if, all of the following conditions are fulfilled: (1) the transferred financial asset has been isolated from the transferor, both in a state of bankruptcy or other receivership; (2) any recipient (or, if the recipient is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the financial assets it receives, each third-party holder of its beneficial interests) can pledge or exchange the assets (or beneficial interests) it received, and no condition exists that also constrains the recipient (or a third-party of its beneficial interests) from taking advantage of its right to pledge or exchange and provides the transferor with more than a trivial benefit; (3) the transferor or consolidated companies included in its financial statements or its agents do not maintain effective control over the financial assets or beneficial interests relating to the transferred financial assets.

As of 1 January 2013, the Bank applies Accounting Standards Update ASU 2011-03 – "Reconsideration of Effective Control for Repurchase Agreements".

In contracts for the transfer of financial assets, the Bank determines that effective control of the assets transferred remains with the transferor if the following conditions are met:

- The assets to be repurchased or redeemed are the same or substantially the same as those transferred;
- The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price;
- The agreement is entered into contemporaneously with the transfer.

In addition, in order for the transfer of some of the financial asset to be considered a sale, the part transferred must comply with the definition of participating interests. Participating interests must comply with the following criteria: the interest must represent a proportionate interest in relation to an entire financial asset; all cash flows received from the assets are divided proportionately among the participating interest holders in an amount equal to their share of ownership; the rights are not subordinated rights in relation to other rights; there is no right of recourse to the transferor or to other holders in participating interests (other than in the event of a breach of representations or warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits received by any holder of participating interests); and neither the transferor, nor the participating interest holder has the right to pledge or exchange the entire financial asset, unless all participating interest holders agree to pledge or exchange the entire financial asset.

If the transaction meets the conditions for treating a transaction as a sale, the transferred financial assets are deducted from the Bank's balance sheet. If the sale conditions are not fulfilled, the transfer is considered a secured debt. A sale of part of a financial asset which is not a participating interest as defined below is treated as a secured debt, i.e., the transferred assets continue to be recorded in the Bank's balance sheet and the proceeds from the sale will be recognized as a liability of the Bank.

Securities sold under conditions of repurchase or purchased under conditions of resale, securities borrowed or lent, and other financial instruments transferred or received by the Bank, in which the Bank did not lose control over the transferred asset or did not acquire control in the asset received, are treated as secured debt. Financial instruments transferred in transactions such as the above, are measured in accordance with the same principles applied before their transfer.

Securities sold as mentioned above are not deducted from the balance sheet and are shown under "Securities", and as opposed to these, the deposit, for which those securities were pledged to ensure its repayment, is shown under "Securities lent or sold under agreements to repurchase".

Securities purchased are recorded according to their value on the day the transaction was made under "Securities borrowed or purchased under agreements to resell".

The Bank monitors the fair value of securities borrowed and lent as well as securities transferred under purchase and resale agreements on a daily basis, and a demand for collateral is made in appropriate cases. Interest received or paid in respect of the said securities is reported under net interest income (expense).

Pursuant to the directives of the Supervisor, securities lending transactions executed as "ordinary" credit transactions, in which the Bank lends securities against the collateral portfolio, and the borrower does not provide the banking corporation with a security margin relating specifically to the securities lending transaction, are shown as credit to the public according to market value and are added to the debt of the borrower. Changes in the value of the above securities on an accrual basis are shown in the profit and loss statement under interest income from credit to the public, and the adjustment to market value is shown under adjustments in respect of securities available for sale according to fair value.

The Bank deducts a liability if and only if the liability is repaid, i.e. one of the following conditions exist: (a) the Bank paid the lender and was released from its obligation under the liability, or (b) the Bank was legally released, by legal proceedings or by agreement of the lender, from being the principal debtor under the liability.

L. Employee rights

Post-retirement benefits - pension, severance pay and other benefits - defined benefit plans

Pension benefit is part of the remuneration paid to employees for their services. In a defined benefit plan, the Bank undertakes in addition to the regular salary to supply pension payments in the years following the employee's retirement. The amount of the benefit paid depends on certain future events that are included in the plan's benefit formula.

Definitions:

- The rate for discounting liabilities in respect of employee benefits - the discount rate used to calculate the actuarial liability for the rights of the Bank's employee is based on market yields in accordance with the alternative the Bank has chosen from the alternatives provided by the Bank of Israel according to which the curve consists of the Israel government bond yield plus a margin curve of corporate bonds ranking AA or higher.
- Actuarial gain / loss – the change in the value of the projected obligation or plan assets resulting from the fact that actual experience differs from that estimated or arising from a change in an actuarial assumption.
- The expected return on plan assets – the Bank calculates the long term forecast rate of return on plan assets using historical rates of return over the long term for a portfolio with a similar composition of assets.
- Obligation for projected benefit – the actuarial present value of all benefits attributed by the plan's benefit formula.

The cost of pensions net for the period charged to profit and loss includes service cost, the cost of interest, the expected return on plan assets, amortization of the net actuarial gain or loss, amortization of a net asset or liability in respect of the transition (amortization of actuarial gains as recognized at 1 January, 2013, the date of initial application of GAAP for US banks on the subject of employee benefits) were credited to accumulated other comprehensive income.

The actuarial loss as at 1 January, 2013 that is due to the difference between the discount rate for calculating reserves to cover employee rights linked to the Consumer Price Index determined by the Temporary Provision in the Public Reporting Directives (4%), and the discount rates at that date determined according to the above, is included in accumulated other comprehensive income. Actuarial gains from 1 January, 2013 and thereafter arising from current changes in the discount rate during the reporting periods, were reported in accumulated other comprehensive income and cancelled out the net loss recorded as of 1 January, 2013.

Actuarial losses and gains arising from changes in current discount rates during the reporting periods and actuarial gains arising from changes in current discount rates during the reporting periods after resetting the balance of loss in respect of the transition, as mentioned above, are charged to other comprehensive income and are amortized using the straight line method according to the average service period remaining of employees expected to receive benefits according to the plan.

Actuarial gains and losses and other (not due to changes in current discount rates) and the difference between the actual yield expected return on plan assets are charged to other comprehensive income and amortized straight-line method according to the average remaining service period of employees expected to receive benefits under the plan.

The obligation for the projected benefit is recorded in the balance sheet after deducting the fair value of plan assets. When the projected benefit obligation exceeds the fair value of plan assets a liability will be recorded in the balance sheet equal to the difference in question. If the fair value of plan assets exceeds the projected benefit obligation, an asset will be recorded in the balance sheet equal to the difference in question.

Post-retirement benefits - defined contribution plans

A defined contribution plan is a plan which provides post-retirement benefits for services rendered, provides an individual account for each participant in the plan, and defines how deposits will be determined in the employee's account. In this plan, the benefits received by a participant in the plan are dependent solely on the amount deposited in the participant's account in the plan, the returns accumulating on the investments of these deposits, and forfeitures of benefits of other individuals in the plan that may be allocated to the account of that individual. In this case, the net cost of the benefit for the period is the deposit required for that period.

The Bank's commitment to payment of severance pay under Section 14 of the Severance Pay Law is dealt with as a defined contribution plan.

Absences granting entitlement to compensation

The Bank accrues a liability for remuneration to employees for future absences.

A liability in respect of vacation days is measured on an ongoing basis, without the use of discount rates and actuarial assumptions.

For purposes of calculating the liability in respect of long-service (Jubilee) vacation, the discount rate and actuarial assumptions are taken into account.

Changes in the liability are charged immediately to the statement of profit and loss.

Share-based payment transactions

Share-based payment transactions include transactions with employees that were settled with capital instruments.

The Bank generally recognizes an expense for share-based payments it makes to its employees.

Capital bonuses are measured at fair value on the date of granting.

Commitment bonuses are measured at fair value on the date of granting, and the liability is re-measured until the settlement date.

M. Offsetting assets and liabilities

The Bank implements the rules set out in the circular of the Supervisor of Banks dated 12 December 2012, updating the Public Reporting Directives of the Supervisor of Banks regarding offsetting assets and liabilities.

The Bank offsets assets and liabilities arising from the same counterparty and reports their net balance in the balance sheet, if the following cumulative conditions are met:

- In respect of those liabilities, there is a legally enforceable right to offset the liabilities from the assets.
- There is an intention to repay the liabilities and realize the assets on a net basis or simultaneously.
- Both the Bank and the counterparty owe each other determinable amounts.

The Bank offsets assets and liabilities with two different counterparties and reports a net balance in the balance sheet if the above three cumulative conditions are met, and provided that there is an agreement between the three parties that clearly defines the Bank's right of offset in respect of those liabilities.

The Bank offsets deposits whose repayment to the depositor is contingent on the extent of collection of the credit and the credit that was granted from these deposits, with the Bank having no risk of loss from the credit. The margin on this activity is included under "Commissions".

The Bank offsets between derivative instruments made with the same counterparty which is subject to a master netting arrangement, for purposes of calculating customer indebtedness reported in the various Notes only. Such offsetting is not carried out in the balance sheet.

N. Buildings and equipment

Recognition and measurement

Buildings and equipment are shown at cost less accumulated depreciation and losses from impairment in value. Cost includes expenses which can be directly attributed to acquisition of the asset. The cost of purchase of software, that constitutes an integral part of operating the related equipment, is recognized as part of the cost of that equipment.

When significant parts of fixed assets have a different life span they are dealt with as separate items of fixed assets.

Buildings earmarked for sale are shown at the lower of their book value or realizable value.

Profit or loss on the sale of fixed assets is included under "Other income" in the statement of profit and loss.

Subsequent costs

The cost of replacement of part of an item of fixed assets is recognized as part of the book value of that item if it is expected that the future economic advantages inherent in the part replaced will come to the Bank, and if its cost can be measured accurately. The book value of the part replaced is deducted in the books.

Ongoing maintenance costs of fixed asset items are charged to the profit and loss statement when incurred.

Costs of software

Pursuant to the Public Reporting Directives, the Bank classifies under this section the costs in respect of software assets acquired or costs capitalized as an asset in respect of software developed internally for its own use.

Software purchased is measured by cost less accumulated depreciation and losses from impairment in value.

Costs in connection with the development and adaptation of computer software intended for internal use are capitalized only if development costs can be measured reliably, the software can be implemented from a technical point of view, a future economic advantage is expected and the Bank has both an intention and sources of funds to complete the development and use the software. In addition, the Bank has determined a materiality threshold of NIS 750 thousand for the capitalization of in-house development costs of software. Capitalized costs include direct costs of materials, services and direct labor cost for employees. These costs are measured by cost less accumulated depreciation and losses from impairment in value. Other costs are charged to profit and loss when incurred. See paragraph D.2 above.

Subsequent costs of software are recognized as an asset only if they increase the future economic advantages inherent in the asset for which they were expended. Other costs are charged to profit and loss when incurred.

Depreciation and amortization

Depreciation is calculated on the cost, in accordance with estimated useful life, on a straight line basis from the date the asset is ready for use. The Bank depreciates separately each part of a fixed asset for which a different useful life has been determined. Leasehold improvements are amortized over the leasing period, including an option which is likely to be exercised, or over its useful life, whichever is shorter. An asset is amortized when it is available for use.

The estimates regarding useful life and residual value are examined periodically, and at least at the end of each financial year, and adjusted if necessary.

In connection with impairment of non-monetary assets, see paragraph U. below.

Leases

Leases, including leases of land from the Israel Land Authority or other third parties, where the Group materially bears all the risks and returns from the property, are classified as financing leases. At the time of initial recognition, leased assets are recognized and a liability is recognized at an amount equal to the lower of fair value and the present value of future minimum lease payments. Future payments for exercising an option to extend the period of the lease with the Israel Land Authority are not recognized as part of the asset and related liability to the extent their amount is derived from the fair value of the land at future renewal dates of the lease agreement. After initial recognition, the asset is dealt with in accordance with accepted accounting policy regarding this asset.

The period of the lease is the period which cannot be canceled, for which the lessor made a contractual agreement for the lease of the asset together with any additional periods for which the lessee has the option of continuing to lease the asset, for an extra payment or for no extra payment, when it is reasonably certain at the date of the leasing commitment that the lessee will exercise the option.

The other leases are classified as operating leases, and the leased assets in these cases are not recognized in the balance sheet.

Lease payments made in advance to the Israel Lands Administration in respect of operating leases are shown in the balance sheet as prepaid expenses and are charged to profit and loss on a straight line basis over the period of the lease.

Investment Property

Investment property is real estate (land or buildings – or part of the same – or both) held by the Bank (as owners or a lessee under a financial lease) for purposes of generating rental income or for an increase in equity value or both, and not for the purposes of:

1. Use for production or supply of goods or services for administrative purposes; or

2. Sale in the normal course of business.

Investment property is measured initially at purchase cost plus transaction costs. In subsequent periods, investment property is measured at cost less accumulated amortization and losses from impairment.

O. Issue expenses

Expenses of issue of debentures, bonds and subordinated notes are amortized by the effective interest method over the expected life of the instrument issued.

P. Assets transferred to Group ownership following the settlement of troubled debts

Assets that were transferred to Group ownership following the settlement of troubled debts and are included in other assets are stated according to the lower of the asset's fair value on the date they were transferred or fair value as at balance sheet date. Decreases in value are charged to operating and other expenses.

Q. Contingent liabilities

The financial statements include appropriate provisions for claims which, in the opinion of Bank Management and the Managements of its consolidated companies, based on the opinions of legal counsel, will not be dismissed or canceled, notwithstanding the fact that such claims are refuted by the Bank. In addition, there are legal proceedings whose chances and/or results cannot be estimated at this stage and therefore no provision was recorded in respect thereof.

Claims made against the Bank are classified in three categories, according to the probability of realization of the risk exposure as follows:

- Probable risk – probability of realization of the risk exposure exceeding 70%. For claims included in this risk group, appropriate provisions are included in the financial statements.

- Reasonably possible risk – probability of realization of the risk exposure between 20% and 70%. For claims included in this risk group, provisions are not included in the financial statements but only disclosure is made.

- Remote risk – probability of realization of the risk exposure less than or equal to 20%. For claims included in this risk group, provisions are not included in the financial statements and no disclosure is made.

In rare cases where the Bank determines that, in the view of Bank Management, with reliance on its legal advisors, it is not possible to evaluate the likelihood of realization of the risk exposure with regard to a normal claim and a claim approved as a class action, no provision is made.

In addition, the Group is exposed to legal claims that have not yet been made / submitted, inter alia, in the event of doubt in the interpretation of an agreement and/or the provision of a law, and/or the method of their implementation. This exposure is brought to the Group's attention in a number of ways. In assessing the risk arising from the demands / claims not yet submitted, the Group relies on internal assessments of the officials dealing with the issues and the management, who weigh the assessment of the risk for submitting a claim, the chance of the claim's success, if it is submitted, and payment in a compromise, if there be any. The assessment is based on accumulated experience in relation to the submission of claims and on an analysis of claims in their own right. In the nature of things, in light of the preliminary stage of clarification of the legal claim, the actual result could be different from the assessment made at a stage prior to the claim being submitted.

In Note 26 on Contingent Liabilities and Special Commitments, details are shown of the amount of the additional exposure in respect of contingent claims whose amount exceeds NIS 2 million and whose realization is not remote. In addition, disclosure is made of material legal proceedings against the Bank and consolidated companies.

R. Tax expenses on income

Taxes on income include current and deferred taxes. Current and deferred taxes are charged to the statement of profit and loss, unless the taxes derive from business combinations, or are charged directly to equity if they derive from items recognized directly in equity.

Current taxes

Current tax is the amount of tax expected to be paid (or received) on income liable to tax for the year calculated at the applicable tax rates under laws that have been enacted or substantively enacted at the reporting date, including changes in tax payments relating to previous years.

The provision for taxes on the income of the Bank and of its consolidated companies that are financial institutions for Value Added Tax purposes, include profit tax levied on the income according to the Value Added Tax Law. Value Added Tax Law levied on salaries in financial institutions is included in the statement of profit and loss under “Salaries and related expenses”.

Deferred taxes

The recognition of deferred tax relates to temporary differences between the Book value of assets and liabilities for financial reporting purposes and their value for tax purposes. However, the Group does not recognize deferred taxes for the following temporary differences:

- Initial recognition of goodwill

- The initial recognition of assets and liabilities in a transaction that is not a business combination and that does not affect the accounting income and profit for tax purposes.

- Differences resulting from investments in subsidiaries and companies included on equity basis, if the Group has control when the difference is reversed, and it is expected that they will not be reversed in the foreseeable future, whether by way of realization of the investment or by way of distribution of dividends in respect of the investment.

The measurement of deferred taxes reflects the tax consequences that will result from the way in which the Group expects, at the end of the reporting period, to reinstate or dispose of the book value of assets and liabilities.

Deferred taxes are measured at the tax rates expected to apply to the temporary differences at the date they are realized, based on the laws that have been enacted or substantively enacted by the balance sheet date.

A deferred tax asset for losses carried forward, unutilized tax credits, tax benefits and deductible temporary differences recognized in the books when it is more likely than not that it will be taxable income which can be utilized in the future. Deferred tax assets are reviewed at each reporting date and, if it is not expected that the related tax benefits will be realized, they are reduced.

In order to determine that it is possible to recognize a deferred tax asset, the Group takes into account all the available evidence - both positive evidence supporting the recognition of a deferred tax asset and negative evidence negating recognition as a deferred tax asset.

Offsetting deferred tax assets and liabilities

The Bank offsets deferred tax assets and liabilities if there is a legally enforceable right to offset current tax assets and liabilities, and they are attributable to the same taxable income taxed by the same tax authority in respect of the same entity that is assessed, or various companies in the Group that intend to settle current tax assets and liabilities on a net basis or the tax assets and liabilities are settled simultaneously.

Additional tax on the distribution of dividends

The Group may be liable for additional tax in the event of distribution of dividends by Group companies. This additional tax is not included in the financial statements when the Group company policy is not to bring about the distribution of a dividend involving additional tax to the recipient company in the foreseeable future. In cases where the investee company is expected to distribute a dividend involving additional tax for the company, the Group creates a provision for tax in respect of the tax increment that the Group may incur in respect of the dividend distribution.

Additional taxes on income arising from the distribution of dividends by the Bank are charged to profit and loss at the date the liability to pay the related dividend is recognized.

Intercompany transactions

Deferred tax in respect of intercompany transactions in the consolidated accounts is recorded at the rate of tax of the acquiring company.

Uncertain tax positions

The Bank recognizes the effect of tax positions only if it is more likely than not that the positions will be accepted by the tax authorities or the Court. Recognized tax positions are measured at the maximum sum whose probability of realization exceeds 50%. Changes in recognition or measurement are reflected in the period in which changes occur in the circumstances that led to a change in judgment. The Bank implements the rules of recognition and measurement set out in the framework of FIN48.

S. Earnings per share

The Bank reports basic and diluted earnings per share with regard to its ordinary share capital. Basic earnings per share are calculated by dividing the profit or loss attributed to the ordinary shareholders of the Bank by the weighted average number of ordinary shares that were in circulation during the period. Diluted earnings per share is determined by adjusting the profit or loss relating to the ordinary shareholders, and adjusting the weighted average of ordinary shares in circulation, for the effect of all the potential dilutive ordinary shares.

T. Transactions with controlling owners

The Bank implements US GAAP for the accounting treatment of transactions between a banking corporation and its controlling owner and a company controlled by the Bank. In those situations where the said principles do not refer to the manner of treatment, the Bank implements the principles set out in Standard No. 23 of the Israel Accounting Standards Board on the matter.
Assets and liabilities regarding which a transaction was carried out with a controlling owner are measured for fair value at the date of the transaction. Due to the fact that this is an equity-type transaction, the Group charges the difference between the fair value and the transaction proceeds to equity.

U. Impairment in value of non-monetary assets

1. The Bank examines the necessity, for every reporting period, of recording a provision for the impairment of non-monetary assets (such as: buildings and equipment, investments in companies included on equity basis, intangible assets including goodwill) when there are signs, resulting from events or changes in circumstances, which indicate that its assets in the balance sheet are shown at an amount which is in excess of their recoverable value.

The recoverable amount of an asset or a cash-generating unit is the higher of the net selling price (fair value less selling expenses) and the value-in-use. The value-in-use is the present value of the estimated future cash flows, discounted by the pre-tax rate of interest, which are expected to be derived from use and realization of the asset. For the purpose of examining impairment, assets which cannot be examined individually are grouped together into the smallest group generating cash flows from continued use, which is largely independent of assets in other groups ("cash-generating unit"). For the purpose of examining impairment of goodwill recognized in the framework of a business combination, cash-generating units to which goodwill has been allocated are grouped so that the level at which impairment is examined represents the lowest level at which goodwill can be monitored for purposes of internal reporting, but will not be larger than an operational segment. When there is a change in the composition of one or more cash-generating units to which the goodwill was allocated, the goodwill is to be reallocated to those units affected.

Assets of the head office of the Bank do not produce separate cash flows. If there are indications that impairment has occurred in an asset belonging to the Bank's headquarters, a recoverable value is determined for the group of cash producing units served by the headquarters.

When the value of the asset is higher than its recoverable value, the Bank recognizes a loss from the impairment in value in the amount of the difference between the book value of the asset and its recoverable value. The loss thus recognized will be cancelled in the event of changes occurring in the estimates that were used to determine the recoverable value of the asset after the date on which the most recent loss from the impairment was recognized, and provided that the book value after cancelling the loss from impairment does not exceed the book value after deducting depreciation or amortization, that would have been determined if the loss from impairment had not been recognized. This is except for impairment of goodwill, which is not cancelled.

2. Impairment with regard to costs of in-house software development

Examination for impairment with regard to costs of in-house software development is to be carried out in addition to indicators for examining the existence of impairment set forth in IAS 36, even if the indicators stated in US GAAP SOP 98-1 exist:

a. It is not expected that the software will provide any significant potential uses;

b. A material change has occurred in the manner or scope of use of the software or of the expected use of the software;

c. A material change has been made or will be made to the software;

d. Costs for developing or adapting the software designated for in-house use deviate significantly from the sums projected in advance;

e. It is no longer expected that the software will be completed and utilized.

If one or more of the indicators stated above exist, it is required to make an examination for impairment in accordance with the principles set out in IAS 36 – Impairment of Assets.

3. Impairment of investments in companies included on equity basis reported according to the equity basis method

An investment in a company included on equity basis is examined for impairment based on the fair value of the investment. When there is no possibility for measuring fair value, impaired is examined when a change has taken place in the circumstances that may have a material negative effect on the fair value of the investment.

Impairment is examined with relation to the investment as a whole. Goodwill representing part of the investment account in a company included on equity basis is not recognized separately, and is therefore not examined separately in the test for impairment. If there is objective evidence indicative that there may be impairment of the investment, the Group makes an evaluation of the amount refundable of the investment which is the higher of the useful value and its net sale price.

A loss from impairment is recognized when the book value of the investment, after applying the equity base method, exceeds the fair value, provided that this loss is not temporary. Impairment that is not temporary is allocated first to goodwill until it is eliminated. The amount remaining is allocated to the non-current assets of the company included on equity basis on a relative basis, and then to its other assets. A loss from impairment that is not temporary that was recognized previously will not be canceled in subsequent periods.

4. Discontinued Activity

Discontinued activity is a component of the Group's business, that represents a significant separate line of business or a significant separate geographical area of activity that was realized, held for sale of distribution or is a subsidiary company purchased for the purposes of selling it. The classification as discontinued activity is done at the date the activity was realized or when it meets the criteria for classification as held for sale.

Non-current assets held for sale

Non-current assets held for sale are measured at the lower of book value and fair value after deducting selling costs.

V. First-Time Implementation of New Accounting Standards, Accounting Standards Updates, and New Directives of the Supervisor of Banks

1. Generally accepted accounting principles in the US related to business combinations, consolidation of financial statements and investments in investee companies

On 10 June 2015, a circular was issued on "Reporting by Banking Corporations and Credit Card Companies in Israel under US GAAP relating to Business Combinations, Consolidation of Financial Statements and Investments in Investee Companies".

Pursuant to the circular, US GAAP are to be implemented on the following issues:

- Rules for the presentation, measurement and disclosure set out in the provisions of Codification Topic 805 on "Business Combinations".

- Provisions of Codification Topic 810 on "Consolidation of Financial Statements".
  Potential rights - potential rights are not to be taken into account
  Uniform accounting policies – the Group's financial statements should be prepared in accordance with US GAAP.
  Non-controlling interests - should be measured at fair value, are included in equity and presented separately from the equity attributable to the parent company.

- Provisions of Topic 350-20 on the subject of "Intangible Assets - Goodwill and Other Assets" in connection with the accounting treatment of impairment of goodwill acquired in a business combination.
  For purposes of assessing impairment, it should be examined if there is a difference between the book value of the reporting unit in respect of which the goodwill was created and its fair value. If there is a gap, the impairment in respect of goodwill will be recognized in the amount of the difference between the fair value and book value up to the canceling out of the value of goodwill in the books.
  The test will be made at least annually and for shorter periods than a year when there are events or circumstances which may suggest impairment.

- US GAAP on the subject of investee companies, including rules for the presentation, measurement and disclosure and guidelines relating to impairment set out in the provisions of Codification Topic 323, "Investments - Equity Method and Joint Investments."
  Measurement - the entity can choose to handle the investments in investees at fair value rather than by the equity method.
  A decrease in the percentage holding - when there is a decrease in the holding, irrespective of the question if the company has lost significant influence or not, the amount of the difference between the proceeds of sale to pro rata share of amortized cost that was sold should be

recognized in profit or loss. When there is a loss of significant influence, the rights remaining in the investment will be shown at the book value of the investment prior to the change.
Impairment - the excess of the amortized cost of the investment over its fair value. An other than temporary impairment recognized will not be cancelled in future periods.
Losses - as a general rule, the investor is to stop implementing the equity method after recognizing losses in the investee up to the canceling out of the investment, while in subsequent periods the investor will again apply the equity method only after canceling out the unrecognized losses. However, the investor is to recognize further loss when the investee's return to profitability in the near future is guaranteed.
Uniform accounting policies – the investor and investee should apply US GAAP.

- Pursuant to the transitional directives, it is permitted in the years 2016-2017 not to carry out adjustments to the accounting policy adopted by a non-banking company included on equity basis that prepares its financial statements according to IFRS.

Initial implementation was carried out in accordance with the transitional provisions set out in the same subjects in US GAAP.

The Bank applied the directive by way of retroactive implementation. Implementation of the directive had no material effect on the financial statements. Note 1.E was updated accordingly.

2. US GAAP on intangible assets

On 22 October 2015, a circular was published on "Reporting of banking corporations and credit card companies under US GAAP on intangible assets". Pursuant to the circular, a banking corporation will implement US GAAP on the subject, and inter alia the rules for presentation, measurement and disclosure set out in the directives of Codification Topic 350 on "Intangible assets – goodwill and other assets".

Below are the main points of the directive:

Impairment of intangible assets with a finite useful life – the test will be made at the level of a group of assets (a very limited level of a group of assets that generates cash flow separately).
It should be examined if the book value of the asset group is higher than the sum of non-discounted cash flows expected from it. If so, impairment is to be recognized equal to the difference between the book value and the fair value of the asset group. The impairment will be allocated proportionally between the Group's assets as long as the value of an individual asset shall not drop below its fair value.
Impairment of intangible assets with an indefinite useful life – the test will be made at least annually. If the book value exceeds its fair value, impairment is to be recognized in the amount that the book value exceeds the fair value.
Reversal of impairment loss - as a general rule, losses cannot be cancelled from impairment of intangible assets.
Capitalization of costs in creating an intangible asset – as a general rule, these will be recognized as an expense when incurred except in cases where there are other specific guidelines such as regarding software development costs for internal use which will be capitalized during the development phase, see paragraph N above.

The Bank applies the directive as of 1 January 2016, by way of retroactive implementation.
Implementation of the directive had no material effect on the financial statements.

3. Regulatory operating segments and reporting on operating segments by management approach

On 3 November 2014, a circular was published on "Reporting on Operating Segments", which updates the Public Reporting Directives including changing some definitions and guidelines, according to which banks are required to classify business customers in regulatory segments according to their activity turnover and private customers according to their characteristics. See Note 29A.B. The amendments to the directives were intended to require reporting on operating segments in accordance with a uniform and comparable format set by the Banking Supervision Department.

In addition, the circular states that the disclosure of "operating segments in accordance with the management approach" will be provided in accordance with generally accepted accounting principles in US banks on operating segments (included in ASC 280) if there is a fundamental difference between the management approach and reporting segments according to the guidelines of the Banking Supervision Department.

An operating segment is a component of the Group that engages in business activities from which it can derive revenues and from which it will incur expenses, whose operating results are reviewed regularly by the management in making decisions about resource allocation and performance evaluations, and which also has separate financial information.

As of the financial statements for the first quarter of 2016, full disclosure is given under the new rules, except for the disclosure of the financial management sector. Comparative figures have been adjusted retroactively.
For purposes of presenting comparative figures, it is possible to use the customer classification into regulatory segments as of 1 January 2016. From the financial statements for the first quarter of 2017, the requirements of the circular are required to be implemented in their entirety.

Implementation of the directive is not expected to have a material effect on the financial statements except for the manner of presentation and disclosure.

4. Troubled debt restructuring

On 22 May 2016, the Banking Supervision Department published a circular entitled "Troubled debt Restructuring". The circular updates the provisions of reporting to the public, in light of update number 2011-02 to the codification which was published by the FASB and in light of new provisions from the regulatory authorities in the USA.

- The key points of the amendment: When a debt, which was not previously considered a specifically impaired debt, is restructured and has been determined as meeting the definition for a troubled debt restructuring, it is not usually correct to decrease the estimated provision for credit losses at the time of restructuring.
- In the event of a troubled debt which has been restructured and thereafter the banking corporation and the debtor entered into an additional restructuring agreement (subsequent restructuring), the banking corporation is not required any longer to regard the debt as a restructured troubled debt anymore, provided that the debtor no longer has financial difficulties at the time of the restructuring and that, in accordance with the subsequent restructuring terms, the banking corporation has not granted a waiver to the debtor. In order to meet these terms, the subsequent restructuring agreement is to be subject to market conditions.

The terms in the circular shall apply to restructurings to be performed or renewed as of 31 December 2016.

The provisions of the circular will be applied initially on a prospective basis on restructurings performed or renewed from 31 December 2016. The comparative figures need not be updated.

Implementation of the directive did not have a material effect on the financial statements.

W. New Accounting Standards and New Directives of the Supervisor of Banks in the period prior to their implementation

1. Recognition of income from contracts with customers

On 11 January 2015, a circular was issued on the adoption of updated accounting rules on the subject of income from contracts with customers. The circular updates the Public Reporting Directives in light of publishing ASU 2014-09, which adopts in US GAAP a new Standard on recognition of income. The Standard states that income will be recognized in the amount expected to be received in exchange for the transfer of goods or services to the customer.

Banks are required to implement the amendments to the Public Reporting Directives pursuant to the transitional provisions for 2015 as of 1 January 2018.

In accordance with the transitional provisions, determined for purposes of initial adoption, it is possible to choose between the alternative of retrospective implementation while restating comparative figures and the alternative of prospective application while recording the cumulative effect on equity at the time of initial application.

The new Standard does not apply, *inter alia*, to financial instruments and rights or contractual obligations within the scope of Codification Chapter 310. In addition, it was explained in the Bank of Israel directives that as a general rule, the provisions of the new Standard will not apply to the accounting treatment of interest income and expenses and non-interest financing income.

The Bank is examining the impact of implementing the new directives.

2. Reporting by banking corporations in Israel under US GAAP on foreign currency issues, accounting policy, changes in accounting estimates and errors and events after the balance sheet date

On 21 March 2016, a circular was issued titled "Reporting by banking corporations in Israel under US GAAP." According to the circular in light of the importance of the accounting treatment of matters such as foreign currency issues, accounting policy, changes in accounting estimates and errors, events after the balance sheet date, it was decided to adapt the accounting treatment of banking corporations on these issues to US GAAP that is included in the following codification subjects and subject to the guidelines set forth in the directives of the Supervisor of Banks:

Topic 830 regarding "Issues in foreign currency"- Starting from the application date of this circular, International Accounting Standard 21 regarding "The effects of changes in Foreign Currency Exchange Rates" and International Accounting Standard 29 regarding "Financial reporting in hyper-inflationary economies", will not be replaced by the provisions of Topic 830. For the avoidance of doubt, it was clarified that there is no change regarding the date on the adjustment of financial statements for inflation was discontinued.
Regarding foreign operations, we should note that the capital reserve for translation differences will be calculated pursuant to the method of consolidation in stages only.

Topic 250 regarding "Changes in accounting policies and corrections of errors"- Starting from the application date of this circular, International Accounting Standard 8 regarding "Accounting Policies, Changes in Accounting Estimates and Errors", will not be replaced by the provisions of Topic 250.

Sub-Topic 855-10 regarding "Events after the balance sheet date"- Starting from the application date of this circular, International Accounting Standard 10 will be replaced regarding "Events after the reporting period" by the provisions of Sub-Topic 855-10.

It is required to implement the requirements of the circular as of 1 January 2017. On initial implementation, a banking corporation shall act in accordance with the transitional provisions set out in those subjects. The aforementioned includes retroactive adjustment of comparative figures if required, depending on these issues. We emphasize that the implementation of the instructions for Topic 830 in the Codification regarding foreign currency in reported periods before 1 January 2019, will not include exchange rates for bonds available for sale within the adjustments for the fair value of these bonds in the capital reserve, but will rather be included in the framework of profit and loss.

Implementation of the circular is not expected to have a material effect on the financial statements.

3. The implementation of US GAAP related to taxes on income.

On 22 October 2015, a circular was issued entitled **"**Reporting by banking corporations in Israel according to US GAAP related to taxes on income ". In accordance with the circular, a banking corporation shall implement the generally accepted accounting principles in US banks related to taxes on income in this matter, and among other things, the presentation, measurement and disclosure rules set out in the provisions of Topic 740 of the Codification regarding "Taxes on Income" and in Topic 830-740 in the Codification regarding "Issues in foreign currency – taxes on income ".

On 13 October 2016, the Banking Supervision Department published a circular entitled "Banking Corporation Reporting in accordance with the US GAAP".

The main points of the amendments:

- The transitional provisions have been updated so that temporary differences in respect of prior periods will continue to be treated in accordance with the provisions that applied before 31 December 2016.
- It has been clarified that fines to the tax authorities and interest income and expenses in respect of taxes on income, shall be classified under "taxes on income ".
- It has been clarified that a law shall be considered as "enacted" only upon its publication in the Official Gazette.
- The disclosure requirements in the Public Reporting Directives, as well as the disclosure format regarding "Provision for taxes on profit", have been adjusted to the requirements of the new directives.
- The requirement for a Note on Information based on historical nominal data for tax purposes has been cancelled.
- Investments in local subsidiaries - deferred tax liabilities are to be recognized unless the tax laws allow tax-exempt recovery of the investment with no significant cost and the parent company expects to make an eventual recovery in this way (the ability and the intention).
- Investment in foreign subsidiaries - deferred tax liabilities are to be recognized unless the investor can control the date of reversal and non-distributed profits will be re-invested indefinitely or they can be distributed tax-free. A deferred tax asset will be recognized only if it appears that the temporary difference will be reversed in the foreseeable future. On recognition of the asset, it should be determined whether there is a future taxable income against which it will be possible to deduct the difference so as to determine whether there is a need to record a Valuation Allowance. Subsequent changes in the

Valuation Allowance will be recognized in profit and loss in the current period even if the allowance was initially recognized in equity.

- Uncertain tax positions – a tax benefit is to be recognized when it is expected (more probable than not) that it will be utilized. The amount of the tax benefit to be recognized is the highest amount expected (more than 50%) to be received.
- Liabilities or deferred tax assets are not to be recognized in respect of temporary differences related to non-monetary assets and non-monetary liabilities, when their tax base is denominated in a currency other than the functional currency of the entity, when the differences are generated in respect of changes in exchange rates or in respect of linkage for tax purposes.
- Changes in tax rates – subsequent changes in deferred taxes that are generated following changes in the tax rates will generally be recorded to profit and loss in the current period even if the deferred taxes have initially recognized in equity.

The provisions of the circular are to be applied as of 1 January 2017 and thereafter, including retroactive correction of comparative figures. Implementation of the circular is not expected to have a material effect on the financial statements.

4. New standard update on share-based based payment

On 30 March 2016, the IASB in the US published Accounting Standards Update No. 2016-09 in the Codification which is an amendment to the provisions of ASC 718 on "Share-Based Payment".

Pursuant to the amendment:

- Any related tax effects related to share-based payment transactions are to be recognized at the time of settlement or expiration through profit and loss. Until the introduction of the amendment, surplus tax benefits that exceeded the expense recognized in the statement of profit and loss (known as "windfalls") were recognized in equity, and shortfalls in a tax benefit which were less than the expense recognized in the statement of profit and loss (known as "shortfalls") were recognized in profit and loss. The amendment is expected to increase the volatility of tax expenses on income. This change is to be implemented prospectively.

- Excess tax benefits are to be recognized when incurred and not postponed until such time as they reduce the taxable income as previously. This change will be applied retroactively while recording the cumulative impact to the opening balance of retained earnings.

- Any tax-related cash flows in respect of share-based payment will be classified as operating activities in the statement of cash flows. The directive may be applied retroactively or prospectively.

- Regarding the impact of forfeitures on the recognition of expenses for share-based bonus payments, it is possible to prepare an estimate of forfeitures as required today or alternatively to recognize the impact of the forfeitures at the time of occurrence.

The provisions of the circular are to be applied from 1 January 2017. Implementing the circular is not expected to have a material effect on the financial statements.

5. **Reporting by Banking Corporations in accordance with US GAAP**

On 13 October 2016, the Banking Supervisions Department published a circular entitled "Banking Corporation Reporting in accordance with the US GAAP".

The circular updates, inter alia, the Public Reporting Directives, and adopts the accounting standards customary in the USA on the following topics:

- Discontinued activities in accordance with Codification Topic 205-20 on "Discontinued Operations".
- Fixed assets in accordance with Codification Topic 360 on "Fixed Assets".
- Earnings per share in accordance with Codification Topic 260 on "Earnings per Share".
- Cash flow statement in accordance with Codification Topic 230-10 on "Statement of Cash Flows".
- Interim Reporting in accordance with Codification Topic 270 on "Interim Reporting".
- Discounting costs of interest in accordance with Codification Topic 835-20 on "Capitalization of Interest ".
- Measurement and disclosure of guarantees in accordance with Codification Topic 460 on "Guarantees".

The provisions of the circular are to be applied as of 1 January 2018. Upon first application, a banking corporation is required to comply with the transitional provisions set forth on the relevant subjects in the US standard mutatis mutandis, including retroactive corrections of the comparative figures, as required according to the US standard rules regarding these subjects.

6. **Standard update on the impact of replacement of a derivative contract for existing hedge accounting relationships**

In March 2016, the US Accounting Standards Board published Update ASU 2016-05 on the matter, which determines that changing the counterparty of a derivative designated as a hedging instrument in accordance with Topic 815 does not detract from the designation itself, provided that all other criteria for hedge accounting continue to exist.

The provisions apply to public entities in the United States from the annual and interim financial statements after December 15, 2016. Companies may elect to apply the new directives prospectively or alternatively in adjusted retroactive application. Early implementation is permitted.

7. **Standard update on the subject of taxes on income**

In October 2016, the US Accounting Standards Board published Update ASU 2016-16 regarding the cancelation of the exception according to which current / deferred taxes are not to be recognized for the transfer of an asset between companies within the group until the sale of the asset to an external body.

The provisions apply to public entities in the United States from the annual and interim financial statements after December 15, 2016. Early implementation is permitted.

8. FAQ on the implementation of the Public Reporting Directives on the subject of impaired debts, credit risk and allowances for credit losses

On 20 February, 2017, an update was published to the FAQ file of the Banking Supervision Department on the subject of "Implementation of the Public Reporting Directives on the subject of impaired debts, credit risk and allowances for credit losses". The update relates mainly to the classification of debt, the definition of impaired debt and the measurement of an individual allowance for credit losses. Despite the support of secondary and tertiary sources of repayment (such as collateral, guarantor support, refinancing by a third party), the appropriate classification of a debt until a default occurs or when its probability is highly probable is to be based on the borrower's repayment ability, i.e. the expected strength of the primary repayment source.

Primary repayment source - a long-term sustainable cash source that must be controlled by the debtor and which must be explicitly or substantially separated to cover the debt. In the FAQ file, it was clarified that as a rule, in order for a repayment source to be recognized as the primary source of repayment, the bank must show that the debtor is reasonably likely to produce an appropriate cash flow from a continuing business activity within a reasonable period of time, which will serve for repayment of all the payments required in full and on the due date set forth in the agreement.
These changes will apply from 1 July 2017 onwards. The implementation of the changes may change the manner of classification and the amount of the allowance recorded in the books. The Bank is examining possible implications of implementing the directive.

Note 2 – Interest income and expenses

	For the year ended 31 December		
	2016	2015	2014
	NIS millions		
A. Interest income (a)			
Credit to the public	**8,697**	8,170	9,053
Credit to governments	**18**	15	18
Deposits with banks	**86**	70	82
Deposits with Bank of Israel and cash	**42**	39	146
Bonds (b)	**707**	487	702
Interest income from securities borrowed or purchased under agreements to resell	**2**	3	11
Total interest income	**9,552**	8,784	10,012
B. Interest expenses (a)			
Deposits of the public	**(1,224)**	(945)	(1,585)
Deposits from governments	**(4)**	(4)	(6)
Deposits from banks	**(15)**	(14)	(46)
Debentures, bonds and subordinated notes	**(781)**	(700)	(1,003)
Interest expense from securities loaned or sold under agreements to repurchase	**(2)**	(3)	(9)
Total interest expenses	**(2,026)**	(1,666)	(2,649)
Total interest income, net	**7,526**	7,118	7,363
C. Details of the net effect of hedging derivative financial instruments on interest income and expenses (c)			
Interest income	**(42)**	(46)	(45)
D. Details of interest income on accrual basis from bonds			
Available for sale	**638**	399	593
Held for trading	**69**	88	109
Total included in interest income	**707**	487	702

(a) Including effective component of hedge relationships.
(b) Including interest in respect of mortgage-backed bonds (MBS) in the amount of NIS 197 million (2015 - NIS 174 million, 2014 – NIS 77 million).
(c) Details of effect of hedging derivative instruments in sub-paragraphs A. and B.

Note 3 – Non-interest financing income

	For the year ended 31 December		
	2016	2015	2014
	NIS millions		
A. Non-interest financing income from activities not for trading purposes			
A.1 From activities in derivative instruments			
Non-effective part of hedging relationships (a)	-	-	10
Net income (expenses) in respect of ALM derivative instruments (b)	**(213)**	(257) (l)	1,896 (l)
Total from activities in derivative instruments	**(213)**	(257)	1,906
A.2 From investment in bonds			
Gains on sale of debentures available for sale (h)	**387**	201	208
Losses on sale of debentures available for sale (f) (h)	**(30)**	(20)	(3)
Total from investment in debentures	**357**	181	205
A.3 Exchange rate differentials, net	**700**	310	(2,252)
A.4 Gains (losses) on investment in shares			
Gains from sale of shares available for sale (c) (h)	**576**	1,048	497
Losses on sale of shares available for sale (g) (h)	**(82)**	(437)	(55)
Gain from sale of shares in companies included on equity basis	**24**	522	-
Dividend from shares available for sale	**10**	170	10
Losses from investee companies	**(18)**	-	-
Total from investment in shares	**510**	1,303	452
A.5 Gains (losses), net in respect of loans sold (j)	**44**	11	28
Total non-interest financing income in respect of activities not for trading purposes	**1,398**	1,548	339
B. Non-interest financing income (expenses) from activities not for trading purposes (i)			
Realized and unrealized profits (losses) from fair value adjustment of bonds for trading, net (d)	**(84)**	67	423
Realized and unrealized profits losses) from fair value adjustment of shares for trading, net (e)	**(32)**	(5)	33
Total from trading activities (k)	**(116)**	62	456
Total non-interest financing income in respect of activities not for trading purposes	**1,282**	1,610	795

(a) Excluding effective component of hedging relationships.

(b) Derivative instruments which constitute part of the Bank's assets and liability management system and were not designated for hedging relationships.

(c) Including mainly profit on the sale of Visa Europe, the Israel Corporation and Dalia in the amounts of NIS 378 million, NIS 87 million, NIS 61 million, respectively (2015 – Including mainly profit on the sale of the Israel Corporation, Mobileye, Safra Fund, and Route 6 in the amounts of NIS 289 million, NIS 288 million, NIS 52 million, and NIS 100 million respectively; 2014 - Tower, Mobileye, Partner, and Otzar Hityashvet Hayehudim in the amounts of NIS 150 million, NIS 144 million, NIS 70 million, and NIS 30 million, respectively).

(d) Of which part of the profits (losses) of NIS 8 million (2015 – NIS (36) million; 2014 – NIS 33 million), relating to bonds held for trading still held as of balance sheet date.

(e) Of which part of the profits (losses) of NIS 8 million (2015 – NIS (62) million, 2014 - NIS 58 million), relating to shares held for trading still held as of balance sheet date.

(f) Including provisions for impairment relating to bonds available for sale in the amount of NIS 3 million (2015 – NIS 1 million, 2014 – NIS 1 million).

(g) Including provisions for impairment relating to shares available for sale in the amount of NIS 5 million (2015 – NIS 283 million; 2014 - NIS 12 million).

(h) Reclassified to accumulated other comprehensive income.

(i) Including exchange differences deriving from trading activity.

(j) For further details see Note 26B.4

(k) For interest income from investment in bonds for trading, see Note 2.

(l) Reclassified.

Note 4 – Commissions

	For the year ended 31 December		
	2016	2015	2014
	NIS millions		
Ledger fees	**715**	762	821
Conversion differences	**327**	325	318
Handling of credit	**177**	200	196
Commissions for distribution of financial products (a)	**240**	258	244
Foreign trade activities	**131**	126	117
Income from transactions in securities and certain derivative instruments	**592**	675	816
Credit cards	**1,023**	963	939
Management fees and commission on life insurance and home insurance	**47**	48	42
Net income from servicing credit portfolios	**16**	22	30
Management, operations, and custody for institutional entities (b)	**61**	56	50
Commissions on financing transactions	**534**	542	487
Other commissions	**104**	115	107
Total operating commissions	**3,967**	4,092	4,167

(a) Mainly distribution fees of mutual funds.
(b) Mainly operations of provident funds.

Note 5 - Other Income

	For the year ended 31 December		
	2016	2015	2014
	NIS millions		
Profit from the realization of assets received for settlement of loans	**1**	-	1
Profits from severance pay funds	**27**	35	39
Capital gain from sale of buildings and equipment	**89**	523 (a)	85
Capital loss from sale of buildings and equipment	**(3)**	(4)	(1)
Other, net	**45**	41	55
Total other income	**159**	595	179

(a) Including gain on the sale of a building of the US subsidiary in the amount of about NIS 380 million.

Note 6 - Salaries and Related Expenses

	2016	2015	2014
	NIS millions		
Salaries	**3,486**	3,669 (c)	3,173 (c)
Expense deriving from share-based payment transactions	**10**	10	-
Other related expenses including supplementary training fund, vacation and sickness	**291**	325	303
Long-term - Jubilee benefits	**(90)**	(371)	87
National Insurance and VAT on salaries	**769**	815	720
Expenses in respect of pension (including severannce pay and provident funds) (a)			
Defined benefit	**787**	777	734
Defined deposit	**158**	172	171
Other post-employment benefits and non-pension post-retirement benefits (a).	**11**	126	16
Special benefits in respect of dismissal (a)(b)	**-**	9	48
Expenses in respect of other benefits to employees (a)	**-**	12	1
Total salaries and related expenses	**5,422**	5,544	5,253
Of which: salaries and related expenses abroad	**491**	632	685

(a) See Note 23 on Employee Rights.
(b) Expenses related to early retirement of employees as part of the plan for structural change in the Bank.
(c) Reclassified.

Note 7 - Other Expenses

	2016	2015	2014
	NIS millions		
Marketing and advertising	**289**	267	280
Legal, audit and professional consultants	**282**	304 (d)	285 (d)
Communications - postage, telephone, delivery services, etc.	**156**	161	159
Computers (a)	**115**	142 (d)	128 (d)
Office expenses	**59**	68	75
Insurance	**101**	16	29
Training	**28**	22	22
Commissions	**151**	180	187
Loss in respect of assets received in settlement of loans	**1**	3	(1)
Other (b) (c)	**279**	446	1,265
Total other expenses	**1,461**	1,609	2,429

(a) The item includes outsourcing expenses and does not include the Bank's computer expenses as the Operations Division is a part of the Bank and its expenses are recorded and classified under the various expense headings.
(b) Regarding directors' fees of the Bank included in this item, see Note 34.C.
(c) Including income in respect of the investigation by US authorities, of about NIS 235 million (2015 – expense of NIS 59 million, 2014 – expense of NIS 1,026 million) – see Note 26.H.1.a.
(d) Reclassified.

Note 8 – Provision for taxes on profit

A. Composition

	2016	2015	2014
	NIS millions		
Current taxes:			
In respect of current year	**1,623**	1,962	1,506
In respect of prior years	**51**	7	(54)
Total current taxes	**1,674**	1,969	1,452
Add (less) changes in deferred taxes			
In respect of accounting year	**(260)**	(327)	(174)
In respect of prior years	**303**	49	-
Total changes in deferred taxes	**43**	(278)	(174)
Provision for taxes on income	**1,717**	1,691	1,278
Of which: provision for taxes abroad	**69**	219	13
Deferred taxes:			
Creation and reversal of temporary differences	**(260)**	(327)	(174)
Change in tax rate	**303**	49	-
Total deferred taxes	**43**	(278)	(174)

B. Reconciliation between the theoretical amount of tax applicable if the profit were liable for tax at the statutory rate of tax in Israel, and the provision for taxes on the profit appearing in the statement of profit and loss:

	2016	2015	2014
	35.9%	37.6%	37.7%
	NIS millions		
Statutory tax rate applying to a banking corporation			
Tax at the statutory tax rate	**1,608**	1,646	1,003
Tax (tax saving) resulting from:			
Income of foreign consolidated companies	**32**	68	(18)
Income exempt and at restricted tax rates	**(102)**	(18)	(40)
Depreciation differences, depreciation adjustment and capital gain	**(46)**	(109)	(6)
Other non-deductible expenses	**32**	33	473
Timing differences for which there are no deferred taxes	**(172)**	50	(53)
Income of Israeli consolidated companies	**(41)**	(76)	(66)
Change in deferred taxes due to change in tax rates	**303**	49	-
Taxes in respect of prior years	**51**	7	(54)
Other	**52**	41	39
Provision for taxes on profit	**1,717**	1,691	1,278

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Note 8 – Provision for taxes on profit (cont'd)

Changes in tax legislation

Companies Tax, Payroll Tax, and Profits Tax

On 5 January 2016, the Amendment to the Income Tax Ordinance (No. 216) Law, 2016 was published, reducing the rate of Companies Tax from 26.5% to 25.0%, with effect from 2016 and thereafter.

On 29 December, 2016, the Law for Economic Efficiency (Legislative Amendments to Achieve Budget Targets for the Budget Years 2017 and 2018), 2016, which stipulated, *inter alia*, a reduction of the rate of Companies Tax from 25% to 23% in two phases. In the first phase, the tax rate will decrease to 24%, from 1 January 2017, and in the second phase the tax rate will decrease to 23% as from 1 January 2018 onwards.

Deferred tax balances as at 31 December 31, 2016 have been calculated based on the tax rate expected to apply at the date of reversal.

Accordingly, the effect of the above changes in the rates of Companies Tax on the financial statements as of 31 December, 2016 is reflected in a reduction in deferred tax balances receivable net of about NIS 380 million. The decrease in deferred tax balances was recognized against deferred tax expenses in the amount of NIS 303 million, and against capital in the amount of NIS 77 million.

Current taxes for the periods reported in these financial statements are calculated in accordance with the tax rates shown in the table below:

The taxes applicable to the revenues of banking corporations include corporate tax imposed by the Income Tax Ordinance and profit tax levied according to the VAT Act. Below is a table of statutory tax rates applicable to naming corporations.

Year	Income tax rate	Revenue tax rate	Total tax tate	Comments
2014	18.00%	26.50%	37.71%	Due to an increase in corporate tax as of 1 January 2014
2015	17.75%	26.50%	37.58%	Due to a decrease of VAT as of 1 October 2015 to 17% rate
2016	17.00%	25.00%	35.90%	Due to a decrease in corporate tax as of 1 January 2016
2017	17.00%	24.00%	35.04%	Due to a decrease in corporate tax as of 1 January 2017
2018 onwords	17.00%	23.00%	34.19%	Due to a decrease in corporate tax as of 1 January 2018

Note 8 – Provision for taxes on profit (cont'd)

C. As a rule, the Bank, in coordination with the tax authorities, is taxed on the basis of the increase in value of the securities in accordance with the manner of presentation of the securities in the financial statements of the financial institutions.

D. Final assessments have been issued to the Bank and the principal consolidated companies for all years up to and including the tax year 2011.

E. Certain consolidated companies have losses and other deductions of about NIS 94 million (31 December 2015 – about NIS 110 million) which were claimed for tax purposes and in respect of which deferred taxes were not recorded since in the opinion of the Group, no taxable income is expected in the future against which tax benefits can be utilized. Utilization of these amounts in the future will be possible if the consolidated companies in which the amounts were recorded will have taxable income.

F. 1. Components of deferred tax assets and the deferred tax reserve are as follows:

	2016	2015	**2016**	2015
	NIS millions		Average tax rate in percent	
Deferred tax assets				
From allowance for credit losses	**1,275**	1,264	**34%**	37%
From provision for vacation and bonuses (a)	**398**	298	**34%**	37%
From surplus liabilities for employee rights on the plan assets (b)	**3,208**	2,982	**35%**	37%
From interest not credited to current income	**25**	46	**39%**	40%
From tax deductions carried forward	**2**	6	**16%**	16%
From activity abroad	**5**	4	**36%**	37%
From securities	**49**	-	**35%**	-
From adjustment of depreciable non-monetary assets	**7**	8	**36%**	21%
Other - from non-monetary items	**75**	70	**21%**	21%
Total	**5,044**	4,678		
Deferred tax reserve				
From securities	**-**	(35)	**-**	43%
In respect of investments in companies included on equity basis	**(98)**	(15)	**20%**	11%
From tax deductions carried forward	**(4)**	-	**36%**	-
From adjustments of non-monetary depreciable assets	**(122)**	(126)	**27%**	29%
Other - from monetary items	**(19)**	(22)	**34%**	37%
Other - from non-monetary items	**(24)**	(33)	**22%**	25%
Total	**(267)**	(231)		
Deferred taxes receivable, net	**4,777**	4,447		
Deferred taxes included: (a)				
In "Other assets"	**4,960**	4,570		
In "Other liabilities"	**(183)**	(123)		
Deferred tax assets, net	**4,777**	4,447		

(a) Including conversion of rights to shares, see Note 23L.

(b) The balances of deferred taxes are shown in the consolidated balance sheet in accordance with the classification of the net balance in the books of the Bank and its consolidated companies.

Note 8 – Provision for taxes on profit (cont'd)

F. 2. Movement in deferred tax assets and liabilities relating to the following items:

For the period ended 31 December 2016	Allowance for credit losses	Provision for vacation and bonuses (a)	Surplus of liabilities for employee benefits over the plan assets	Interest not charged to income this year
	NIS millions			
Balance of deferred tax asset (liability) at 1 January 2016	**1,264**	**298**	**2,982**	**46**
Changes charged to profit and loss	**111**	**127**	**151**	**(21)**
Changes charged to equity	**-**	**-**	**329**	**-**
Change in deferred taxes due the change in the rate of tax that was charged to profit and loss	**(100)**	**(27)**	**(174)**	**-**
Change in deferred taxes due the change in the rate of tax that was charged to equity	**-**	**-**	**(80)**	**-**
Balance of deferred tax asset (liability) at 31 December 2016	**1,275**	**398**	**3,208**	**25**
Deferred tax asset	**1,275**	**398**	**3,208**	**25**
Balances available for offsetting				
Deferred tax asset at 31 December 2016				
Deferred tax liability	**-**	**-**	**-**	**-**
Balances available for offsetting				
Deferred tax liability at 31 December 2016				

For the period ended 31 December 2015	Allowance for credit losses	Provision for vacation and bonuses	Surplus of liabilities for employee benefits over the plan assets	Interest not charged to income this year
	NIS millions			
Balance of deferred tax asset (liability) at 1 January 2015	1,197	396	2,995	61
Changes charged to profit and loss	83	(94)	284	(15)
Changes charged to equity	-	-	(257)	-
Change in deferred taxes due the change in the rate of tax that was charged to profit and loss	(16)	(4)	(28)	-
Change in deferred taxes due the change in the rate of tax that was charged to equity	-	-	(12)	-
Balance of deferred tax asset (liability) at 31 December 2015	1,264	298	2,982	46
Deferred tax asset	1,264	298	2,982	46
Balances available for offsetting				
Deferred tax asset at 31 December 2015				
Deferred tax liability	-	-	-	-
Balances available for offsetting				
Deferred tax liability at 31 December 2015				

Deductions carried forward for tax purposes	Foreign operations	Securities	Investments in investee companies	Adjustments of depreciable non-monetary assets	Other monetary items	Other non-monetary items	Total
6	**4**	**(35)**	**(15)**	**(118)**	**(22)**	**37**	**4,447**
(8)	**1**	**(39)**	**(82)**	**3**	**3**	**14**	**260**
-	**-**	**121**	**-**	**-**	**-**	**-**	**450**
-	**-**	**(2)**	**-**	**-**	**-**	**-**	**(303)**
-	**-**	**4**	**(1)**	**-**	**-**	**-**	**(77)**
(2)	**5**	**49**	**(98)**	**(115)**	**(19)**	**51**	**4,777**
2	**5**	**49**	**-**	**7**	**-**	**75**	**5,044**
							(84)
							4,960
(4)	**-**	**-**	**(98)**	**(122)**	**(19)**	**(24)**	**(267)**
							(84)
							(183)

Deductions carried forward for tax purposes	Foreign operations	Securities	Investments in investee companies	Adjustments of depreciable non-monetary assets	Other monetary items	Other non-monetary items	Total
21	6	(69)	(181)	(46)	(24)	36	4,392
(15)	(2)	(61)	166	(72)	2	1	277
-	-	96	-	-	-	-	(161)
-	-	(1)	-	-	-	-	(49)
-	-	-	-	-	-	-	(12)
6	4	(35)	(15)	(118)	(22)	37	4,447
6	4	-	-	8	-	70	4,678
							(108)
							4,570
-	-	(35)	(15)	(126)	(22)	(33)	(231)
							(108)
							(123)

Note 8 – Provision for taxes on profit (cont'd)

F. 3. Taxes on income recognized directly in equity:

	2016			2015			2014		
	Before tax	Tax expense (benefit)	Net of tax	Before tax	Tax expense (benefit)	Net of tax	Before tax	Tax expense (benefit)	Net of tax
	NIS millions								
Translation adjustments of financial statements	**(9)**	**-**	**(9)**	9	-	9	459	(41)	418
Profits (losses) net in respect of net hedges of investments in foreign currency	**(2)**	**(1)**	**(3)**	(18)	7	(11)	(267)	98	(169)
Financial assets available for sale	**(281)**	**128**	**(153)**	(423)	96	(327)	355	(140)	215
Other comprehensive income in respect of companies included on equity basis	**(20)**	**-**	**(20)**	11	5	16	(108)	30	(78)
Retained earnings in respect of companies included on equity basis	**17**	**-**	**17**	(6)	(12)	(18)	92	(17)	75
Adjustments in respect of employee benefits	**(928)**	**249**	**(679)**	683	(269)	414	(1,384)	500	(884)
Total taxes recognized in equity	**(1,223)**	**376**	**(847)**	256	(173)	83	(853)	430	(423)

Note 8 – Provision for taxes on profit (cont'd)

G. Deferred taxes are measured at the tax rates expected to apply to temporary differences at the date when they will be realized, based on laws passed or effectively passed at the balance sheet date.

H. Following the publication of a circular of the Supervisor of Banks concerning the measurement and disclosure of impaired debts, credit and allowance for credit losses, the banks, including the Bank, have reached agreements with the Israel Taxes Authority regarding the recognition of allowances for credit losses for tax purposes. The agreement was signed on 19 March 2012, and applies to impaired debts recorded from January 1, 2011 (the previous agreement applied to doubtful debts recorded before 31 December, 2010).

The main points of the new agreement are as follows:

Large impaired debts under individual examination - The provision is deductible for tax purposes in the year the expense was recorded in the financial statements. In the tax year in which the allowance for credit losses was decreased (not as a result of an accounting "write-off" or a "waiver"), "surtax" will be added to the tax liability of the Bank, plus interest and linkage, which will lead to collection of the tax that would have been collected if the allowance that was allowed had not been recognized from the outset.
In this regard - a "large debt" is a debt of NIS 1 million or more, or a lower amount notified by the Bank to the assessing officer and in accordance with the characteristics of the Bank.

Impaired debts that are not large - expenses in respect of the net "write-offs" (after deducting collections in the same year) - half of which will be allowed for tax purposes in the first tax year after the year in which the expense was recorded, and half of them will be allowed in the second tax year after the year in which the expense was recorded.

Collective allowance - not recognized for tax purposes.

According to the agreement with the tax authorities dated April 14, 2005 and June 29, 2014, the Bank is entitled to offset amounts of tax under certain conditions if the overall tax rate on income of the Bank in Israel will be higher than the tax rate applicable to subsidiaries abroad. The amounts not yet offset from the tax liability, for which future tax savings were not included in the balance sheet at 31 December, 2016, are approximately $ 36 million.-

Note 9 – Earnings per ordinary share

A. Basic earnings attributed to the shareholders of the Bank

The calculation of basic earnings per share is based on the earnings attributed to the ordinary shareholders of the Bank divided by the weighted average number of ordinary shares in circulation, as follows:

	2016	2015	2014
	NIS millions		
Basic earnings			
Total net profit attributed to the shareholders of the Bank	**2,791**	2,835	1,413
Weighted average of the number of shares (in thousands of shares)			
Balance at 1 January	**1,473,798**	1,473,551	1,473,551
Effect of exercised RSU, PSU units and issuance of shares	**38,528**	247	-
Weighted average of the number of shares	**1,512,326**	1,473,798	1,473,551
Basic earnings per shares	**1.85**	1.92	0.96

B. Diluted earnings per share

The calculation of the diluted earnings per share of the Bank divided by the weighted average number of ordinary shares in circulation, after adjustment for all the potential dilutive ordinary shares, as follows:

	2016	2015	2014
	NIS millions		
Diluted earnings			
Weighted average of the number of shares used for calculating basic earnings per share	**1,512,326**	1,473,798	1,473,551
Effect of exercised RSU, PSU units and issuance of shares	**1,035**	475	475
Weighted average of the number of shares fully diluted	**1,513,361**	1,474,273	1,474,026
Deluted earnigs per shares	**1.84**	1.92	0.96

Note 10 – Accumulated Other Comprehensive Income (Loss)

A. Changes in accumulated other comprehensive income (loss), after the effect of tax

	For the year ended 31 December 2016						
	Other comprehensive income before attribution to non-controlling interests						
	Adjustments for presentation of securities available for sale at fair value	Translation adjustments (a), net after effect of hedges (b)	Banking corporation's share in other compre- income of investee companies dealt with under the equity method	Adjustments in respect of employee benefits	Total	Other compre- hensive income attributed to non-controlling interests	Other compre- hensive income attributed to shareholders of the Bank
	NIS millions						
Balance at 1 January 2014 after initial implementation of the new accounting rules	179	(314)	100	(1,020)	(1,055)	(4)	(1,051)
Net change during the year	215	249	(78)	(884)	(498)	-	(498)
Balance at 31 December 2014	394	(65)	22	(1,904)	(1,553)	(4)	(1,549)
Net change during the year	(327)	(2)	16	414	101	-	101
Balance at 31 December 2015	67	(67)	38	(1,490)	(1,452)	(4)	(1,448)
Net change during the year	**(153)**	**(12)**	**(20)**	**(679)**	**(864)**	**-**	**(864)**
Balance at 31 December 2016	**(86)**	**(79)**	**18**	**(2,169)**	**(2,316)**	**(4)**	**(2,312)**

(a) Adjustments from translation of financial statements of foreign operations whose functional currency differs from the functional currency of the banking corporation, including adjustments in respect of companies included on equity basis.

(b) Profit (loss) in respect of hedging net investment in foreign currency.

Note 10 – Accumulated Other Comprehensive Income (Loss) (cont'd)

B. Changes in components of accumulated other comprehensive income (loss), before and after the effect of tax

	2016			2015			2014		
	Before tax	Tax effect	After tax	Before tax	Tax effect	After tax	Before tax	Tax effect	After tax
	NIS millions								
Changes in components of other comprehensive income (loss) before attribution to non-controlling interests:									
Adjustments for presentation of securities available for sale at fair value									
Unrealized profits (losses) from adjustments to fair value	**570**	**(194)**	**376**	369	(203)	166	1,002	(273)	729
(Profits) losses in respect of securities available for sale reclassified to the statement of profit and loss (a)	**(851)**	**322**	**(529)**	(792)	299	(493)	(647)	133	(514)
Net change in the period	**(281)**	**128**	**(153)**	(423)	96	(327)	355	(140)	215
Translation adjustments (b):									
Adjustments for translation of financial statements	**(9)**	**-**	**(9)**	9	-	9	459	(41)	418
Hedges (c)	**(2)**	**(1)**	**(3)**	(18)	7	(11)	(267)	98	(169)
Net change in the period	**(11)**	**(1)**	**(12)**	(9)	7	(2)	192	57	249
Banking corporation's share in other comprehensive income of investee companies dealt with under the equity base method	**(20)**	**-**	**(20)**	11	5	16	(108)	30	(78)
Net change in the period	**(20)**	**-**	**(20)**	11	5	16	(108)	30	(78)
Employee benefits:									
Actuarial gain (loss) this year	**(1,241)**	**361**	**(880)**	464	(190)	274	(1,439)	521	(918)
Credit (cost) of service prior to this year	**313**	**(112)**	**201**	219	(79)	140	55	(21)	34
Net change in the period	**(928)**	**249**	**(679)**	683	(269)	414	(1,384)	500	(884)
Total net change in the period (d)	**(1,240)**	**376**	**(864)**	262	(161)	101	(945)	447	(498)
Changes in components of other comprehensive income attributed to non-controlling interests:									
Total net change in the period	**-**	**-**	**-**	-	-	-	-	-	-
Changes in components of other comprehensive income (loss) attributed to shareholders of the banking corporation:									
Total net change in the period	**(1,240)**	**376**	**(864)**	262	(161)	101	(945)	447	(498)

(a) The amount before tax in the statement of profit and loss under non-interest financing income, see Note 3 – Non-interest financing income.

(b) Adjustments from translation of financial statements of foreign operations whose functional currency differs from the functional currency of the banking corporation, including adjustments in respect of companies included on equity basis.

(c) Profits (losses) in respect of hedging net investment in foreign currency.

(d) The amount before tax in the statement of profit and loss under salaries and related expenses. For further details, see Note 23 – Employee rights.

Note 11 – Cash and deposits in banks

	31 December 2016	31 December 2015
	NIS millions	
Cash and deposits incentral banks	**69,559**	55,116
Deposits in commercial banks (a)	**5,198**	5,339
Total	**74,757**	60,455
Of which: cash and deposits in central and commercial banks for original periods not exceeding three months (b)	**72,269**	58,130 (c)

(a) Net of the allowance for credit losses.
(b) Of which pledged cash in the amount of NIS 810 million (31 December 2015 – NIS 850 million).
(c) Restated.

Note: For liens – See Note 27.

Note 12 – Securities

	31 December 2016					31 December 2015				
			Other comprehensive accumulated profit					Other comprehensive accumulated profit		
	Book value	Amortized cost (for shares - cost)	Profits	Losses	Fair value (a)	Book value	Amortized cost (for shares -	Profits	Losses	Fair value (a)
	NIS millions									
1. Securities available for sale: Bonds -										
Government of Israel	**35,409**	**35,386**	**131**	**(108)**	**35,409**	28,553	28,359	201	(7)	28,553
Foreign governments	**11,929**	**11,998**	**12**	**(81)**	**11,929**	8,128	8,127	5	(4)	8,128
Financial institutions in Israel	**23**	**22**	**1**	**-**	**23**	35	33	2	-	35
Financial institutions abroad (*)	**7,460**	**7,452**	**27**	**(19)**	**7,460**	6,262	6,257	31	(26)	6,262
Asset-backed (ABS) or mortgage-backed securities (MBS)	**9,749**	**9,892**	**21**	**(164)**	**9,749**	9,566	9,630	24	(88)	9,566
Others in Israel	**296**	**280**	**16**	**-**	**296**	586	562	25	(1)	586
Others abroad	**1,882**	**1,892**	**13**	**(23)**	**1,882**	1,694	1,706	12	(24)	1,694
	66,748	**66,922**	**221**	**(395)**	**66,748**	54,824	54,674	300	(150)	54,824
Shares and mutual funds (b)	**1,942**	**1,860**	**97**	**(15)**	**1,942**	2,703	2,559	158	(14)	2,703
Total securities available for sale	**68,690**	**68,782**	**318** (c)	**(410)** (c)	**68,690**	57,527	57,233	458 (c)	(164)(c)	57,527

(*) Including an amount of NIS 7,506 million of, Supernationals Sovereign and Agencies (SSA) (in 2015 – NIS 6,142 million).

Note 12 – Securities (cont'd)

	31 December 2016					31 December 2015				
	Book value	Amortized cost (for shares - cost)	profits from adjustments to fair	losses from adjustments to fair	Fair value (a)	Book value	Amortized cost (for shares - cost)	profits from adjustments to fair	losses from adjustments to fair	Fair value (a)
	NIS millions									
2. Securities held for trading: Bonds -										
Government of Israel	**5,091**	**5,086**	**12**	**(7)**	**5,091**	6,664	6,657	17	(10)	6,664
Foreign governments	**2,458**	**2,457**	**1**	**-**	**2,458**	3,058	3,087	-	(29)	3,058
Financial institutions in Israel	**159**	**159**	**-**	**-**	**159**	238	238	1	(1)	238
Financial institutions abroad	**104**	**105**	**-**	**(1)**	**104**	148	149	-	(1)	148
Asset-backed (ABS) or mortgage-backed securities (MBS)	**280**	**280**	**2**	**(2)**	**280**	751	754	4	(7)	751
Others in Israel	**132**	**130**	**2**	**-**	**132**	152	150	2	-	152
Others abroad	**286**	**284**	**4**	**(2)**	**286**	320	326	1	(7)	320
	8,510	**8,501**	**21**	**(12)**	**8,510**	11,331	11,361	25	(55)	11,331
Shares and mutual funds	**1**	**1**	**-**	**-**	**1**	617	687	10	(80)	617
Total securities for trading	**8,511**	**8,502**	**21** (d)	**(12)** (d)	**8,511**	11,948	12,048	35 (d)	(135) (d)	11,948
Total securities (e)	**77,201**	**77,284**	**339**	**(422)**	**77,201**	69,475	69,281	493	(299)	69,475

(a) Fair value data are generally based on stock exchange prices, which do not necessarily reflect the price which will be obtained upon sale of securities in large volumes.
(b) Includes shares which have no readily available fair value, which are shown at cost, amounting to NIS 981 million (31 December 2015 - NIS 1,050 million).
(c) Unrealized profits (losses) are included in equity in the item "other comprehensive income (loss), net after the effect of tax", except for securities hedged in a fair value hedge.
(d) Charged to the profit and loss statement but not yet realized.
(e) Including impaired bonds accruing interest amounting to NIS 16 million at 31 December 2015.

General comments:
Securities lent amounting to NIS 324 million (31 December 2015 – NIS 111 million) are shown under credit to the public.
Securities pledged to lenders amounted to NIS 4,272 million (31 December 2015 – NIS 3,131 million).
For details of results of investment activities in bonds and in shares and mutual funds – see Notes 2 and 3.
The distinction between Israeli and foreign bonds is made in accordance with the country of residence of the entity issuing the security.

Note 12 – Securities (cont'd)

Additional details of fair value and unrealized losses by maturity and rate of impairment of securities available for sale that are in an unrealized loss position

	31 December 2016									
	Less than 12 months (a)					12 months and above (b)				
		Unrealized losses					Unrealized losses			
	Fair value	0-20% (c)	20%-35% (d)	More than 35% (e)	Total	Fair value	0-20% (c)	20%-35% (d)	More than 35% (e)	Total
	NIS millions									
Bonds										
Government of Israel	**24,825**	**108**	**-**	**-**	**108**	**-**	**-**	**-**	**-**	**-**
Foreign governments	**5,438**	**80**	**1**	**-**	**81**	**38**	**-** (f)	**-**	**-**	**-**
Financial institutions abroad	**4,810**	**16**	**-**	**-**	**16**	**16**	**3**	**-**	**-**	**3**
Asset-backed securities (ABS) or mortgage-backed securities (MBS)	**7,782**	**163**	**-**	**-**	**163**	**53**	**1**	**-**	**-**	**1**
Others in Israel	**3**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Others abroad	**1,018**	**23**	**-**	**-**	**23**	**-**	**-**	**-**	**-**	**-**
Shares and mutual funds	**54**	**3**	**-**	**-**	**3**	**172**	**12**	**-**	**-**	**12**
Total securities available for sale	**43,930**	**393**	**1**	**-**	**394**	**279**	**16**	**-**	**-**	**16**

	31 December 2015									
	Less than 12 months (a)					12 months and above (b)				
		Unrealized losses					Unrealized losses			
	Fair value	0-20% (c)	20%-35% (d)	More than 35% (e)	Total	Fair value	0-20% (c)	20%-35% (d)	More than 35% (e)	Total
	NIS millions									
Bonds										
Government of Israel	15,057	7	-	-	7	-	-	-	-	-
Foreign governments	5,730	4	-	-	4	-	-	-	-	-
Financial institutions abroad	3,961	23	-	-	23	34	3	-	-	3
Asset-backed securities (ABS) or mortgage-backed securities (MBS)	6,863	63	-	-	63	742	25	-	-	25
Others in Israel	126	1	-	-	1	-	-	-	-	-
Others abroad	778	15	9	-	24	39	- (f)	-	-	-
Shares and mutual funds	136	8	-	-	8	91	6	-	-	6
Total securities available for sale	32,651	121	9	-	130	906	34	-	-	34

Notes:
(a) Investments in an unrealized loss position continuing for less than 12 months.
(b) Investments in an unrealized loss position continuing for 12 months and more.
(c) Investments of which the unrealized loss represents 20% of their amortized cost.
(d) Investments of which the unrealized loss represents 20% to 35% of their amortized cost.
(e) Investments of which the unrealized loss represents more than 35% of their amortized cost.
(f) Losses less than NIS 1 million.

Note 12 – Securities (cont'd)

Additional details of mortgage-backed and asset-backed securities that are in an unrealized loss position

	31 December 2016					
	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value
	NIS millions					
Mortgage-backed securities (MBS)	**2,918**	**(75)**	**52**	**(1)**	**2,970**	**(76)**
Other mortgage-backed securities (including REMIC, CMO and STRIPPED MBS)	**4,417**	**(88)**	**-**	**-**	**4,417**	**(88)**
Asset-backed securities (ABS)	**447**	**-**	**1**	**-**	**448**	**-**
Total	**7,782**	**(163)**	**53**	**(1)**	**7,835**	**(164)**

	31 December 2015					
	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value
	NIS millions					
Mortgage-backed securities (MBS)	1,860	(25)	87	(2)	1,947	(27)
Other mortgage-backed securities (including REMIC, CMO and STRIPPED MBS)	3,321	(22)	558	(21)	3,879	(43)
Asset-backed securities (ABS)	1,682	(16)	97	(2)	1,779	(18)
Total	6,863	(63)	742	(25)	7,605	(88)

Note 12 – Securities (cont'd)

Additional details on consolidated basis of mortgage-backed and asset-backed securities available for sale

	31 December 2016				31 December 2015			
		Other comprehensive accumulated profit (loss) (a)				Other comprehensive accumulated profit (loss) (a)		
	Amortized cost	Profits	Losses	Fair value	Amortized cost	Profits	Losses	Fair value
	(NIS millions)							
1. Bonds available for sale								
Pass-through securities:								
Securities guaranteed by GNMA	**281**	**-**	**(8)**	**273**	11	-	-	11
Securities issued by FNMA and FHLMC	**2,039**	**-**	**(53)**	**1,986**	1,245	-	(21)	1,224
Other securities	**743**	**-**	**(15)**	**728**	796	-	(6)	790
Total mortgage-backed pass-through securities	**3,063**	**-**	**(76)**	**2,987**	2,052	-	(27)	2,025
Other mortgage-backed securities (including CMO and STRIPPED MBS)								
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	**4,539**	**1**	**(85)**	**4,455**	4,987	5	(42)	4,950
Other mortgage-backed securities	**544**	**2**	**(3)**	**543**	494	1	(1)	494
Total other mortgage-backed securities	**5,083**	**3**	**(88)**	**4,998**	5,481	6	(43)	5,444
Total mortgage-backed securities (MBS)	**8,146**	**3**	**(164)**	**7,985**	7,533	6	(70)	7,469
Asset-backed securities (ABS)								
Credit card receivables	**-**	**-**	**-**	**-**	94	-	(2)	92
Other credit to private persons	**332**	**4**	**-**	**336**	4	-	-	4
Credit not to private persons	**1**	**-**	**-**	**1**	1	-	-	1
CLO debentures	**1,413**	**14**	**-**	**1,427**	1,998	18	(16)	2,000
Total asset-backed securities	**1,746**	**18**	**-**	**1,764**	2,097	18	(18)	2,097
Total mortgage-backed and asset-backed securities available for sale	**9,892**	**21**	**(164)**	**9,749**	9,630	24	(88)	9,566

(a) Amounts charged to capital reserve as part of other comprehensive income, net after the effect of tax.

Note 12 – Securities (cont'd)

Additional details on consolidated basis of mortgage-backed and asset-backed securities for trading

	31 December 2016				31 December 2015			
	Amorized cost	Unrealized profits from adjustments to fair value (a)	Unrealized losses from adjustments to fair value (a)	Fair value	Amorized cost	Unrealized profits from adjustments to fair value (a)	Unrealized losses from adjustments to fair value (a)	Fair value
	(NIS millions)							
2. Bonds for trading								
Pass-through securities:								
Securities issued by FNMA and FHLMC	**6**	**-**	**-**	**6**	8	-	-	8
Total mortgage-backed pass-through securities	**6**	**-**	**-**	**6**	8	-	-	8
Other mortgage-backed securities (including CMO and STRIPPED MBS)								
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	**-**	**-**	**-**	**-**	410	1	(3)	408
Other mortgage-backed securities	**86**	**-**	**-**	**86**	92	1	-	93
Total other mortgage-backed securities	**86**	**-**	**-**	**86**	502	2	(3)	501
Total mortgage-backed securities (MBS)	**92**	**-**	**-**	**92**	510	2	(3)	509
Asset-backed securities (ABS)								
Credit card receivables	**12**	**-**	**-**	**12**	12	-	-	12
Lines of credit for any purpose secured by dwelling	**-**	**-**	**-**	**-**	1	-	-	1
Credit for purchase of vehicles	**51**	**-**	**-**	**51**	68	-	(1)	67
Other credit to private persons	**12**	**-**	**-**	**12**	14	-	-	14
Others	**113**	**2**	**(2)**	**113**	149	2	(3)	148
Total asset-backed securities	**188**	**2**	**(2)**	**188**	244	2	(4)	242
Total mortgage-backed and asset-backed securities for trading	**280**	**2**	**(2)**	**280**	754	4	(7)	751

(a) Profits (losses) charged to profit and loss.

Note 13 – Credit Risk, Credit to the Public and the Allowance for Credit Losses

A. Debts[(a)], credit to the public and the allowance for credit losses

	31 December 2016					
	Credit to the public				Banks and	
			Other		govern-	
	Commercial	Residential	private	Total	ments	Total
	(NIS millions)					
Recorded debt balance of debts[a]						
Examined on an individual basis	**112,550**	**45**	**512**	**113,107**	**7,890**	**120,997**
Examined on a collective basis[1]	**35,212**	**79,086**	**38,045**	**152,343**	**4,148**	**156,491**
[1]Of which: the allowance was calculated by extent of arrears	**909** (c)	**78,656**	**-**	**79,565**	**-**	**79,565**
Total debts(a)[2]	**147,762**	**79,131**	**38,557**	**265,450**	**12,038**	**277,488**
[2]Of which:						
Debts under restructuring	**1,971**	**-**	**87**	**2,058**	**-**	**2,058**
Other impaired debts	**1,524**	**-**	**71**	**1,595**	**-**	**1,595**
Total impaired debts	**3,495**	**-**	**158**	**3,653**	**-**	**3,653**
Debts in arrears of 90 days or more	**161**	**719**	**123**	**1,003**	**-**	**1,003**
Other problem debts	**2,634**	**-**	**409**	**3,043**	**-**	**3,043**
Total impaired debts	**6,290**	**719**	**690**	**7,699**	**-**	**7,699**
Allowance for credit losses for debts[a]:						
Examined on an individual basis	**1,913**	**6**	**214**	**2,133**	**1**	**2,134**
Examined on a collective basis[3]	**362**	**467**	**575**	**1,404**	**-**	**1,404**
[3]Of which the allowance was calculated by extent of arrears	**-**	**462** (b)	**-**	**462**	**-**	**462**
Total allowance for credit losses[4]	**2,275**	**473**	**789**	**3,537**	**1**	**3,538**
[4]Of which in respect of impaired debts	**671**	**-**	**12**	**683**	**-**	**683**

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) Including balance of allowance in excess of that required by the extent of arrears method calculated on a collective basis in the amount of NIS 294 million.

(c) Including housing loans granted to purchasing groups under construction.

Note 13 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

A. Debts(a), credit to the public and the allowance for credit losses (cont'd)

	31 December 2015					
	Credit to the public				Banks and governments	Total
	Commercial	Residential	Other private	Total		
	(NIS millions)					
Recorded debt balance of debts[a]						
Examined on an individual basis	107,182 (d)	45	1,438 (d)	108,665	7,515	116,180
Examined on a collective basis[1]	38,097	81,760	36,548	156,405	3,254	159,659
[1]Of which: the allowance was calculated by extent of arrears	1,014 (c)	80,616	-	81,630	-	81,630
Total debts(a)[2]	145,279	81,805	37,986	265,070	10,769	275,839
[2]Of which:						
Debts under restructuring	2,192	-	86	2,278	-	2,278
Other impaired debts	1,617	-	26	1,643	-	1,643
Total impaired debts	3,809	-	112	3,921	-	3,921
Debts in arrears of 90 days or more	67	770	105	942	-	942
Other problem debts	3,151(d)	11	299 (d)	3,461	-	3,461
Total impaired debts	7,027	781	516	8,324	-	8,324
Allowance for credit losses for debts[a]:						
Examined on an individual basis	2,177	15	45 (d)	2,237	3	2,240
Examined on a collective basis[3]	355 (d)	498	581	1,434	-	1,434
[3]Of which the allowance was calculated by extent of arrears (b)	1	497(b)	-	498	-	498
Total allowance for credit losses[3]	2,532	513	626	3,671	3	3,674
[3]Of which in respect of impaired debts	816 (e)	-	51 (e)	867	-	867

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) Including balance of allowance in excess of that required by the extent of arrears method calculated on a collective basis in the amount of NIS 310 million.

(c) Including housing loans granted to purchasing groups under construction.

(d) Reclassified.

(e) Restated.

Note 13 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

B. Change in balance of credit loss allowance

	31 December 2016					
	Allowance for credit losses					
	Credit to the public					
	Commercial	Residential	Other private	Total	Banks and governments	Total
	(NIS millions)					
Balance of allowance for credit losses at beginning of year	**2,981** (a)	**513**	**659** (a)	**4,153**	**3**	**4,156**
Expenses (income) in respect of credit losses	**(571)**	**(9)**	**457**	**(123)**	**(2)**	**(125)**
Accounting write-offs	**(524)**	**(31)**	**(691)**	**(1,246)**	**-**	**(1,246)**
Collection of debts written off in previous years	**843**	**-**	**400**	**1,243**	**-**	**1,243**
Net accounting write-offs	**319**	**(31)**	**(291)**	**(3)**	**-**	**(3)**
Adjustments from translation of financial statements	**(2)**	**-**	**-**	**(2)**	**-**	**(2)**
Balance of allowance for credit losses at end of year[1]	**2,727**	**473**	**825**	**4,025**	**1**	**4,026**
[1]Of which: in respect of off-balance sheet credit instruments	**452**	**-**	**36**	**488**	**-**	**488**

	31 December 2015					
	Allowance for credit losses					
	Credit to the public					
	Commercial	Residential	Other private	Total	Banks and governments	Total
	(NIS millions)					
Balance of allowance for credit losses at beginning of year	3,365(a)	513	604(a)	4,482	4	4,486
Expenses in respect of credit losses	(123)	14	309	200	(1)	199
Accounting write-offs	(676)	(12)	(614)	(1,302)	-	(1,302)
Collection of debts written off in previous years	410	-	361	771	-	771
Net accounting write-offs	(266)	(12)	(253)	(531)	-	(531)
Adjustments from translation of financial statements	5	(2)	(1)	2	-	2
Balance of allowance for credit losses at end of year[1]	2,981	513	659	4,153	3	4,156
[1]Of which: in respect of off-balance sheet credit instruments	449	-	33	482	-	482

(a) Reclassified

Note 13 – Credit Risk, Credit to the Public and the Allowance for Credit Losses (cont'd)

B. Change in balance of credit loss allowance (cont'd)

	31 December 2014					
	Allowance for credit losses					
	Credit to the public					
	Commercial	Residential	Other private	Total	Banks and governments	Total
	(NIS millions)					
Balance of allowance for credit losses at beginning of year	3,349(a)	498	448(a)	4,295	2	4,297
Expenses in respect of credit losses	90	24	356	470	2	472
Accounting write-offs	(578)	(10)	(560)	(1,148)	-	(1,148)
Collection of debts written off in previous years	479	-	364	843	-	843
Net accounting write-offs	(99)	(10)	(196)	(305)	-	(305)
Adjustments from translation of financial statements	25	1	(4)	22	-	22
Balance of allowance for credit losses at end of year[1]	3,365	513	604	4,482	4	4,486
[1]Of which: in respect of off-balance sheet credit instruments	446	1	47	494	-	494

(a) Reclassified.

Note 14 – Credit to Governments

	31 December 2016	31 December 2015
	(NIS millions)	
Credit to the government	**206**	262
Credit to foreign governments	**436**	191
Total credit to governments	**642**	453

Note 15 - Investments in and Details of Investee Companies

A. Composition

	31 December 2016	31 December 2015
	Companies included on equity basis	
	NIS millions	
Total investments in shares on equity basis (including other assets and goodwill)	**901**	924
Of which: post-acquisition profits	**442**	411
Post-acquisition items accrued in equity:		
Adjustments in respect of companies included on equity basis	**(6)**	(1)
Details regarding goodwill:		
Amortization period	**0-20 years**	0-20 years
Original amount, net	**262** (a)	262
Unamortized balance	**247**	256

(a) As of the date of approval of the financial statements, the subsidiary had not yet completed attributing the cost of acquisition to the acquired assets and liabilities.

Details of book value and market value of quoted investments:

	31 December 2016		31 December 2015	
	Book value	Market value	Book value	Market value
	NIS millions		NIS millions	
Avgol Industries 1953 Ltd.	**119**	**205**	154	203

B. Group's equity in profits or losses of companies included on equity basis:

	For the year ended 31 December		
	2016	2015	2014
	NIS millions		
Group's equity in profits of companies included on equity basis	**69**	223	88
Provision for deferred taxes	**(3)**	(46)	(46)
Group's equity in after-tax profits of companies included on equity basis	**66**	177	42

Note 15 - Investments in and Details of Investee Companies (cont'd)

C. Details concerning principal investee companies

1. Consolidated subsidiaries[a]

		31 December		31 December		31 December	
		2016	2015	**2016**	2015	**2016**	2015
Name of company	Details of the company	Percentage of equity granting a right to profits		Percentage of voting rights		Investment in shares - net asset value	
		(%)				(NIS millions)	
In Israel							
Arab-Israel Bank Ltd. (f)	General banking services	-	100.0	-	100.0	-	716
Leumi Partners Ltd. (c)	Business and financial services	**100.0**	100.0	**100.0**	100.0	**1,430**	1,289
Leumi Tech Ltd. (e)	Comprehensive financing for high tech companies	**99.6**	99.6	**99.8**	99.8	**1,000**	995
Leumi Card Ltd.	Provision of credit card services	**80.0**	80.0	**80.0**	80.0	**1,440**	1,329
Leumi Capital Market Services Ltd.	Operating services to provident and mutual funds	**100.0**	100.0	**100.0**	100.0	**49**	45
Leumi Financial Holdings Ltd.	Financial holdings	**100.0**	100.0	**100.0**	100.0	**543**	586
Abroad							
Bank Leumi le-Israel Corporation	Holding company - registered in the U.S.	**100.0**	100.0	**100.0**	100.0	**371**	374
Bank Leumi USA (e)	General banking services - registered in the U.S.	**99.9**	99.9	**99.9**	99.9	**2,419**	2,418
Bank Leumi (UK) plc	General banking services - registered in the U.K.	**100.0**	100.0	**100.0**	100.0	**870**	845
Leumi Switzerland (g)	General banking services - registered in Switzerland	**99.8**	99.8	**99.8**	99.8	**209**	290
Leumi Re Ltd.	Insurance	**100.0**	100.0	**100.0**	100.0	**73**	111
Bank Leumi (Luxembourg) SA (h)	- registered in Luxembourg	**100.0**	100.0	**100.0**	100.0	**10**	103
Leumi Romania S.A.	General banking services - registered in Romania	**99.9**	99.9	**99.9**	99.9	**149**	148

(a) Data regarding consolidated companies reflecting the Bank's investment therein less investments of each company in other companies in the Bank Group, and the Bank's share in their results less each company's share in the results of other companies in the Bank Group in respect of the abovementioned investments.
(b) Other equity investments include capital notes and shareholders' loans.
(c) The Bank's share in a capital reserve in respect of the benefit in controlling shareholders' loans is NIS 155 million (2015 – NIS 152 million).
(d) The Bank's share in a capital reserve in respect of the benefit in controlling shareholders' loans is NIS 82 million (2015 – NIS 82 million).
(e) Bank Leumi USA is a company whose functional currency differs from the shekel. See Note 1D.
(f) On 1 January 2016, the activity of the Bank was merged with Arab Israel Bank.
(g) During 2015, most of Leumi Switzerland's (formerly Leumi Private Bank) customers were transferred to Julius Baer. The office is being liquidated.
(h) The office is being closed.

31 December		31 December		31 December		31 December	
2016	2015	**2016**	2015	**2016**	2015	**2016**	2015
Other equity investments (b)		Contribution to net profit attributed to shareholders of the banking corporation		Other items in accumulated shareholders' equity (c)		Guarantees for the company in favour of parties outside the Group	
-	-	**-**	86	**-**	8	**-**	-
1,049	1,139	**145**	403	**(5)**	(245)	**487**	487
-	-	**5**	1	**-**	-	**1**	-
-	-	**147**	144	**-**	-	**-**	-
-	-	**3**	4	**-**	-	**-**	-
-	-	**(80)**	1	**-**	-	**-**	-
-	-	**3**	1	**(5)**	2	**-**	-
-	-	**94**	239	**(93)**	73	**-**	-
300	484	**(64)**	45	**(8)**	29	**-**	-
-	197	**(64)**	(134)	**(17)**	(4)	**-**	-
-	-	**(38)**	(24)	**-**	-	**-**	-
-	25	**(1)**	(39)	**-**	(2)	**1**	21
-	-	**2**	(41)	**(1)**	(1)	**-**	-

Note 16 – Buildings and Equipment

A. Composition

	Buildings and real estate (a)	Equipment, furniture and vehicles	Software costs	Total
	NIS millions			
Cost				
As at 31 December 2014	3,517	3,445	5,495 (c)	12,457
Additions	55	156	555 (c)	766
Disposals	(198)	(135)	(1,345) (c)	(1,678)
Adjustments from translation differences	-	1	-	1
As at 31 December 2015	3,374	3,467	4,705	11,546
Additions	**46**	**556**	**151**	**753**
Disposals	**(118)**	**(79)**	**(237)**	**(434)**
Adjustments from translation differences	**(1)**	-	**(3)**	**(4)**
As at 31 December 2016	**3,301**	**3,944**	**4,616**	**11,861**
Accumulated depreciation and losses from impairment				
As at 31 December 2014	1,935	2,889 (c)	4,471 (c)	9,295
Provision for the reporting year	97 (c)	166 (c)	390	653
Cancellation of loss from impairment	2	-	-	2
Disposals	(136)	(133)	(1,230)	(1,499)
Adjustments from translation of reports	-	-	-	-
As at 31 December 2015	1,898	2,922	3,631	8,451
Provision in the reporting year	**89**	**158**	**416**	**663**
Cancellation of loss from impairment	-	-	-	-
Disposals	**(87)**	**(79)**	**(235)**	**(401)**
Adjustments from translation of reports	-	-	**1**	**1**
As at 31 December 2016	**1,900**	**3,001**	**3,813**	**8,714**
Amortized balance as at 31 December 2014	1,582	556	1,024	3,162
Amortized balance as at 31 December 2015	1,476	545	1,074	3,095
Amortized balance as at 31 December 2016	**1,401**	**943**	**803**	**3,147**

(a) Including leasehold installations and improvements.

(b) Includes expenses capitalized relating to the development costs of software for in-house use totaling NIS 284 million at 31 December 2016.

(c) Reclassified.

B. Average rate of depreciation:

	31 December 2016	31 December 2015
Buildings and real estate -	**3.16%**	4.57%
Equipment, furniture and vehicles -	**14.01%**	13.75%
Software	**23.95%**	25.09% (a)

(a) Restated.

Note 16 – Buildings and Equipment (cont'd)

C. The Group has rental or discounted leasing rights on real estate and equipment for a period of 1 to 99 years from the balance sheet date in an amount (net of depreciation) of NIS 152 million (31 December 2015 – NIS 129 million). The balance of the period of the maximum discounted lease is 80 years.

D. Investment property - buildings and real estate not used by the Group, mainly rental buildings, amount to NIS 68 million in the balance sheet (31 December 2015 – NIS 45 million).

E. The item "Buildings and equipment" includes improvements and leasehold rights, including payments on account. Some of the buildings are on leased land. Assets in the amount of NIS 172 million (31 December 2015 – NIS 147 million) in the balance sheet have not yet been registered in the name of the Bank at the Land Registry Office. The principal reasons for the non-registration are the absence of a land registry arrangement in the area ("parcellation"), and non-registration of the project as a condominium building by the contractor/developer.

F. The balance of Buildings and Equipment earmarked for sale, amounted on 31 December 2016 to NIS 66 million (31 December 2015 – In a total of NIS 77 million) No loss is anticipated from the realization of buildings and equipment available for sale, in addition to provisions in their respect.

Note 17 – Intangible Assets and Goodwill

A. Intangible assets

	Goodwill	Customer securities portfolios	Total
	NIS millions		
Cost			
As at 31 December 2014	275	83	358
Adjustments from translation differences	-	-	-
As at 31 December 2015	275	83	358
Adjustments from translation differences	(1)	-	(1)
As at 31 December 2016	**274**	**83**	**357**
Amortization and losses from impairment			
As at 31 December 2014	232	83	315
Amortization and losses from impairment	25	-	25
As at 31 December 2015	257	83	340
Loss from impairment	-	-	-
As at 31 December 2016	**257**	**83**	**340**
Amoritzed balance as at 31 December 2016	**17**	**-**	**17**
Book value			
As at 31 December 2014	43	-	43
As at 31 December 2015	18	-	18
As at 31 December 2016	**17**	**-**	**17**

Note 17 – Intangible Assets and Goodwill (cont'd)

B. Goodwill

Change in goodwill by regulatory operating segments and by management approach

	Foreign operations
	Other
	NIS millions
As at 31 December 2014	43
Loss from impairment	25
As at 31 December 2015	18
Amortization for the year	**1**
As at 31 December 2016	**17**

Note 18 – Other Assets

	31 December 2016	31 December 2015	
	NIS millions		
Deferred tax asset, net - see Note 8.F.	**4,960**	4,570	
Excess of advance tax payments over current provisions	**118**	73	
Excess of plan funds over liabilities in respect of employee benefits	**971**	1,144	
Assets received in respect of settlement of loans	**5**	4	
Balance of issuance expenses to be amortized of debentures, bonds and subordinated notes	**42**	37	
Value of insurance policies in foreign branch	**431**	440	
Prepaid expenses	**225**	189	
Accrued income	**139**	157	
Assets in respect of activity in Maof Clearing House (a)	**978**	548	(b)
Other receivables and prepayments	**218**	504	(b)
Total other assets	**8,087**	7,666	

(a) Shown at fair value.
(b) Reclassified.

Note 19 - Deposits of the public

A. Types of deposits by location raised and type of depositor

	31 December 2016	31 December 2015	
	NIS millions		
In Israel			
On demand			
Non-interest bearing	**79,516**	72,060	
Interest bearing	**97,328**	80,521	
Total on demand	**176,844**	152,581	
Fixed term	**143,289**	149,697	
Total deposits in Israel[1]	**320,133**	302,278	
Outside Israel			
On demand			
Non-interest bearing	**10,306**	9,872	
Interest bearing	**4,339**	3,693	
Total on demand	**14,645**	13,565	
Fixed term	**12,076**	12,850	
Of which: non-interest bearing	**32**	14	
Total deposits outside Israel	**26,721**	26,415	
Total deposits of the public[1]	**346,854**	328,693	
[1]Of which:			
Deposits of private persons	**143,644**	135,595	
Deposits of institutional entities	**55,862**	55,889	(a)
Deposits of corporations and others	**120,627**	110,794	(a)

(a) Reclassified.

Note 19 - Deposits of the public (cont'd)

B. Deposits of the public by size on consolidated basis

	31 December 2016	31 December 2015
	NIS millions	
Up to 1	**96,368**	95,789
From 1 to 10	**93,912**	83,813
From 10 to 100	**60,809**	58,268
From 100 to 500	**37,271**	30,868
Above 500	**58,494**	59,955
Total	**346,854**	328,693

Note 20 - Deposits from banks

	31 December 2016	31 December 2015
	NIS millions	
In Israel		
Commercial banks:		
Demand deposits	**1,849**	2,754
Time deposits	**1,045**	545
Acceptances	**423**	459
Outside Israel		
Commercial banks:		
Demand deposits	**3**	16
Time deposits	**-**	1
Acceptances	**74**	84
Total deposits from banks	**3,394**	3,859

Note 21 – Debentures, Bonds and Subordinated Notes

	Average duration (a)	Internal rate of return (b)	**31 December 2016**	31 December 2015
	Years	%	NIS millions	
Debentures and notes (c):				
In Israeli currency linked to the CPI	**3.5**	**0.6**	**5,285**	2,023
In unlinked Israeli currency	**6.5**	**3.0**	**1,159**	1,159
Subordinated notes (c)(f)(g):				
Unlinked Israeli currency	**3.8** (d)	**2.3**	**5,133**	4,545
In Israeli currency linked to the CPI (d)	**3.0** (d)	**0.8**	**11,063**	13,581
Total debentures, notes and subordinated notes			**22,640**	21,308

(a) The average duration is the average of the payment periods, weighted according to the payment flow discounted at the internal rate of return.

(b) The internal rate of return is the rate of interest discounting the value of the anticipated future flow of payments to the balance sheet amount included in the financial statement.

(c) The unamortized balance of the discount less the premium on debentures and on subordinated notes not yet charged to profit and loss has been deducted from the amount of the debentures.

(d) The average duration as of the date of change in interest is based on a calculation of the effective average duration as calculated for purposes of the exposure to changes in interest rates. In unlinked subordinated notes it is 2.7 years, in those linked to the CPI it is 2.6 years.

(e) Of which: subordinated notes (unquoted) deemed Tier 2 capital in the amount of NIS 1,446 million (31 December 2015 – NIS 514 million) that in certain circumstances may be converted into shares. See Note 25A.A.

(f) Of which: listed for trading on the Tel Aviv Stock Exchange an amount of NIS 8,664 million linked to the CPI and an amount of NIS 5,084 million unlinked (31 December 2015 – NIS 10,915 million linked and NIS 4,499 million unlinked).

(g) Tier 2 capital pursuant to the Basel III transitional provisions.

Note 22 - Other Liabilities

	31 December 2016	31 December 2015
	NIS millions	
Excess of liabilities in respect of employee benefits over plan assets - see Note 23.N.	**10,129**	8,998 (c)
Excess of current provisions for income tax over advance payments	**383**	619
Income in advance	**378**	454
Payables in respect of credit cards	**5,726**	5,686
Accrued expenses in respect of salaries and related expenses	**903**	746
Market value of securities sold short	**768**	815
Allowance for credit losses in respect of off-balance sheet items	**488**	482
Expenses to pay	**371**	373
Other provisions in respect of employee rights	**323**	376 (c)
Provision for vacation	**208**	227
Deferred tax liability, net – see Note 8(G)	**183**	123
Jubilee (a)	**82**	524
Liabilities in respect of activity in Maof Clearing House (b)	**978**	548 (c)
Other payables and credit balances	**965**	775 (c)
Total other liabilities	**21,885**	20,746

(a) For the year 2016, accumulated Jubilee vacation.

(b) Shown at fair value.

(c) Reclassified.

Note 23 – Employee Rights

A. Remuneration Law for Office Holders in Financial Corporations (Special Approval and Disallowance of Expenditure for Tax Purposes for Exceptional Remuneration), 2016 (henceforth: "the Remuneration Limitation Law")

The Law was published on 12 April 2016. The Law sets the limitations on remuneration for office holders or other employees in financial corporations, in which the main one is setting a ceiling for annual remuneration of NIS 2.5 million.

On 29 September 2016, a ruling was given dismissing the appeal challenging the legality of the legislation, while the Court determined that the law does not apply to rights acquired in return for work performed by the employee before the expiration of the period of reorganization (12 October 2016), even if they will be paid in the future.

Against the background of the significant increase in the probability of members of management under personal contracts who are ending their term of office in the relatively near future, the Board of Directors of the Bank, in view of the management's estimation and in accordance with a legal opinion, approved updating the provision for the termination of employee-employer relationships, according to the accumulated rights, in accordance with the terms of employment of members of the management and other managers employed under personal contracts. Pursuant to the abovementioned, the Bank increased the amount of the provision in the financial statements as at 31 March 2016 in respect of the population of the above office holders and key personnel by about NIS 117 million, out of which NIS 36 million in respect of office holders, including the President and CEO. In accordance with accounting principles and the Public Reporting Directives, the said update to the estimate was charged to other comprehensive income. See Note 1.L. This amount will be amortized in subsequent reporting periods to the statement of profit and loss.

Note 23 – Employee Rights (cont'd)

B. Severance pay and pensions

1. General

For employees that commenced their employment with the Bank since 1 January 1999 (hereinafter: "second generation employees") and had not yet received permanent employment status as at the signing date of the special collective bargaining agreement in 2000 covering a special pension arrangement, current deposits are made to an external pension fund. The Bank will not have any pension liability in respect of these employees other than to supplement severance pay in accordance with the agreement.

Employees, who began working with the Bank before 1 January 1999 (hereinafter: ("first generation employees") and received permanent employment status before the date of signing the aforementioned agreement, and who retire from the Bank at retirement age, except those mentioned above and in (C) below, may choose between the right to receive severance pay plus their accumulated provident fund, or the right to receive a pension from the Bank, in which case they relinquish their right to the severance pay and provident fund, subject to the provisions of the law. The entitlement to a pension is calculated at a pension rate of 40% for the first 15 years of employment, i.e. 2.67% per annum, and of 1.5% for each additional year, up to a maximum rate of 70%.

Provisions for provident funds are based on an actuarial calculation that takes the retirement age into account according to the Retirement Age Law, 2004. The actuarial calculation was made according to the accrued benefits valuation method, taking into account various parameters including the probability, based on past experience, of the rate of utilization of the pension benefits and the rate of withdrawal of severance and remuneration benefits (current utilization rate of pension rights is about 76%, while the remainder choose severance pay and provident funds), and past experience regarding disability, etc.
The accumulation of liability is on a straight-line basis up to the earliest retirement age (an average of retirement ages in practice of first generation employees in recent years, for men and women). After this date, additional benefits are attributed for subsequent years based on the formula of the benefit plan of first generation employees.

The actuarial calculation is based on the updated provisions of the Chief Actuary in the Ministry of Finance with respect to mortality rates from March 2013, which were determined by the Commissioner of the Capital Market, Insurance and Savings for insurance companies and that were adopted for the population of the Bank’s employees.

Calculation of the Bank's actuarial liability for pension payments is made using the government bonds yield in Israel plus an average margin on corporate bonds with an international rating of AA and above at the reporting date. For practical reasons, it was decided that the calculation of the margin will be based on US corporate bond margins. In addition, a calculation is made on the assumption of a real increase in salary based on past experience and varying in accordance with the age of the employee.

The calculation is made under a comprehensive pension plan, which includes old age, disability and survivor pensions and also takes into account employees who have not yet completed the period required for receipt of pension benefits (15 years of service).

Note 23 – Employee Rights (cont'd)

2. Benefits to "Leumi Alumni"

"Leumi Alumni" are entitled to receive, in addition to their individual choice of a pension and/or severance payments, additional benefits which consist mainly of a holiday gift, and participation in the cost of additional welfare and social activities.

"Leumi Alumni" – persons who, regardless of their age, have concluded working with the Bank after 25 years of employment, or have concluded working with the Bank at the legal retirement age after at least 15 years of employment.

The accumulated amount at 31 December 2016 for expected costs in respect of the above entitlements in the period following the employment period, according to actuarial calculation, amounts to some NIS 255 million (31 December 2015 - NIS 239 million).

C. Terms of employment and retirement for employees under personal employment contracts

1. Employees with personal employment agreements with the Bank (that are not members of Management), who have a first generation employment agreement with the Bank, were transferred to second generation employment conditions as of 2014, as follows: their rights to a defined-benefit pension from the Bank pursuant to their first generation rights will only be in respect of the frozen salary level (the salary at the date of transfer from first generation to second generation plus linkage to the CPI), whereas rights regarding salary increments above the frozen salary level will be pursuant to second generation conditions (provident fund and severance fund contributions without defined-benefit pension rights from the Bank).

2. In accordance with first generation terms of employment, members of Management of the Bank are entitled to a non-contributory pension and a group of senior executives of the Bank are entitled, in the event of dismissal, to an immediate pension, if the numerical total of their age plus the number of years of employment with the Bank amounts to 75 or 80 under the new personal contracts. The years of service of a member of Management (if the employee served at least 7 years as a member of Management) will be counted as additional years of seniority for purposes of the said aggregate years of service.

   The pension for members of Management will be calculated at the rate of 40% for the first 15 years of employment, i.e. 2.67% per annum, and 1.5% for each additional year until signing a personal contract, 2% for each year under a personal contract, and 2.5% for each year of service as a member of Management, up to a maximum rate of 70%. The pension for senior executives is calculated at the rate of 40% for the first 15 years of employment, i.e. 2.67% per annum, 1.5% for each additional year until signing a personal contract, and 2% for each year thereafter, up to a maximum rate of 70%. Alternatively, the said employees are entitled to choose, in the event of dismissal, severance pay at the rate of 200% (and 250% if their age plus the number of years of employment with the Bank does not amount to 75, or 80 as mentioned) of their latest monthly salary multiplied by the number of years of employment, plus the amounts accumulated to their credit in the provident fund. In such case, the employees are not entitled to a pension.

   An employee who voluntarily resigns will be entitled to severance pay at the rate of 100%, plus the funds accumulated to his credit in the provident fund.

   The Bank and the said employees are entitled to terminate the employee-employer relationship by giving advance notice of six months.

Note 23 – Employee Rights (cont'd)

Personal employment contracts of members of Management of the Bank provide, inter alia, as follows: an employee who retires voluntarily at the age of 62 years or more will be entitled, upon fulfillment of a number of conditions, to severance pay at a rate of 200% plus accrued amounts in his provident. An employee who, upon termination of the employee-employer relationship did not utilize his special jubilee vacation will be entitled to an additional month of advance notice. In the cooling-off period, which does not coincide with the period of advance notice, the employee will be entitled to a salary and to related benefits.

According to the personal contracts with members of the management of the Bank, who are not first generation or second generation in the Bank, in the event of dismissal, these members of Management will not be entitled to a pension from the Bank, but to compensation amounting to 150% of the monthly salary as of 1 October 2016 multiplied by the number of years of seniority up until then, with an addition of 100% from the last salary multiplied by their years of seniority in the Bank on the date of termination of employee-employer relationship from which are deducted the amounts accrued in the severance pay fund.

The Bank approved personal employment contracts for a group of senior managers from among the second generation in the Bank. These managers are not entitled to a first generation pension from the Bank. It was therefore stipulated in these personal contracts that the Bank undertook, in the event of dismissal, to pay compensation at the rate of 250% of the last monthly salary for each year of work in the Bank, together with provident fund allocations, after deduction of the amounts accrued in the severance pay fund.

If a manager is dismissed whose age is 55 or above, and whose period of service in the Bank is 25 years or more, the manager will be entitled to chose, on dismissal, between compensation at the rate of 200% of the last monthly salary for each year of work in the Bank, together with provident fund allocations, after deduction of the amounts accrued in the severance pay fund; or alternatively, to receive all the funds and rights in the compensation and provident fund, when until the date he will be entitled to receive them, under the terms of the rules of the fund and the provisions of the law, he will be entitled to receive a pension from the Bank.

The maximum additional expense that the Bank may incur in the event of the employees mentioned in this paragraph being immediately dismissed, amounts to NIS 194 million (including salary tax payable on the pension) (2015 – NIS 285 million). The reason for the decrease is due to changes in time assumptions and probability of retirement.

In December 2016, the Remunerations Committee and the Board of Directors approved, pursuant to clause 272(C1) of the Companies Law, 1999 and according to clause 2(A) of the Remuneration Limitation Law, the updating of the terms of service and employment for the members of management of the Bank. The said updating of the terms of service and employment includes the updating of components of fixed remuneration, including salary, social rights and related salary terms, and components of variable remuneration, including annual bonus, pursuant to the new Remuneration Policy of the Bank that was approved in the General Meeting on 3 November 2016, and pursuant to the limitations set out in the framework of the Remuneration Limitation Law.

Note 23 – Employee Rights (cont'd)

3. CEO

Ms. Rakefet Russak-Aminoach serves in the position of President and CEO of the Bank as of 1 May 2012. The monthly salary of the President and CEO is NIS 195,400 (linked to the CPI).

For details of the prior terms of service and employment of the President and CEO, see the chapter on "Salary of Senior Office Holders" and Notes 23B.3.A to the 2015 financial statements as published in the Periodic Report for the year 2015 of the Bank, whose contents are included below by way of reference (henceforth: **"the previous terms of service"**). The previous terms of service are in accordance with the previous remuneration policy of the Bank.

Following the coming into effect of the Remuneration Limitation Law, the terms of service and employment of the President and CEO were adapted to its provisions.

On 3 November, 2016, after the receipt of approval of the Remuneration Committee and the Board of Directors of the Bank, the General Meeting of the Bank approved the new terms of service and employment of the President and CEO of the Bank (including the granting of an amended deed of indemnity), in accordance with the new remuneration policy as defined and set forth below, which are in effect as of 12 November, 2016 (henceforth: "the date of commencement"), including the agreement of the Board of Directors to reemploy the President and CEO without the need for receiving additional approval of the General Meeting.

The main changes vs. previous terms of service and employment are: adjusting the overall remuneration of the President & CEO to that determined by the Remuneration Limitation Law, including the President and CEO's waiver of her entitlement to continue accumulating non-contributory pension rights from the Bank in accordance with the First Generation employment terms at the Bank ("the retirement pension") for the period after the date of commencement, while freezing and preserving the rights which had already been accumulated to her credit up to the date of commencement and depositing the said amount in an external fund.

1. Salary

The President and CEO will be entitled to a monthly salary in the total amount of NIS 195,400, linked to the rise in index known in October 2016[1] (**"the salary"**).

The President and CEO is entitled, subject to the approval of the Remuneration Committee and the Board of Directors, to an additional fixed payment component. The amount of this component shall be determined in such a way that the total of the remuneration components paid to the President and CEO (excluding remuneration for which the expenses are unpredictable, in accordance with generally accepted accounting principles) will not exceed the limit determined in Section 2(b) of the Remuneration Limitation Law. No social provisions, aside from severance pay and pension provisions as required by law, shall be made in respect of this fixed component.

2. Advance notice of employment termination

The employment agreement of the President and CEO is for an indefinite period. Each of the parties may terminate the engagement by providing prior notice of six (6) months in advance.

Note 23 – Employee Rights (cont'd)

3. Provisions and deductions for pensions, severance pay and social benefits

The Bank shall make provisions for provident funds and insurance for occupational disability for the President and CEO, which will be transferred, on a monthly basis, to executive insurance, provident funds and / or a pension arrangement, as agreed upon between the parties, from time to time, at a rate of 7.5%, and furthermore, the Bank will deduct an additional 5% of the President and CEO's salary for pensions (hereinafter: **"the provisions for provident funds"**). The Bank will make provisions to severance pay, which will be transferred, on a monthly basis, into a severance pay fund, at a rate of 8⅓% of the President and CEO's salary. The Bank shall make provisions for the President and CEO into a study fund, at its expense, on a monthly basis, in the amount of 7.5% of her salary, as applicable from time to time, and shall simultaneously deduct, at the President and CEO's expense, an amount of 2.5% of the salary, up to the limit of entitlement for tax purposes, and transfer it into a study fund.

4. The rights of the President and CEO upon termination of the work relations according to the new terms of employment:

In the event of termination of the working relations between the President and CEO and the Bank (dismissal, resignation or retirement) the President and CEO shall be entitled to severance pay of 100% in addition to rights she accumulated in an external fund. Non-competition bonus - The President and CEO shall commit to a non-competition period of up to 6 months from the end of her office as the Bank's President and CEO ((henceforth: "non-competition period"). Throughout the non-competition period, The President and CEO shall be entitled to the salary and all related benefits, apart from contributions to social benefits.

5. Exemption, insurance and indemnification

The President and CEO is entitled to exemption, insurance and office-holder indemnification, as periodically customary at the Bank.

6. Provisions regarding annual bonuses

The President and CEO shall not be entitled to a variable annual bonus as of the date of commencement.

The President and CEO is entitled to a variable annual bonus in accordance with the current tenure terms for the relative portion of 2016 for the period in 2016 during which the current tenure terms were in effect.

Regarding the payment of the deferred variable annual bonus, in accordance with the previous remuneration policy, as well as the payment of a variable annual bonus upon termination of employer-employee relations – the provisions of the new remuneration policy shall apply.

Note 23 – Employee Rights (cont'd)

4. The Chairman of the Board of Directors of the Bank

Mr. David Brodet was initially appointed to serve as a director at the Bank and as Chairman of the Board of Directors in 2010. During the years 2013 and 2016[1] the Chairman of the Board of Directors was appointed to serve as a director at the Bank and as Chairman of the Board of Directors for two additional service terms of three years each. The Chairman of the Board of Directors will be entitled to a monthly salary in the total sum of NIS 168,200 (linked to the increase in the index).

On November 4, 2010, following the approval of the Board of Directors and the Audit Committee, the General Meeting approved the contract terms between the Bank and the Chairman of the Board of Directors Mr. David Brodet, who served as an active Chairman of the Bank Board of Directors, and on February 11, 2014, following the approval of the Board of Directors and the Audit Committee, the General Meeting confirmed that the Chairman of the Board of Directors is entitled to a performance contingent annual bonus in accordance with and subject to the aforesaid in the previous remuneration policy, regarding each of the years 2013 to 2016. For details concerning the current terms of service and employment of the Chairman of the Board of Directors, including the remunerations that were paid to him in 2014 and 2015 in regards to his tenure, see the Chapter concerning "Salary of Senior Office-holders" and Note 23B.4 of the Bank's financial statements for 2015 as published within the framework of the Bank's Periodic Report for 2015, the content of which is included below by way of the reference (hereinafter: **"the previous terms of cervice"**). The current terms of service match the Bank's previous remuneration policy.

On November 3, 2016, the General Meeting of the Bank, after receiving approval of the Remuneration Committee and the Board of Directors, approved the new terms of service and employment of the Chairman of the Bank's Board of Directors Including indemnification), in accordance with the new Remuneration Policy, with effect from 22 July 2016, the date on which Mr. Brodet's current term begins as a director and Chairman of the Board of Directors.

The new terms of service were approved in accordance with Directive 301A, which stipulates that the Chairman of the Board of Directors shall only be entitled to a fixed remuneration and social benefits and related expenses, as is acceptable for office-holders in the Bank. Additionally, and in light of the Remuneration Limitation Law, the terms of service and employment of the Chairman of the Board of Directors were adjusted and reduced so as to meet the requirements of the Remuneration Limitation Law. The new terms of service are in accordance with the terms of the new Remuneration Policy as defined and specified below.

The Chairman of the Board of Directors is entitled in accordance with the previous terms of service to a variable bonus for a relative part of 2016 for the period in 2016 in which the current terms of service are in effect.

Details of the new terms of employment of the Chairman of the Board of Directors

1. **Salary – From the date of commencement, t**he Chairman of the Board of Directors will be entitled to a monthly salary in the total sum of NIS 168,200, linked to the increase in the inde[x] ("**the salary**").

2. Fixed remuneration adjusted to the new provisions of the Law

The Chairman of the Board of Directors is entitled, subject to the approval of the Remuneration Committee and the Board of Directors, to an additional fixed payment component. The amount of this component shall be determined in such a way that the sum of the remuneration components paid to the Chairman of the Board of Directors (excluding remuneration for which the expenses are unpredictable, in accordance with the accepted accounting principles) will be in accordance with the limit determined in Section 2(b) of the Remuneration Limitation Law.

No social provisions, aside from severance pay and pension provisions, shall be made in respect of this fixed component.

3. Employment term and end of employment term

The employment agreement of the Chairman of the Board of Directors is valid throughout his employment period, beginning the date of commencement ("**the employment term**"). Throughout the employment term, each of the parties may terminate the engagement by providing a prior notice of six (6) months in advance (in events, for which the working relations can be terminated without prior notice according to the law, the working relations can be terminated immediately) ("**prior notice**").

It is hereby clarified that the Bank shall be entitled to demand that the Chairman of the Board of Directors shall continue to act as Chairman, in full or in part, throughout the prior notice period. During the prior notice period, the Chairman of the Board of Directors shall be entitled to the salary and all other benefits (including social benefits).

4. Provisions and deductions for remunerations, severances and social benefits

4.1 The Bank shall make provisions to remunerations[7] for the Chairman of the Board of Directors, which will be transferred, on a monthly basis, to manager insurance, provident funds and / or pensioner arrangement, as agreed upon between the parties, periodically, at a rate of 7.5%, and furthermore, the Bank will deduct an additional 5% of the Chairman of the Board of Directors' salary for remunerations (hereinafter: "**provisions to remuneration**"). Alternatively, the Chairman of the Board of Directors shall be permitted to choose, at his sole discretion, that instead of the provisions to remuneration, in full or in part, the sums that were meant to be paid as the Bank's provisions to remuneration will be paid to him on a current basis.

4.2 The Bank will make provisions to severance pay, which will be transferred, on a monthly basis, into a severance fund, at a rate of 8⅓% of the Chairman of the Board of Directors' salary.

4.3 The Bank shall make provisions into a study fund, at the Chairman's expense, on a monthly basis, in the amount of 7.5% of his salary, be that as it may, and shall simultaneously deduct, at the Chairman of the Board of Directors' expense, an amount of 2.5% of the salary, up to the credit limit for tax purposes, and transfer it into a study fund.

Note 23 – Employee Rights (cont'd)

5. Retirement terms - The rights of the Chairman of the Board of Directors upon the end of his tenure shall be as follows:

5.1 **Severance and remuneration -** Following the end of the Chairman of the Board of Directors' tenure at the Bank, for any reason (excluding exceptional circumstances in which the Chairman can be denied severance pay), the Chairman of the Board of Directors shall be entitled to the following rights:

a. For the Chairman of the Board of Directors' past tenure – the Chairman of the Board of Directors' period of service from 2010 and until the date of commencement (**"the past period"**), the Chairman of the Board of Directors shall be entitled to severance pay in the amount of 150% of the last salary paid to the Chairman of the Board of Directors before the date of commencement, multiplied by the number of years (and / or partial years) during which he served as Chairman of the Board of Directors in the last period, this in addition to the Chairman's right to the payments and rights accumulated in the remuneration and severance fund due to provisions to remuneration and severance made by the Bank and the Chairman of the Board of Directors for the past period.

b. For the Chairman of the Board of Directors' tenure as of the date of commencement and until the end of his tenure at the Bank ("**additional tenure**"), the Chairman of the Board of Directors shall be entitled to severance pay in the amount of 100%[9] of his last salary, multiplied by the number of years (and / or partial years) during which he served as Chairman of the Board of Directors in his additional tenure, this in addition to the Chairman's right to the payments and rights accumulated in the remuneration and severance fund due to provisions to remuneration and severance made by the Bank and the Chairman of the Board of Directors for his additional tenure.

5.2 **Adaptation bonus -** Upon the end of the Chairman's employment as Chairman of the Board of Directors, the Chairman shall be entitled to an adaptation bonus in the amount of 6 monthly salaries ("**adaptation bonus**" or "**adaptation bonus period**"), which can and will be contingent upon the Chairman's commitment to a non-competition period of up to 6 months from the end of his actual service as the Bank's Chairman of the Board of Directors, as determined by the Bank's Board of Directors of Directors ("**non-competition period**").

6. Exemption, insurance and indemnification - The Chairman is entitled to exemption, insurance and office-holder indemnification, as periodically customary at the Bank.

7. Vacation days, recuperation and sick leave - As customary for senior executives at the Bank.

8. Related benefits - The Chairman of the Board of Directors shall be entitled to benefits as customary for senior executives at the Bank.

Note 23 – Employee Rights (cont'd)

9. Provisions regarding annual bonuses

9.1 The Chairman of the Board of Directors shall not be entitled to a variable annual bonus as of the date of commencement.

Regarding this matter, it is hereby clarified that the Chairman of the Board of Directors may be entitled to a variable annual bonus in accordance with the current tenure terms for the variable portion of 2016 for the period in 2016 during which the current tenure terms were in effect.

9.2 The provisions set forth in the remuneration policy regarding the vesting of the deferred share of the bonus shall also apply, respectively, to share-based instruments that were allotted (and will be allotted, if allotted) to the Chairman of the Board of Directors by virtue of the previous remuneration policy, notwithstanding that stated regarding this matter in the previous remuneration policy.

D. Provision for vacations

In "Other Liabilities" there is a provision for unutilized vacation days calculated on the basis of the latest salary plus related benefits. In addition, there is provision for sick days to be converted to vacation days calculated on an actuarial basis. The provisions amount to NIS 208 million (31 December 2015 – NIS 227 million).

E. Provident and severance pay funds of employees of the Bank

The Bank deposits provident and severance monies for "first generation" employees in the Bank Leumi Employees Provident and Severance Funds, which is managed by a management company held by the members of the funds.

In March 2015, the Bank entered into an agreement with institutional entities from the Migdal Group to transfer the provident funds which have been accrued or will be accrued from 2008 and onwards and severance pay funds which have been accrued or will be accrued in the provident and severance pay funds of the Bank's employees, on behalf of first-generation employees that have chosen or will choose on retirement a continuous social security arrangement track (full or partial), to a non-contributory fund under the management of Migdal.

In addition, on 25 March 2015, the Bank received approval from the Tax Authority for the transfer of the severance pay funds accumulated in the Bank's central severance pay fund in favor of the severance pay component in personal provident funds maintained on the employees' behalf, and the conditions and mechanism were set for the withdrawal of surplus monies from the central severance pay fund.

Note 23 – Employee Rights (cont'd)

F. Remuneration Policy for Office Holders in the Bank (2013-2015 and part of 2016)

On 11 February 2014, the General Meeting of the Bank, after obtaining the approval and recommendation of the Remuneration Committee and the approval of the Board of Directors, approved a remuneration policy regarding conditions of service and employment of Bank office holders (including senior office holders), pursuant to Amendment 20 of the Companies Law, 1999, pursuant to the directives of the Supervisor of Banks concerning remuneration policy of a banking corporation (**"the previous remuneration policy"**), which includes a program for bonuses to office holders of the Bank (**"the previous bonus program"**). The previous remuneration policy and the previous bonus program are valid for each of the years 2013, 2014, 2015, and part of 2016. For details of the previous remuneration policy including the previous bonus program, see Note 23.F to the 2015 financial statements.

G. Remuneration Policy for Office Holders in the Bank for part of 2016 and for the years 2017, 2018 and 2019

On 3 November, 2016 the General Meeting of the Bank approved the new Remuneration Policy for office holders in the Bank to be applied as from 12 October 2016 until the end of 2019 (hereinafter: "the new remuneration policy"), following the approval of the Board of Directors pursuant to the approval and recommendations of the Remuneration Committee. The new remuneration policy is based on the provisions of Amendment 20 to the Companies Law regarding conditions of service and employment of office holders in the Bank, that set out in the revised Directive 301A of the Proper Conduct of Banking Business Directives concerning remuneration policy in a banking corporation and the provisions of the Remuneration Limitation Law.

The new remuneration policy and new bonus program will be valid for the last quarter of 2016 and for each of the years 2017, 2018 and 2019.

The new remuneration policy includes, *inter alia*, reference to the matters set forth in Part A of Schedule A of the Companies Law, in which were determined, inter alia, the detailed provisions of Part B of that Schedule. The new remuneration policy was formulated in order to adapt remuneration mechanisms set out to the size of the Bank, the nature of its business and the goals and objectives which the Bank's remuneration policy was to achieve, despite the strict limitations established in the Remuneration Limitation Law. The new compensation policy provides for a framework for remunerating office holders in the Bank, and includes, among other things, reference to fixed remuneration components, which is the main remuneration to office holders (whereas members of the Board of Directors, including the Chairman of the Board and the President and CEO of the Bank, will not be entitled according to the new remuneration policy, including a variable annual bonus), including fixed salary, social rights and related benefits to the salary and terms of retirement and termination of employment (other than terms of retirement classified as a component of variable remuneration, as described below), and to components of variable remuneration which include any remuneration that is not fixed, including: an annual performance-dependent bonus, consisting of a bonus component based on return on equity and a bonus component based on the yield of the stock of the Bank compared with the yield on the TA-Banks index; an individual qualitative bonus, which is based on the achievement of personal objectives and quality criteria in accordance with the areas of responsibility of the office holder in question; and a special bonus in respect of special events.

Note 23 – Employee Rights (cont'd)

Total variable bonuses to an office holder are limited to seven months' salary per year and the Board of Directors of the company has the authority to reduce the performance-contingent bonus at its discretion. In addition, the new remuneration policy has determined, in accordance with Directive 301A, a mechanism of reclaiming variable bonuses, including criteria for restitution, the circumstances for activating the restitution mechanism and the restitution period. For details of the new bonuses program, see section H.2 in this Note below.

1. The new remuneration policy framework also sets arrangements for deferring the payment of the variable bonus to office holders, the payment of which is subject to the Bank's compliance with the capital adequacy ratios required by the Supervisor of Banks immediately prior to each vesting date.

2. In addition, the remuneration policy includes provisions concerning the protection of rights upon retirement, including pension rights, of office holders of the Bank, which were accrued and will be accrued for the period until the end of the transitional period of the remuneration limit law.

3. Taking into account that the new remuneration policy was formulated against the background of arrangements in process of formation, mechanisms and various arrangements were set in the new remuneration policy designed to allow the Remuneration Committee and the Board of Directors to approve updates to the new remuneration policy or remuneration components in terms of service and employment of the office holders that the new remuneration policy applies to during the period the new remuneration policy, without being required to receive a renewed approval by the General Meeting of the Bank on the date of such update. As stated, policy updates will be made insofar as circumstances existing at the time of the update, justify in the opinion of the Remuneration Committee and the Board of Directors the making of the stated updates.

   For example, the new remuneration policy determines a mechanism linking the lowest remuneration in the Bank, for the purpose of Section 2 (b) in the Remuneration Limitation Law, to the remuneration ceiling of the office holders in the Bank, so that total remuneration components to office holders (excluding remuneration whose expense is not predictable under GAAP) will rise by the same rate for the increase in the lowest remuneration in the Bank at the time.

H. Bonus Program for Senior Officers

1. Bonuses for the years 2013, 2014, 2015 and part of 2016

The previous remuneration policy, as defined above, includes a bonus program for office holders of the Bank ("previous bonus program"). The previous bonus program will be valid for each of the years 2013, 2014, 2015 and part of 2016.

The previous bonus program determines, among other things, The bonus program provides, inter alia, the manner of determining the annual variable bonus for senior officers and the manner of determining the annual bonus for office holders who are not senior officers, the eligibility of the President and CEO to a fixed annual bonus, the eligibility of senior staff members in audit and control functions to a fixed annual bonus, and the possibility for the competent organs in the Bank to approve a signing-up bonus to a new office holder in the Bank; in accordance with the provisions of the previous remuneration policy. For details of the previous remuneration policy including the previous bonus program, see Note 23.F. in the financial statements of the Bank for 2015.

Note 23 – Employee Rights (cont'd)

2. Bonuses in respect of part of 2016 and for the years 2017, 2018 and -2019

The new remuneration policy, as defined above, includes a bonus program for office holders of the Bank (**"the new bonus program"**). The new bonus program will be valid in respect of part of 2016 and for each of the years 2017, 2018 and 2019. If it is decided by the Remuneration Committee and the Board of Directors to pay a variable bonus to office holders of the Bank for the year 2016, eligibility of the office holders of the Bank in respect of the last quarter of 2016 will be in accordance with the new remuneration policy, as described below.

Under the new remuneration policy, a framework has been decided for remuneration of the Bank's office holders, and it includes, inter alia, reference to variable remuneration components that include all the non-fixed remuneration including: a performance-contingent annual bonus; a personal qualitative bonus; a special bonus for special events.

The total of variable bonuses to an office holder is limited to a ceiling of 6 monthly salaries per year (and one salary in addition as a special bonus) and the Board of Directors of the Bank has the authority to reduce the performance-contingent bonus at its discretion. In addition, the new remuneration policy, pursuant to Directive 301A, stipulates a mechanism for restitution of variable bonuses, including criteria for restitution, circumstances for activating the restitution mechanism, and the period of restitution.

The new remuneration policy also stipulates arrangements for deferring payments of the variable bonus to office holders and the conditions for releasing deferred bonuses, which will apply also to bonuses deferred before the entry into effect of the new remuneration policy.

For further information on the new remuneration policy, see the report on the convening the Special General Meeting of the Bank, published on 21 October 2016 (Reference: 2016-01-066408).

For information on the updating of the terms of employment of the Chairman of the Board of Directors and the President and CEO, see Sections C.3 and 4 above in this Note.

I. Allocation of PSU's to office holders in the Bank

In respect of the year 2016, part of the variable annual bonus will be paid in cash, and part will be granted by means of performance-contingent blocked PSU's to the Chairman of the Board of Directors, the President and Chief Executive Officer, and the other office holders in the Bank.

For details regarding the allocation of performance-contingent blocked PSU's, see Note 24A.

Note 23 – Employee Rights (cont'd)

J. Update of terms of employment of key employees

On 31 March 2015, the Board of Directors of the Bank, after approval of the Remuneration Committee, approved an update in the terms of employment of key employees (as defined in Directive 301A of the Supervisor of Banks, and in the Remuneration Policy of the Bank by virtue of the said Directive 301A) and of office holders in the Bank, including the President and Chief Executive Officer, as follows:

1. Cancellation in full of the entitlement of office holders and key employees, including the President and Chief Executive Officer, to jubilee (long-service) bonuses and jubilee vacations (benefits to which office holders in the Bank are entitled according to the provisions of the employment agreements between them and the Bank), with effect from 31 December 2014, as follows:

   The accumulated rights for each office holder and key employee in respect of jubilee (long-service) bonuses and jubilee vacations, during the period of their employment in the Bank until the date of cancellation of the entitlement, namely until 31 December 2014, were reduced, without any compensation and/or consideration, by about 45% (in a similar manner to the reduction carried out in the collective agreement for all employees of the Bank). The balance of the said accumulated rights for the office holder or key employee, as applicable, was cancelled against payment of one-time compensation, in an amount equal to the balance of the accounting provision remaining in the books of the Bank at 31 December 2014, after the reduction, in respect of that office holder or key employee, as applicable. Subject to the aforesaid, the entitlement of office holders and key employees to jubilee (long-service) bonuses and jubilee vacations was cancelled in full and the employment agreement of office holders and key employees will be amended accordingly. Accordingly, after cancelation of the said entitlements, the Bank discontinued recording a current expense in respect of accumulating rights to jubilee bonuses and vacations for office holders and key employees.

   The decision to cancel jubilee (long-service) bonuses and jubilee vacations for office holders and key employees in the Bank, as stated above, was made in consideration of the provisions of Proper Conduct of Banking Business Directive No. 301A on Remuneration Policy in a Banking Corporation. This does not allow granting a variable bonus independent of performance and that is only conditional on employment (for office holders in the Bank). Pursuant to the transitional provisions of the said directive, it was possible to amend employment agreements with office holders and key employees in this matter as required in Directive 301A until the end of 2016. However, because of the arrangement with the other employees of the Bank in the framework of the collective agreement signed recently in the Bank, in which the employees to which the collective agreement applies waived their entitlement to jubilee (long-service) bonuses and jubilee vacations, it was decided to cancel, already at this stage, the entitlement of office holders in the Bank to jubilee (long-service) bonuses and jubilee vacations. In this connection it should be noted that the payment of reduced compensation to office holders and key employees against cancellation of their entitlement to jubilee (long-service) bonuses and jubilee vacations, as explained above, did not create an accounting expense for the bank, since a salary expense was recorded over the years for office holders and key employees in the Bank for jubilee (long-service) bonuses and jubilee vacations, and, as described above, the compensation mechanism granted office holders and key employees a payment that represents about half the accounting reserve recorded in the books of the Bank. Furthermore, in light of the cancellation of the entitlement to jubilee (long-service) bonuses and jubilee vacations for office holders and key employees, the Bank discontinued recording a current expense in respect of the accumulation of the said rights. Pursuant to the cancelation of the entitlement to jubilee bonuses and jubilee vacations, the cancelation of an expense amounting to NIS 16 million was recorded in the Bank's books in 2015, and an annual current expense of NIS 3 million, in respect of office-holders and key employees, was saved.

2. The increase in salary of certain office holders in the Bank that are not directors is in effect as of 1 January 2015. Included in this, it was approved that the salary of the President and Chief Executive Officer of the Bank will be increased at the annual rate of 4% of the total cost of the terms of employment of the President and Chief Executive Officer in the Bank. The salary of the President and Chief Executive Officer of the Bank, after the said update, will be NIS 195,400. The said update of the terms of employment was made in accordance with the Bank's Remuneration Policy and after the Remuneration Committee and the Board of Directors reviewed the normal cost of employment of holders of equivalent positions in comparable companies, and after they have examined the contribution of the said office holders and of the President and Chief Executive Officer to the activity of the Bank.

3. Similar to normal practice in the Bank for all the employees, by virtue of the collective agreements, the increase in the rate of the Bank's contributions to provident funds (the employer's contribution) for key employees and office holders of the Bank, including the long-serving office holders in the Bank who previously waived their entitlement to be included in 1st generation terms and transferred to second generation terms, including for the President and Chief Executive Officer of the Bank, will be so that the rate of contributions by the Bank to provident funds (the employer's contribution) is 7.5% of the employee's salary for contributions (instead of 5%). The said increase in the rate of contributions to provident funds is only in respect of the part of the salary of the office holders that is not paid under first generation terms (if relevant). In other words, the increment will be added to the external fund without rights to a defined-benefit pension from the Bank, and only the part of salary not included in first generation terms.

The Remuneration Committee and the Board of Directors of the Bank approved that the abovementioned update to the terms of employment constitutes an insignificant update in relation to the existing terms of office and employment of office holders in the Bank, including the President and Chief Executive Officer, as stated in Section 272(D) of the Companies Law, and that updating the said terms of employment is in the interest of the Bank, taking into consideration the contribution of the office holders and the importance of their remuneration in a manner giving them motivation to continue in their position over time. The Remuneration Committee and the Board of Directors were also of the opinion that the updates determined in the updated terms of engagement with office holders in the Bank, as set forth above, would encourage these office holders to continue investing their best efforts in the interest of the Bank, taking into account the challenges facing Bank Management in the short and the long term, and considering the work load placed upon them as part of coping on an ongoing basis with these challenges.

On 25 December, 2016, the Board of Directors, after receiving the approval and recommendation of the Remuneration Committee of the Board of Directors, approved a remuneration policy applying to "key employees" in the Bank who are not office-holders, pursuant to the provisions of and as required by Proper Conduct of Banking Business Management Regulation No. 301A of the Supervisor of Banks.

The aforesaid remuneration policy for "key employees" provides the framework for the remuneration of key employees, and includes, *inter alia*, consideration of the salary component, the related conditions, the terms of retirement and the annual bonus component. This policy was devised paying attention to the principles of the remuneration policy for office-holders in the Bank, mutatis mutandis.

Note 23 – Employee Rights (cont'd)

K. Remuneration policy for all employees

In December 2014, the Board of Directors, after receiving the approval of the Remuneration Committee, approved the remuneration policy for all the employees of the bank not covered by the remuneration policy for key employees.

The remuneration policy for all the employees of the Bank is based on the provisions of Proper Conduct of Banking Business Management Directive No. 301A of the Supervisor of Banks

The remuneration policy for all the employees of the Bank is intended to serve as a tool for promoting the meeting of the Bank's business targets, including facilitating the recruitment of quality employees to work in the Bank, to retain them in the long-term and motivate them to improve performance and achieve the business objectives and targets of the Bank, while preventing the taking of risks deviating from the risk appetite of the bank.

The remuneration policy refers to the current remuneration for employees, including salaries and salary-related benefits and bonuses, conditions of retirement and other payments to which the employees are entitled.

L. Signing of the collective agreement regarding conversion of share rights

On 17 February 2016, a special collective agreement was signed by the representatives of the Bank's employees and the Bank, for the conversion of rights that accrued in favor of the Bank's employees, into shares of the Bank to be issued to employees for the same amount as the rights, based on the amount in which those rights are recorded in the books of the Bank, and as described below.

The issuance of the shares was made at the market price of the shares on the date set out in the outline plan published for purposes of carrying out the issuance. The issuance of the shares was carried out in exchange for a waiver by the employees on the rights that were converted that are recorded in the books of the Bank, for an amount of the value of the shares issued. The shares issued were blocked for two years.

The rights that were converted into shares:

1. Annual bonus for the year 2015, insofar as it will be approved. This conversion applied to all the employees, including office holders in subsidiary companies of the Bank, who are employees of the subsidiaries.

2. Voluntary conversion of up to 25% of pension rights ("social security arrangement") that accumulated in favor of the employees entitled to the same, to shares of the Bank, in exchange for a waiver of rights to that amount, as the rights were recorded in favor of the employee in the books of the Bank, as at 31 December 2015, except for utilizing a discount rate of 3.5%, instead of a discount rate of about 2.68%, which was utilized pursuant to the directives of the Bank of Israel. Every employee under a "first generation" arrangement, who was entitled to a "non-contributory pension", was entitled to choose the percentage of the rights to be converted into the shares of the Bank. Employees whose salary for purposes of social contributions did not exceed NIS 10,000 for the month of December 2015, were not be entitled to convert the aforementioned rights. The decrease in liabilities was recorded in other comprehensive income.

Note 23 – Employee Rights (cont'd)

3. The conversion of the eligibility recorded in the books of the Bank to "Jubilee" bonuses and "Jubilee" vacations that accrued in favor of the employees to "Jubilee" bonuses, whose date of payment was from 1 January 2017. This conversion was carried out for all the employees eligible for "Jubilee" bonuses, as the rights in favor of the employee appear in the Bank's books, as at 31 December 2015, except for employees who were eligible for "Jubilee" bonuses in 2016. The decrease in liabilities was recorded in profit and loss.

The Bank applied the conversion of the relevant rights also to managers and office holders employed by the Bank under personal contracts.

On 18 February 2016, the Bank published an outline plan for the issuance of shares to the employees, for carrying out that stated in the special collective agreement. Pursuant to the outline plan, employees could convert rights as set out in Section 1.2 above from 8 March 2016 and at the end of the response period determined, the issuance of shares took place.

The results of the offer to employees and office holders pursuant to the outline published in an Immediate Report on 20 March 2016, according to which:

1. The total amount of the rights of employees and office holders that were converted into shares of the Bank in accordance with the outline amounts to NIS 636 million, divided as follows: (a) in respect of employee rights to receive "Jubilee" bonuses - about NIS 259 million; (b) in respect of employee and office holders' rights to receive bonuses for 2015 - about NIS 292 million; and (c) in respect of rights to social security arrangement - about NIS 85 million.

2. The value of the Bank's shares for purposes of conversion of rights is NIS 13.0 (the closing price of the Bank's shares on 6 March, 2016). Accordingly, the Board of Directors approved the issuance of 48,938,037 shares, representing approximately 3.21% of the issued and paid-up capital of the Bank (after the allocation). In accordance with the provisions of the outline, the shares will be allotted to a trustee, to hold the shares in trust for the employees, in accordance with Section 102 of the Income Tax Ordinance.

3. The total number of shares issued pursuant to the outline set forth above includes 1,955,016 shares issued to office holders of the Bank.

M. Streamlining

On 12 January 2016, the Banking Supervision Department published a letter on "Operational Streamlining of the Banking System in Israel" (henceforth: "the Streamlining Directive"). Pursuant to the letter, the Board of Directors of a banking corporation will make a multi-year streamlining outline plan. A banking corporation meeting the conditions defined in the letter will receive relief under which it can spread the effect of the costs of the plan over five years on a straight-line basis for purposes of calculating capital adequacy.

On 1 June, 2016, the Board of Directors of the Bank approved the streamlining plan, after receiving approval in principle from the Banking Supervision Department in accordance with the requirements in the Streamlining Directive.

Note 23 – Employee Rights (cont'd)

The main points of the streamlining plan and related changes (henceforth: "the streamlining plans"):

- Implementation of the plan will be accompanied by making operational and organizational changes;
- In accordance with the plan, some 700 employees will be allowed to resign from the Bank by taking early retirement and to receive early retirement benefits from the Bank;
- The benefits offered were: (a) increased severance pay of up to 270%; or (b) an early pension arrangement until retirement age under the law, to those entitled to a non-contributory pension from the Bank that meet the parameters defined in the plan.
  Additional non-material benefits were granted as part of the retirement terms
- The early retirement will be carried out, as far as possible, by the end of 2016.

For purposes of implementation of the efficiency plan, and the need for engagement of the employees and the employees' organization in the realization of the plans, Management of the Bank reached an agreement with the employees' organization for a one-time bonus payment (henceforth: "the signing-on bonus"). This bonus was paid in June 2016 to employees unionized in collective agreements only. The total cost of the signing-on bonus is approximately NIS 155 million.

Below are the main points of the accounting treatment, as included in the financial statements for the second quarter of 2016:

- The costs of the actuarial liability to employees in respect of the streamlining plan amounting to approximately NIS 529 million, before tax (NIS 339 million after tax) were treated as an actuarial loss and charged to other comprehensive income (and later these costs will be amortized to profit and loss, see Note 1L).
- The costs of the signing-on bonus amounting to NIS 155 million, before tax (NIS 99 million after tax) were charged to profit or loss.
- Pursuant to the accounting principles applicable to the Bank various conditions and restrictions, including quantitative, were applied regarding the total of the streamlining plans. In view of this, the Board of Directors decided that no changes are made or extensions will be made to the plan, if these will mean that it will not be possible to account for the plan as set out above.

Pursuant to the Bank of Israel directives, the Bank shall enjoy relief in calculating the capital adequacy ratios in respect of the cost of the streamlining plan amounting to approximately NIS 438 million (after tax). Accordingly, the effect of the streamlining cost will be spread over five years, starting from June 2017.

As of the date of publication of the statements, 695 employees signed up to retirement arrangements as part of the streamlining plan and terminated their employment by 30 December 2016. In addition, over the next five years some 633 more employees are expected to retire within the framework of natural retirement. The Bank is making preparations for the retirement and investing efforts in adapting the organizational structures, filling gaps in critical professions, conducting training, and retention of knowledge by means of methodology and a plan formulated on the matter.

Note 23 – Employee Rights (cont'd)

L. Composition of benefits

1. Employee benefits

	As at 31 December		
	2016	2015	2014
	Audited		
	NIS millions		
Post-retirement benefits - pension and severance pay			
Amount of liability	**16,948**	15,764	16,256
Fair value of plan assets	**6,819**	6,766	7,041
Excess liabilities over plan assets (included under other liabilities)	**10,129**	8,998	9,215
Long-service (Jubilee) bonus			
Amount of liability (a)	**82**	524	942
Fair value of plan assets	**-**	-	-
Excess liabilities over plan assets (included under other liabilities)	**82**	524	942
Other benefits			
Amount of liability	**559**	549	499
Fair value of plan assets	**-**	-	-
Excess liabilities over plan assets (included under other liabilities)	**559**	549	499
Total[1]			
Excess liabilities in respect of employee rights over plan assets (included under "Other liabilities")	**10,770**	10,071	10,656
[1]Of which: in respect of employee benefits overseas	**117**	111	222

(a) For the year 2016, accumulated Jubilee vacation.

2. Defined benefit pension plan

A. Commitment and state of funding

a. Change in commitment in respect of forecast benefit

	As at 31 December		
	2016	2015	2014
	Audited		
	NIS millions		
Commitment in respect of forecast benefit at the beginning of the period	**15,764**	16,256	14,367
Service cost	**163**	198	223
Interest cost	**687**	735	838
Deposits of plan participants	**48**	46	49
Actuarial loss (profit)	**1,174**	(701)	1,410
Changes in foreign currency exchange rates	**(38)**	(9)	43
Benefits paid (a)	**(865)**	(739) (b)	(722)
Amendments in the program including structural change	-	(22) (b)	48
Other	**15**	-	-
Commitment in respect of forecast benefit at the end of the year	**16,948**	15,764	16,256
Commitment in respect of accumulated benefit at the end of the year	**16,011**	15,074	15,374

(a) Including non-material amounts in respect of downsizing, disposals, special and contractual benefits in respect of dismissals.
(b) Reclassified.

Note 23 – Employee Rights (cont'd)

2. Defined benefit pension plan (cont'd)

A. Commitment and state of funding (cont'd)

2. Change in fair value of plan assets and state of funding of the plan

	As at 31 December		
	2016	2015	2014
	Audited		
	NIS millions		
Fair value of plan assets at the beginning of the period	**6,766**	7,041	7,119
Actual return on plan assets:	**257**	53	388
Deposits in the plan by the banking corporation	**158**	169	157
Deposits by plan participants	**48**	46	49
Changes in foreign currency exchange rates	**(37)**	(10)	37
Benefits paid	**(449)**	(510)	(708)
Amendments in the program	**-**	(22)	-
Other	**76**	(1)	(1)
Fair value of plan assets at the end of the year	**6,819**	6,766	7,041
State of funding - net liability recognized at the end of the year	**10,129**	8,998	9,215

(a) Including non-material amounts in respect of downsizing, disposals, special and contractual benefits in respect of dismissals.

3. Amounts recognized in the consolidated balance sheet

	As at 31 December		
	2016	2015	2014
	Audited		
	NIS millions		
Amounts recognized under other assets	**-**	-	-
Amounts recognized under other liabilities	**10,129**	8,998	9,215
Liability net recognized at the end of the period	**10,129**	8,998	9,215

3. Amounts recognized in the consolidated balance sheet

	As at 31 December		
	2016	2015	2014
	Audited		
	NIS millions		
Amounts recognized under other assets	-	-	-
Amounts recognized under other liabilities	**10,129**	8,998	9,215
Liability net recognized at the end of the period	**10,129**	8,998	9,215

4. Amounts recognized in accumulated other comprehensive income (loss) before the effect of tax

	2016	2015	2014
	Audited		
	NIS millions		
Net actuarial loss	**3,241**	2,329	1,958
Net liability in respect of transition	**-**	-	974
Closing balance in accumulated other income	**3,241**	2,329	2,932

Note 23 – Employee Rights (cont'd)

B. Expense for the period

1. Benefit cost components included in profit and loss

	For the year ended 31 December		
	2016	2015	2014
	Audited		
	NIS millions		
Service cost	**163**	198	223
Interest cost	**687**	735	838
Forecast return on plan assets	**(373)**	(392)	(380)
Amortization of amounts not recognized - net actuarial loss	**310**	206	53
Reductions, disposals, special contractual benefits in respect of dismissal	**-**	9	-
Other	**-**	30	48
Total cost of benefit, net	**787**	786	782

2. Changes in plan assets and commitment for benefit recognized in other comprehensive income (loss) before the effect of tax

	For the year ended 31 December		
	2016	2015	2014
	Audited		
	NIS millions		
Net actuarial loss (profit) for the year	**1,290**	(362)	1,402
Amortization of amounts not recognized - net actuarial profit	**(310)**	(206)	(53)
Changes in foreign currency exchange rates	**(4)**	(5) (a)	2
Other	**(64)**	(30) (a)	-
Total recognized in other comprehensive income	**912**	(603)	1,351
Net cost of benefit	**787**	786	782
Total recognized in cost of benefit, net, for the year and in other comprehensive income	**1,699**	183	2,133

(a) Reclassified.

3. Estimate of amounts included in accumulated other comprehensive income that are expected to be deducted from accumulated other comprehensive income to appear as an expense in the statement of profit and loss in 2017 before the effect of tax

	For the year ended 31 December 2017
	Audited
	NIS million
Net actuarial loss	**(291)**
Total expected to be amortized from accumulated other comprehensive income	**(291)**

Note 23 – Employee Rights (cont'd)

3. Assumptions[a]

A. Assumptions based on a weighted average used for determining the commitment in respect of a benefit and for measuring the cost of the benefit net for the periods ended 31 December

1. Basic assumptions used for determining the commitment in respect of the benefit

	2016	2015	2014
	Audited		
	%		
Discount rate	**2.49%**	2.68%	2.63%
CPI discount rate	**1.90%**	1.78%	2.20%
Employee turnover rate	**0.1%-3.7%**	0.1%-3.7%	0.1% - 2%
Rate of growth of remuneration	**0%-6.3%**	0%-6.3%	0.8% - 7.2%

2. Basic assumptions used for measuring the cost of the benefit net for the period

	2016	2015	2014
	Audited		
	%		
Discount rate	**2.48%**	2.91%	3.26%
Long term forecast return on plan assets	**5.50%**	5.50%	5.32%
Rate of growth in remuneration	**0% - 6.3%**	0%-6.3%	0.8% - 7.2%

(a) The assumptions relate to data of the Bank only.
(b) For practical reasons the Bank elected to use the actual rates of return for the purpose of determining the expected long-term forecast return during these periods. See also Note 1L.

B. Effect of a change of one percentage point on the commitment in respect of a forecast benefit before effect of tax[a]

	Increase of one percentage point			Decrease of one percentage point		
	As at 31 December			As at 31 December		
	2016	2015	2014	**2016**	2015	2014
	Audited					
	NIS millions					
Discount rate	**(2,191)**	(2,059)	(2,081)	**2,745**	2,577	2,630
CPI discount rate	**(130)**	(206)	(242)	**131**	210	247
Employee turnover rate	**222**	237	277	**(241)**	(256)	(238)
Rate of growth in remuneration	**663**	661	745	**(581)**	(585)	(662)

(a) The assumptions relate to data of the Bank only.

Note 23 – Employee Rights (cont'd)

The level of the liability for employee rights is affected by several key variables that include market variables (rates of interest for discounting the liability over various periods) and actuarial variables as mentioned, with some of the actuarial variables being behavioral variables of employees. It is possible that there will be a link between changes in market variables and changes in actuarial behavioral variables. For example, it is possible that if there is a sharp increase in interest rates in the Israeli economy, and in its wake government bond yields will also rise (which will decrease the level of pension liabilities), the percentage of employees electing for a pension track will also decrease (a decision which will also reduce the level of the Bank's liability for pensions).

4. Plan assets

A. Composition of the fair value of plan assets

	As at 31 December			
	2016			
	Level 1	**Level 2**	**Level 3**	**Total**
	NIS millions			
Cash and deposits in banks	**278**	**1**	**-**	**279**
Shares	**2,242**	**126**	**33**	**2,401**
Government bonds	**1,520**	**110**	**-**	**1,630**
Corporate bonds	**1,840**	**100**	**-**	**1,940**
Other	**141**	**167**	**261**	**569**
Total	**6,021**	**504**	**294**	**6,819**

	As at 31 December			
	2015			
	Level 1	Level 2	Level 3	Total
	NIS millions			
Cash and deposits in banks	144	9	30	183
Shares	2,223	97	43	2,363
Government bonds	1,694	201	-	1,895
Corporate bonds	1,723	115	-	1,838
Other	192	142	153	487
Total	5,976	564	226	6,766

B. The fair value of plan assets by type of assets and target for allocation in 2017

	Allocation target	Percentage of plan assets	
		As at 31 December	
	2016	2015	2014
	Percentage		
Cash and deposits in banks	**2%**	4%	3%
Shares	**38%**	36%	35%
Government bonds	**19%**	24%	28%
Corporate bonds	**31%**	28%	27%
Other	**10%**	8%	7%
Total	**100%**	100%	100%

Note 23 – Employee Rights (cont'd)

4. Plan assets (cont'd)

C. Change in the fair value of plan assets whose value is measured on the basis of the use of significant unobserved data (Level 3)

	For the year ended 31 December 2016					
		Actual yield on plan assets				
	Opening balance	Gains/(losses) realized	Gains/(losses) not realized	Purchases/ sales and extinguishments, net	Transfer to/from Level 3	Closing balance
	NIS millions					
Cash and deposits in banks	**30**	**-**	**-**	**(30)**	**-**	**-**
Shares	**43**	**2**	**(4)**	**(8)**	**-**	**33**
Other	**153**	**5**	**4**	**99**	**-**	**261**
Total	**226**	**7**	**-**	**61**	**-**	**294**

	For the year ended 31 December 2015					
		Actual yield on plan assets				
	Opening balance	Gains/(losses) realized	Gains/(losses) not realized	Purchases/ sales and extinguishments, net	Transfer to/from Level 3	Closing balance
	NIS millions					
Cash and deposits in banks	22	-	-	8	-	30
Shares	12	-	-	31	-	43
Other	167	10	(3)	(21)	-	153
Total	201	10	(3)	18	-	226

Note 23 – Employee Rights (cont'd)

5. Cash flows

A. Deposits

	Forecast	Actual deposits		
		For the year ended 31 December		
	2016	2015	2014	2013
	Unaudited			
	NIS millions			
Deposits	**195**	206	215	206

(a) Estimate of deposits that the Bank expects to pay into a defined benefit pension plan during the remainder of 2017.

2. Benefits that the Bank expects to pay in the future

Year	NIS millions
2017	604
2018	593
2019	628
2020	659
2021	675
2022-2026	4,080
2027 and thereafter	10,938
Total (a)	18,177

(a) In discounted values.

Note 24 - Share-based payment transactions

A. General

Pursuant to the Remuneration Policy approved on 11 February, 2014 by the General Assembly of the Bank, the Bank grants half pf the annual variable bonus for office holders of the Bank which will be paid in blocked Performance Share Units (or PSU).

For details, see Note 25A.B.1.

In addition, the Bank granted Restricted Share Units (or RSU) to two office holders of the Bank.
RSU units are restricted share units which, if appropriate vesting terms are met, are converted automatically to ordinary shares of the Bank, as Treasury Stock, without payment of any exercise price.
RSU units are allocated pursuant to the capital gains track under Section 102(B)(2) of the Income Tax Ordinance (New Version), 1961.

For details, see Note 25A.B.1.

B. Details of Share-Based Payment Transactions settled with Capital Instruments

	Number of units at 31 December, 2016									
	Senior managers		Members of Management		President & CEO		Chairman		Managers who retired	
	Blocked	Contingent	Blocked	Contingent	Blocked	Contingent	Blocked	Contingent	Blocked	Contingent
Opening balance at 31 December 2015	**-**	**16,139**	**54,276**	**234,619**	**-**	**56,912**	**-**	**47,488**	**-**	**65,603**
Granted during the year	**-**	**73,476**	**-**	**630,585**	**-**	**130,717**	**-**	**103,879**	**-**	**-**
Vested during the year	**-**	**(8,069)**	**(27,138)**	**(117,311)**	**-**	**(28,456)**	**-**	**(23,744)**	**-**	**(32,801)**
Managers who retired	**-**	**-**	**(8,384)**	**(163,980)**	**-**	**-**	**-**	**-**	**8,384**	**163,980**
Redeemed during the year	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Closing balance at 31 December 2016	**-**	**81,546**	**18,754**	**583,913**	**-**	**159,173**	**-**	**127,623**	**8,384**	**196,782**

	Number of units at 31 December, 2015									
	Senior managers		Members of Management		President & CEO		Chairman		Managers who retired	
	Blocked	Contingent	Blocked	Contingent	Blocked	Contingent	Blocked	Contingent	Blocked	Contingent
Opening balance at 31 December 2014	-	24,208	81,414	378,658	-	85,367	-	71,232	-	98,404
Granted during the year	-	-	-	-	-	-	-	-	-	-
Vested during the year	-	(8,069)	(27,138)	(126,220)	-	(28,455)	-	(23,744)	-	(32,801)
Managers who retired	-	-	-	-	-	-	-	-	-	-
Redeemed during the year	-	-	-	(17,819)	-	-	-	-	-	-
Closing balance at 31 December 2015	-	16,139	54,276	234,619	-	56,912	-	47,488	-	65,603

Note 25A – Capital

A. Share capital

	31 December 2016		31 December 2015	
	Authorized	Issued and paid (a)	Authorized	Issued and paid (a)
	NIS		NIS	
Ordinary shares of NIS 1.0 each	**3,215,000,000**	**1,522,973,205**	3,215,000,000	1,473,797,649

(a) All shares issued are registered in the names of the shareholders. Shares that have been or will be issued have been or will be converted into ordinary stock which is transferable in units of NIS 1.0.
The related rights to the shares of the Bank are set out in the Bank's Articles of Association.

The ordinary stock is listed on the Tel-Aviv Stock Exchange.

NIS 400,000,000 par value deferred index-linked deposits/capital notes (unquoted), issued in June and July 2002, and repayable in June and July 2101, and that were recognized by the Bank of Israel as Upper Tier 2 capital of the Bank, are convertible, in certain circumstances defined by the Supervisor of Banks, according to a conversion formula as set out in the terms of the deposit / deferred capital note, to 151,121,833 ordinary shares of the Bank, as of the date of the report. On 26 January 2017, the Board of Directors of the Bank resolved to redeem the above deposits / deferred capital notes by way of early redemption in full during June-July 2017.

NIS 925,750,000 par value subordinated notes (Series 400) were issued by the Bank on 21 January 2016, and are convertible in certain circumstances to 147,492,625 ordinary shares of the Bank. For further details, see Section C (3) below.

For details of the allotment of 48,938,037 shares of NIS 1 par value to Bank employees against the conversion of accumulated rights of the employees, see paragraph D. below.

B. Share-based Remuneration Plan

1. On 11 February 2014, the General Meeting of the Bank, approved the remuneration policy for office holders in the Bank for the years 2013-2016 (henceforth: **"the previous remuneration policy"**), after obtaining the approval of the Board of Directors pursuant to the approval and recommendation of the Remuneration Committee. The Remuneration Policy is based on Amendment 20 of the Companies Law regarding terms of office and employment of office holders in the Bank and on that stipulated in the new Proper Conduct of Banking Business Directive 301A concerning remuneration policy in a banking corporation. Pursuant to the previous remuneration policy, half of the variable annual bonus to office holders in the Bank will be paid in blocked Performance Share Units (or PSU).

   Pursuant to that stated in the previous remuneration policy, the percentage of the total cumulative amount of PSU units to be allocated to all the senior officers (the Chairman of the Board of Directors, the President and CEO, and members of Bank Management) in respect of all the years of the bonus plan (2013 to 2016) will not exceed 0.38% pf the issued and paid-up capital of the Bank (see Note 23F).

   As part of the approval of the performance-contingent annual bonus for office holders in the Bank for 2013 and pursuant to the above remuneration policy, the Remuneration Committee and the Board of Directors of the Bank in March 2014 approved the allocation without payment of 657,869 Performance Share Units (henceforth: **"2014 PSU units"**), to the Chairman of the Board of Directors, the President and Chief Executive Officer, and other office holders in the Bank, in an equity track with a Trustee under Section 102 of the Income Tax Ordinance. Accordingly, the Bank issued on 13 April 2014 the above PSU units in the name of the Trustee, ESOP Management and Trust Services Ltd. (henceforth **"the Trustee"**). If the condition is met for exercising 2014 PSU units at each of the vesting dates, as detailed henceforth the 2014 PSU units will vest and converted automatically into 657,869 ordinary shares of NIS 1 par value each of the bank, which represented 0.04% of the issued and paid capital of the Bank at the date of issue of the 2014 PSU units. According to the 2014 Private Offering Report published by the Bank on 31 March 2014, the aggregate fair value of all the said 2014 PSU units amounted to about NIS 8.97 million.

As part of the approval of the performance-contingent annual bonus for office holders in the Bank for 2015 and pursuant to the previous remuneration policy, the Bank issued on 15 March 2016 938,657 new PSU units (henceforth: **"2016 PSU units"**), in the name of the Trustee to the Chairman of the Board of Directors, the President and Chief Executive Officer, and other office holders in the Bank, in an equity track with a Trustee under Section 102 of the Income Tax Ordinance. If the condition is met for exercising 2016 PSU units at each of the vesting dates, as detailed henceforth the 2016 PSU units will vest and automatically converted into 938,657 ordinary shares of NIS 1 par value each of the Bank, which represented about 0.064% of the issued and paid capital of the Bank at the date of issue of the 2016 PSU units. According to the 2016 Private Offering Report, published by the Bank on 29 February 2016 including clarifications published in respect to it on 13 March 2016, the aggregate fair value of all the said 2016 PSU units amounted to about NIS 12.3 million.

The vesting of 2014 PSU units and 2016 PSU units in each of the vesting dates will be contingent on the Bank meeting the capital adequacy ratio required by the Supervisor of Banks in accordance with the latest financial statements published close to each of the vesting dates. If the Bank did not meet the aforesaid ratio, the vesting of the relevant share will be postponed to the next date in which the Bank will meet the required capital adequacy ratio, as previously mentioned, in accordance with the financial statement that will be published.

The 2014 PSU units and 2016 PSU units allocated as above are not quoted, and pursuant to the approval of the Tel-Aviv Stock Exchange Ltd. (henceforth **"the Stock Exchange"**), the shares deriving from the vesting of the above units will be listed for trading on the Stock Exchange in the name of the nominee company of Bank Leumi Le-Israel B.M.

The vesting of the 2014 PSU units and 2016 PSU units will be in three equal tranches and is contingent on the business results of the Bank in each of the three calendar years 2014, 2015 and 2016 in respect of 2014 PSU units, and in each of the three calendar years 2016, 2017 and 2018 in respect of 2016 PSU units, whereby subject to the fulfillment of all the terms in relation to the vesting date, each PSU unit will be converted automatically to 1 ordinary share of NIS 1 par value each of the Bank, on reaching each vesting date.

Shortly after approval of the 2016 financial statements, the Board of Directors is expected to approve, after receiving the approval of the Remuneration Committee, the issue of PSU units to office holders in the Bank, pursuant to the remuneration policy in respect of the first three quarters of 2016. The remuneration policy ends with the coming into force of the new remuneration policy approved in the General Meeting of the Bank on 3 November 2016 (henceforth: **"the new remuneration policy"**). In respect of the last quarter of 2016, the eligibility of office holders in the Bank to a variable bonus is in accordance with that prescribed in the new remuneration policy. For details on the new remuneration policy, see Note 23.

2. In March 2014, the Remuneration Committee and the Board of Directors of the Bank approved the allocation without payment of 81,414 Restricted Share Units (henceforth: **"RSU units"**) for two office holders in the Bank, in an equity track with the Trustee under Section 102 of the Income Tax Ordinance, pursuant to the provisions of the Remuneration Policy regarding the granting of signing rights to a new office holder, and as set forth in the 2014 Private Offering Report. Accordingly, the Bank issued on 13 April 2014 the above RSU units in the name of the Trustee.

The vesting of the RSU units will be in three equal tranches and is contingent on the continued employment of each of the office holders who are offerees in the Bank or in the banking group, at the vesting date of each of the tranches, pursuant and subject to that stated and the terms set forth in the 2014 Private Offering Report.

C. Changes in the Bank's equity

1. The third vesting date of the 2014 PSU units is expected to be after the date of publication of the financial reports. In addition, the first vesting date of the 2016 PSU units is expected to be after the date of publication of the financial statements.

2. The third vesting date of the RSU units is expected to be after the date of publication of the financial statements.

3. Pursuant to the Shelf Prospectus dated 20 January 2016, the Bank issued NIS 926 million COCO-type subordinated notes (Leumi Subordinated Series 400) on 21 January 2016.

   The subordinated notes are redeemable in one payment on 21 January 2026 with an option for the issuer of early redemption not before 21 January 2021, and not later than 21 February 2021, are not linked to any linkage base, bear fixed annual interest of 3.25%, until the earlier redemption date. At that date, if the Bank's right to early redemption is not exercised, the interest rate on the note will be updated according to the difference between the base ("Ogen") interest (as defined in the Shelf Offering Report on the date of issue and that on the interest rollover date.

   If circumstances are met for a defining event (a defining event for non-sustainability or a defining event for absorption of losses of principal, whichever the earlier), the subordinated notes will be converted into shares at the market value of the shares at the date of conversion or according to the floor price determined (NIS 6.78 per share), whichever the higher.

   This subordinate notes are eligible to be included in the Tier 2 Capital as of the issuance date.

D. Outline of share issue to employees

On 17 February 2016, a special collective agreement was signed by the representatives of the Bank's employees and the Bank, under which the rights set out below that accrued in favor of the Bank's employees, will be converted into shares of the Bank to be issued to employees for the same amount as the rights, based on the amount in which those rights are recorded in the books of the Bank.

Entering into an undertaking in the special collective agreement was made after receiving the approval of the Remuneration Committee and the Board of Directors of the Bank. The special collective agreement requires the signature of the New Histadrut Labor Organization.

For additional information, see Note 23.L.

E. Dividend

The Bank did not distribute dividends in respect of the years 2011-2016.

On 29 March, 2017, the Board of Directors of the Bank approved a dividend distribution policy, with effect from the date of publication of the financial statements for the first quarter of 2017. Pursuant to the dividend policy, each quarter, the Bank will distribute 20% of the net profit of the Bank according to the Bank's financial statements, for the previous quarter, and subject to, among other things, the Bank being in compliance with its capital adequacy targets, even after the dividend distribution. The actual dividend distribution is subject to the specific resolutions of the Board of Directors prior to each distribution, and subject to the provisions of the law which apply to the distribution of dividends, including the provisions of the Company Law, and directives of the Bank of Israel.

Restrictions on the distribution of dividends

In addition to restrictions under the Companies Law, an amendment was issued on 15 January, 2013 to the Proper Conduct of Banking Business Directive No. 331 concerning dividend distribution by banking corporations. In light of requirements added in recent years to the Public Reporting Directives making it mandatory to record certain profits and losses of the Bank in other comprehensive income and not in profit and loss, the tests for distributing a dividend were updated. Pursuant to the update, "distributable profits" include elements of other comprehensive income, and the Bank shall not carry out a dividend distribution (unless it received prior approval from the Supervisor), inter alia:

- When the cumulative balance of retained earnings, net of negative differences included in cumulative other comprehensive income is not positive, or if the amount of the proposed distribution would cause such a balance of retained earnings;
- When one or more of the last three calendar years ended in a loss or in a comprehensive loss;
- When the cumulative result of the three quarters ended at the end of the interim period for which the last financial statement has been published indicates a loss or a comprehensive loss.

It was further established that the Bank shall not perform distributions from capital reserves or from positive differences included in the statement of cumulative other comprehensive income.

The amendment came into effect as of 1 January 2013.

Furthermore, in the letter of the Supervisor of Banks on the subject of capital policy for interim periods, it was determined that a banking corporation shall not distribute a dividend if it does not have a core capital ratio of at least 7.5%, or if such distribution would cause a failure to comply with the aforesaid ratio. In the letter of the Banking Supervision Department, concerning minimum core capital ratios under Basel III, the banks were required, inter alia, to refrain from distributing a dividend if as a result it may not meet the capital targets required in it.

Notwithstanding the above, in certain cases the Bank can distribute dividends even if the aforesaid circumstances apply, if it obtains prior written approval of the Supervisor of Banks for such distribution, up to the amount thus approved.

Note 25B – Capital Adequacy, Leverage and Liquidity

General

In May 2013, the Supervisor of Banks amended Proper Conduct of Banking Business Directives No. 201-211 on *Measurement and Capital Adequacy*, so as to adapt them to the Basel III directives.

It should be emphasized that the Basel III directives set forth significant changes in the calculation of regulatory capital requirements, *inter alia*, relating to:

- Regulatory capital components
- Deductions from capital and regulatory adjustments
- Treatment of exposures to financial corporations
- Treatment of exposures to credit risk in respect of impaired debts
- Allocation of capital in respect of CVA risk.

The amendments to the above directives came into effect on 1 January 2014, and implementation is gradual pursuant to the transitional provisions set forth in Proper Conduct of Banking Business Directive No. 299 on *Measurement and Capital Adequacy – Regulatory Capital – Transitional Provisions*.

In addition, on 29 August 2013, a circular of the Banking Supervision Department was published on *Basel Disclosure Requirements relating to the Composition of Capital*, which set forth updated disclosure requirements that banks will be required to include as part of the adoption of the Basel III directives.

On 22 October 2015, the Banking Supervision Department published a final circular on "Capital Requirements in respect of Exposures to Central Counterparties ((hereinafter: "the circular"). The circular amends Proper Conduct of Banking Business Directives 203 and 204 with the aim of adapting them to the Basel Committee recommendation relating capital requirements of banking corporations to central counterparties. The circular sets out the new instructions that will apply to exposures to central counterparties caused by OTC derivatives, derivative transactions quoted on the Tel Aviv Stock Exchange and securities financing transactions.

The directives define what is a qualified central counterparty and what is not a qualified central counterparty, with reduced capital requirements determined for the former. The main changes relate to calculating the following exposures:

- As a rule, exposures of a banking corporation that is a member of a clearing house to a central counterparty will be given a risk weighting of 2% compared with a zero exposure value prior to the amendment.
- Exposures of a banking corporation to a customer active in the Stock Exchange that were calculated according to Stock Exchange rules will be canceled. Pursuant to the amendment, the capital requirement for these exposures is to be calculated as if it were a two-sided transaction, including the allocation of capital in respect of CVA risk.
- In addition, provisions were set out regarding calculating exposures of a banking corporation to a customer active by means of a member of the clearing house as well as the treatment of collateral deposited by a banking corporation with a member of the clearing house or with a central counterparty.
- Exposures to a central counterparty that is not qualified will be weighted in accordance with the relevant risk weighting for the counterparty whereas transfers to a risk fund will be weighted at 1250%.

The aforesaid in this circular will come into effect on 1 July 2016. Through 30 June 2017, the Tel Aviv Stock Exchange may be considered a qualified central counterparty. The Bank is taking steps to update the manner of calculating the capital ratios and the leverage ratio in accordance with the update of the said directive. In addition, the bank is examining the effect of the update of the said directive on its capital planning, capital targets and leverage targets. At this stage, the Bank is preparing for implementation of the directive and examining the effect of its implementation.

Note 25B – Capital Adequacy, Leverage and Liquidity (cont'd)

On 28 December, 2016, the Banking Supervision Department published a letter stating that notwithstanding the aforementioned, calculation of the exposure in respect of customers active in the Maof Stock Exchange will continue in accordance with the scenario approach.
The Bank believes that the expected effect of adopting the "Capital Requirements in respect of Exposures to Central Counterparties" circular as at the reporting date is a change of approximately 0.02% in the Tier 1 shareholders' equity ratio, and a change of approximately 0.03% in the Bank's overall capital ratio and 0.05% in leverage ratio.

It should be noted that this opinion was given on the assumption that the Tel Aviv Stock Exchange complies with the terms of eligibility required and is recognized as an eligible central counterparty.

Insurance for the Portfolio of Guarantees under the Sales Law

On 8 March 2016, agreements were completed with international reinsurers, with a high international ranking, for the purchase of insurance for the Portfolio of Guarantees under the Sales Law (Apartments) and obligations to issue such guarantees. The insurance policy guarantees the Bank in the event it is required to pay due to the realization of the guarantees, under the terms of the policy. Purchasing insurance enables the reduction in restricted capital for credit risk arising from the issuance of guarantees, using the policy as a "Credit Risk Mitigator", in accordance with Proper Conduct of Banking Business Directive No. 203, and contributed in the first quarter to an improvement of approximately 0.23% in the capital adequacy ratio of Tier 1 shareholders' equity as at 31 March 2016.

Capital deduction in respect of deferred tax asset

On 4 April 2016, an updated FAQ was published by the Banking Supervision Department for implementation of Proper Conduct of Banking Business Directives concerning the measurement and adequacy of capital adequacy. The aim of the update is to clarify the handling of the salary tax component with regard to the calculation of capital requirements and deduction from capital in respect of a deferred tax asset. According to the clarification, a banking corporation which concludes that under the circumstances at the time of the report, it is virtually certain regarding a deferred tax asset in the amount of salary tax included in the Bank's books, it will not be possible to apply the deduction threshold contained in Section 13 of the Directive on that part of the deferred tax asset. To this end, the Bank will be entitled to apply the test of the deduction threshold on the amount of net deferred taxes, after deduction of salary tax as stated above. The deferred tax asset as stated not deducted from equity will be weighted as a risk asset by 250%. The Bank implements guidelines from the date of their publication on a prospective basis, without adjusting comparative figures and subject to the transitional provisions set forth in Proper Conduct of Banking Business Directive No. 299 of the Banking Supervision Department. This update contributed as at 31 March 2016 to an improvement of approximately 0.20% in the Bank's capital adequacy ratio of Tier 1 shareholders' equity and approximately 0.17% in the total capital ratio.

Note 25B – Capital Adequacy, Leverage and Liquidity (cont'd)

The effect of the pension liability discounting rate

The Standards regarding employee rights which adopted for the first time in January 2015, is a factor expected to have a most significant impact on Leumi's Tier 1 shareholders' equity, mainly due to the fact that the liability is measured in accordance with market interest rates at historically low levels and because of the high volatility that measurement of this kind brings with it.

On 12 July 2016 the Bank received an approval from the Bank of Israel regarding the calculating method used for calculating the employees' rights in regards with measuring the regulatory capital. In accordance with the approval, the discount rate is to be calculated according to a moving average of the market yields, for a period of eight quarters ended at the reporting date. The change will apply from the financial reports as at 30 June 2016 until 31 December 2020 (inclusive). The change in the calculation methodology significantly moderates the volatility that stems from the changes in the discount interest.

On 15 November 2016 the Board of Directors of the Bank decided, based on the recommendation of the Audit Committee, to calculate the pension liabilities to employees based on a fixed margin of bonds that are internationally rated as AA. The effect of this change on the regulatory capital as at 30 September 2016 amounted to NIS 296 million.

For regulatory capital purposed, the pension liability amounts to NIS 15,966 million and Tier 1 shareholders' equity to NIS 32,599 million, compared with the pension liability in the books of NIS 16,864 million and Tier 1 shareholders' equity of NIS 31,994 million.

For further information, see Note 1.A.2.

Note 25B – Capital Adequacy, Leverage and Liquidity (cont'd)

	31 December	
	2016	2015 (a)
	NIS millions	
A. Consolidated data		
Capital for purposes of calculating capital ratio		
Tier 1 shareholders' equity, after regulatory adjustments and deductions	**32,586** (b)	29,001
Tier 2 capital, after deductions	**11,850**	12,593
Total capital	**44,436**	41,594
Weighted balance of risk assets		
Credit risk	**266,534** (b)	277,034
Market risk	**4,788**	5,167
Operational risk	**20,843**	20,432
Total weighted balances of risk assets	**292,165**	302,633
Ratio of capital to risk components		
Ratio of Tier 1 shareholders' equity to risk components	**11.15%**	9.58%
Ratio of total capital to risk components	**15.21%**	13.74%
Ratio of minimum Tier 1 shareholders' equity required by the Supervisor of Banks (a)	**9.24%**	9.10%
Ratio of total minimum capital required by the Supervisor of Banks (a)	**12.74%**	12.60%
B. Major subsidiary companies		
Leumi Card Ltd.		
Ratio of Tier 1 shareholders' equity to risk components	**16.81%**	16.89%
Ratio of total capital to risk components	**17.79%**	17.82%
Ratio of minimum Tier 1 shareholders' equity required by the Supervisor of Banks	**8.00%**	9.00%
Ratio of total minimum capital required by the Supervisor of Banks	**11.50%**	12.50%
Bank Leumi USA		
Ratio of Tier 1 shareholders' equity to risk components	**12.21%**	12.33%
Ratio of total capital to risk components	**14.75%**	15.13%
Ratio of minimum Tier 1 shareholders' equity required by the local authorities	**8.00%**	8.00%
Ratio of total minimum capital required by the local authorities	**10.00%**	10.00%

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

(b) These figures include adjustments for the efficiency plan, which were determined in accordance with the letter written by the Supervisor of Banks on 12 January 2016, regarding "Operational Streamlining of the Banking System in Israel" (hereinafter: adjustments for the streamlining plan), which are gradually decreasing until 30 June 2021. For further information regarding the impact of the transitional provisions and the adjustments for the streamlining plan, see section D below. From the total weighted balances of risk assets, NIS 116 million were reduced due to adjustments in respect of the streamlining plan.

On 31 December 2015, the Arab Bank was merged with and into Leumi.

Note 25B – Capital Adequacy, Leverage and Liquidity (cont'd)

C. Capital components for purposes of calculating the capital ratio (a)

	31 December 2016	31 December 2015
	NIS millions	
C. Capital components for purposes of calculating the capital ratio		
1. Tier 1 shareholders' equity		
Equity attributed to shareholders of the Bank	**31,347**	28,767
Differences between equity attributed to shareholders of the Bank and Tier 1 shareholders equity - minority interests	**245**	262
Differences between equity attributed to shareholders of the Bank and Tier 1 shareholders equity - in respect of employee benefits	**868**	894
Adjustments in respect of the transition from the accounting curve to the 8-quarter curve (a)	**137**	-
Tier 1 shareholders' equity before regulatory adjustments and deductions	**32,597**	29,923
Regulatory adjustments and deductions:		
Goodwill and intangible assets	**(265)**	(273)
Deferred tax assets	**(120)**	(643)
Equity investments in financial corporations that are not consolidated in reports to the public	**-**	-
Regulatory adjustments and deductions - Tier 1 shareholders' equity	**(19)**	(6)
Total regulatory adjustments and deductions - Tier 1 shareholders' equity	**(404)**	(922)
Total adjustments in respect of the streamlining plan	**393**	-
Total Tier 1 shareholders' equity, after regulatory adjustments and deductions	**32,586**	29,001
2. Tier 2 capital		
Tier 2 capital: instruments before deductions	**8,662**	9,450
Tier 2 capital: provisions before deductions	**3,188**	3,143
Total Tier 2 capital before deductions	**11,850**	12,593
Deductions:		
Total deductions - Tier 2 capital	**-**	-
Total Tier 2 capital	**11,850**	12,593
Total overall capital	**44,436**	41,594

(a) Pursuant to the specific approval of the Banking Supervision Department. For additional information, see the section of "The effect of the discount rate on pension obligations" above.

Note:
Calculated pursuant to Proper Conduct of Banking Business Directives Nos. 201-211, 299 on "Capital Measurement and Adequacy".

D. Effect of the transitional provisions on Tier 1 shareholders' equity ratio

	31 December	
	2016	2015
	Percentages	
Ratio of capital to risk components		
Ratio of Tier 1 shareholders' equity to risk components before application of the effect of transitional directives in respect of the streamlining plan (a)	**10.66%**	8.93%
Effect of the transitional directives	**0.35%**	0.65%
Ratio of Tier 1 shareholders' equity to risk components before the effect of adjustments in respect of the streamlining plan	**11.01%**	9.58%
Effect of adjustments in respect of the streamlining plan	**0.14%**	-
Ratio of Tier 1 shareholders' equity to risk components	**11.15%**	9.58%

(a) Including the effect of adoption of US GAAP on employee rights

Note 25B – Capital Adequacy, Leverage and Liquidity (cont'd)

E. Leverage ratio pursuant to the Directives of the Supervisor of Banks

On 28 April 2015, the Supervisor of Banks issued Proper Conduct of Banking Business Directive no. 218 on the subject of the leverage ratio. The directive sets a simple, transparent and non-risk based leverage ratio to act as a supplementary and reliable measure of risk-based capital requirements, and is intended to limit the accumulation of leverage in the banking corporation.

The leverage ratio is expressed as a percentage, and is defines as the ratio between the measurement of equity and the measurement of exposure. Equity for purposes of measuring the leverage ratio is the Tier 1 capital as defined in Proper Conduct of Banking Business Directive No. 202, taking into account the transitional arrangements that were set. The total exposure measurement of the Bank is the amount of balance-sheet exposures, exposures to derivatives and securities financing transactions, and off-balance sheet items. In general, this measurement will be consistent with the accounting values and risk weights are not taken into account. In addition, the Bank is not allowed to use physical or financial collateral, guarantees or other techniques for credit risk mitigation, to reduce the exposure measurement, unless specifically permitted in accordance with the Directive. Balance sheet assets deducted from Tier 1 capital (in accordance with Directive 202) are deducted from the exposure measurement. Pursuant to the Directive, the Bank calculates the exposure to derivatives with Appendix III of Proper Conduct of Banking Business Directive No. 203, and exposures for off-balance sheet items by the conversion of the notional value of the items by credit conversion coefficients as stipulated in Proper Conduct of Banking Business Directive No. 203.

Pursuant to the Directive, banking corporations will have a leverage ratio of not less than 5% on a consolidated basis. A banking corporation whose total balance sheet assets on a consolidated basis is 20% or more of total balance sheet assets in the banking system, will have a leverage ratio of not less than 6%. Pursuant to that stated above, the minimum leverage ratio required from the Bank is 6%.

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

Note 25B – Capital Adequacy, Leverage and Liquidity (cont'd)

	As at 31 December	
	2016	2015
	NIS millions	
A. In consolidated terms		
Tier 1 capital (a)	**32,586**	29,001
Total exposures	**481,384**	462,680
Leverage ratio		
Leverage ratio	**6.77%**	6.27%
Minimum leverage ratio required by the Supervisor of Banks	**6.00%**	6.00%
B. Major subsidiary companies		
Leumi Card Ltd.		
Leverage ratio	**11.73%**	11.66%
Minimum leverage ratio required by the Supervisor of Banks	**5.00%**	5.00%
Bank Leumi USA		
Leverage ratio required by local regulators	**8.94%**	9.98%

(a) For the effect of transitional provisions and the effect of adjustments in respect of the streamlining plan, see Section D above.

F. Liquidity cover ratio pursuant to the directives of the Supervisor of Banks

On 28 September 2014, the Supervisor of Banks published a circular in which was added Proper Conduct of Banking Business Management Directive No. 221 on the liquidity coverage ratio that adopts the recommendations of the Basel Committee on the subject of the liquidity cover ratio in the banking system in Israel.
The liquidity cover ratio examines a horizon of 30 days in a stress scenario and is intended to ensure that a banking corporation has an inventory of high-quality liquid assets that provide a response to the liquidity requirements of the corporation in this time horizon.

The stress scenario set forth in the directive includes a shock combining a specific shock to the corporation with a systemic shock, and in this context standard withdrawal rates were defined for outgoing cash flows and deposit rates of incoming cash flows in accordance with the categories of the various balances.

The liquidity cover ratio came into effect on 1 April 2015.

Pursuant to the transitional provisions, commencing on 1 April 2015, the minimum requirement will be set at 60% and will increase to 80% on 1 January 2016, and to 100% on 1 January 2017 and thereafter. However, in a period of financial pressure, a banking corporation can go below these minimum requirements.

In addition, on 28 September 2014, a circular was published by the Banking Supervision Department on the subject of a Temporary Provision – Implementation of a Disclosure Requirement under the Third Pillar of Basel – Disclosure in respect of the Liquidity Cover Ratio. In the framework of the circular, the Public Reporting Directives were amended to incorporate the disclosure requirements that the banks will be required to include as part of adopting the liquidity cover ratio.

Accordingly, it was determined, inter alia, that as of 1 April 2015, disclosure requirements were added for the liquidity coverage ratio in consolidated and single entity terms (subject to its application) in the Note to the financial statements, whose name will be changed to "Note on Capital Adequacy and Liquidity Pursuant to the Directives of the Supervisor of Banks".

Note 25B – Capital Adequacy, Leverage and Liquidity (cont'd)

The factors which significantly affected the liquidity cover ratio include, inter alia, a change in volume of liquid assets deriving from issuances of debt instruments and an increase in the volume of deposits.

The liquidity coverage ratio of the banking corporation is calculated based on average daily observations and the consolidated liquidity coverage ratio is calculated based on the average of monthly observations for the period.

	For the year ended 31 December	
	2016	2015
	Percentages	
A. In consolidated terms		
Liquidity cover ratio	**132%**	105%
Minimum liquidity cover ratio required by the Supervisor of Banks	**80%**	60%
B. In terms of the banking corporation		
Liquidity cover ratio	**130%**	103%
Minimum liquidity cover ratio required by the Supervisor of Banks	**80%**	60%

Note: Leumi Card and Bank Leumi USA have no requirements for a liquidity cover ratio.

Note 26 - Contingent liabilities and special commitments

A. Off-balance sheet commitments for transactions based on extent of collections [(a)]

Balance of credit from deposits based on extent of collections [(b)]

	31 December 2016	31 December 2015
	NIS millions	
Israeli currency unlinked	**354**	454
Israeli currency linked to the CPI	**1,685**	2,039
Foreign currency	**7**	27
Total	**2,046**	2,520

Cash flows in respect of collection commissions and interest margins on activities based on the extent of collections as at December 31:

	Up to one year	One to three years	Three to five years	Five to ten years	Ten to twenty years	More than twenty years	Total 2016	Total 2015
	NIS millions							
CPI linked sector (c)								
Cash flows of futures contracts	**20**	**22**	**17**	**20**	**6**	**-**	**85**	105
Expected future cash flows after management estimate of early repayments	**20**	**22**	**17**	**20**	**6**	**-**	**85**	104
Discounted expected future cash flows after management estimate of early repayments (d)	**19**	**20**	**15**	**16**	**4**	**-**	**74**	95
Unlinked shekel sector								
Cash flows of futures contracts	**8**	**2**	**1**	**1**	**-**	**-**	**12**	14
Expected future cash flows after management estimate of early repayments	**8**	**2**	**1**	**1**	**-**	**-**	**12**	14
Discounted expected future cash flows after management estimate of early repayments (d)	**8**	**2**	**1**	**1**	**-**	**-**	**12**	14

(a) Credit and deposits out of deposits returnable upon repayment of the credit (or the deposits) with interest margin or with collection commission (instead of interest margin).

(b) Standing loans and government deposits given in respect thereof in the amount of NIS 113 million (previous year - NIS 146 million) are not included in this table.

(c) Including foreign currency sector.

(d) Discounting was at the rate of 3.69% (2015 – at the rate of 2.73%).

Note 26 - Contingent liabilities and special commitments (cont'd)

Information on loans granted during the year by mortgage banks:

	2016	2015
	NIS millions	
Information on loans granted during the year by mortgage banks:		
Loans from deposits on collection basis	**16**	11
Standing loans	**21**	10

B. Other contingent liabilities and special commitments:

	2016	2015
	NIS millions	
(1) Long-term rental contracts - rental of buildings, equipment and motor vehicles and maintenance in respect of commitments payable in following years		
First year	**301**	324
Second year	**203**	223
Third year	**169**	197
Fourth year	**148**	164
Fifth year	**117**	138
After five years	**1,160**	1,248
Total long-term rental contracts	**2,098**	2,294
(2) Commitments to purchase securities	**920**	466
(3) Commitments to invest in and acquire buildings and equipment	**38**	26

(a) Restated

(4) Credit sale activity

	2016	2015	2014
	NIS millions		
Book value of credit sold	**2,663**	268	316
Cancellation of provision for credit losses	-	38	-
Proceeds received in cash	**2,723**	317	344
Deferred service liability	**(16)**	-	-
Total net profit from sale of credit	**44**	11	28

Note 26 - Contingent liabilities and special commitments (cont'd)

C. Legal claims

In the regular course of business, legal claims have been filed against the Bank and certain consolidated companies, including petitions for approval of class actions.

In the opinion of the Management of the Bank and the managements of the consolidated companies, the total additional exposure arising from legal claims filed against the Bank and against the consolidated companies on various subjects, the amount of each of which exceeds NIS 2 million, and regarding which the chances of the claims succeeding are not remote, amounts to some NIS 41 million.

1. Below are details of claims, that have been filed against the Bank in which the amount claimed is material. In the opinion of the Management of the Bank based on legal opinions regarding the chances of the claims succeeding, appropriate provisions have been recorded in the financial statements, insofar as required, to cover damages resulting from the said claims.

1.1 Claims filed during the period of the report (and subsequent to the period of the report, if filed)

A. On 11 February 2016, petition for approval of a class action was filed with the Tel Aviv District Court against the Bank and against four other banks, claiming that the banks give various benefits in student accounts, but restricts the age of the students. The amount of the overall claim is estimated at NIS 219 million.

B. On 7 March 2016, a petition was filed in the United States Court by a large number of petitioners, against tens of respondents, among them the Bank, Bank Leumi USA, and Bank Hapoalim, claiming that the respondents support settlements, in such a way as to harm Palestinian residents, their property and their rights, inter alia, by making bank transfers. The amount claimed against all the respondents together was originally $34.5 billion, subsequently reduced to US$ 1 billion.

C. On 22 May 2016, a petition was filed to approve a class action against the Bank, and against other banks, claiming that when the banks charge teller transaction fees in cash, they charge the fee specified in the price list, without discounts which should apply to certain population groups, and that they do not take these fees into account when calculating the minimum fee charged to the customers' accounts. According to the petitioners, they cannot evaluate the precise amount which they claim was unlawfully charged by the various respondents from members of the group.

1.2 Claims that were concluded during the period of the report (and subsequently if applicable)

A. On 12 September 2006, a petition to approve a class action was filed against the Bank and other banks in an amount claimed of NIS 7 billion. According to the petitioner, the respondent banks charged their customers with interest for unlinked shekel credit, a commission for credit allotment and fixed management fees with regard to current loan accounts at identical rates and amounts, as a result of a prohibited restrictive arrangement. As part of the appeal proceedings against the decision of the Anti-Trust Commissioner dated 26 April 2009, the Anti-Trust Tribunal on 15 June 2014 gave effect to an agreed order for agreement, under which, inter alia, subject to the deposit by the banks of an amount of NIS 70 million (the Bank's share – NIS 21.425 million) with a trustee, the decision would be void. It was also decided in the framework of the agreed order that the banks that are party to it can use these funds to make settlement agreements in various claims, including the claims listed in paragraph B below, and additional claims filed against the banks for the alleged adjustment of interest rates which ended during 2015, subject to terms set forth in the order.

On 15 May 2016, the Court approved the compromise agreement in proceedings described in this section, and in proceedings described in Section B below, and thus the proceedings were concluded.

B. On 23 November 2006, a petition to approve a class action was filed against the Bank, and other banks. The petitioners allege that in respect of credit to the household sector, the banks collect interest at a rate that is much higher than that collected from the commercial sector and from the corporate sector. The alleged damage is about NIS 5.6 billion. On 21 January 2014, the Court decided to transfer the proceedings in the claim to the court dealing with the proceedings described in Section A above. See Section A above for an update regarding the conclusion of proceedings in this claim as well.

C. On 1 April 2007, a petition was filed to approve a class action against the Bank, against three other banks and against other respondents. The amount of the claim is NIS 386 million, of which NIS 130 million is attributed to the Bank. According to the petitioners, the respondents charged the managers of mutual funds under their control commissions for purchase and sale of securities (brokerage commissions) and for performing transactions in foreign currency, which were higher than the fees charged to other institutions. The petitioners claimed that the collection of the (alleged) excessive fees continued unlawfully even after the sale of control of the mutual funds by the banks to the other respondents. On 10 May 2016, the Court handed down its verdict rejecting the petition for approval of the class action.

D. On 11 October 2012, a petition for approval of a class action was filed against the Bank and against five other banks. The petitioners claim that payments that were paid by customers of the Bank against whom collection proceedings are being conducted, and who made payments directly to files in the Execution Office, were updated in their bank account at a date later than the date of payment. As a result of the delay in updating payments in the bank account, the plaintiffs were charged excessive interest charges. On 15 November 2016, the court approved a settlement arrangement in these proceedings and thus the claim was concluded.

E. On 27 November, 2013, a petition for approval of a class action was filed against the Bank, claiming that the Bank calculates incorrectly the theoretical value of options traded on the Tel Aviv Stock Exchange. According to the petitioners, the Bank uses the Black & Scholes mathematical model, but inserts an erroneous element regarding the expiry date of the option, adding an extra value date to this element. According to the petitioners, they cannot accurately assess the damages, but estimate it to be tens of millions of shekels.
On 22 June 2016, the Court's handed down its decision, accepting the petitioner's petition for withdrawal from the request to approve the claim as a class action and to dismiss his personal claim. Thus, the claim was concluded.

F. On 13 April 2014, a petition was filed in the Tel Aviv Central District Court for approval of a class action against the Bank in the amount of about NIS 184 million. According to the petitioner, when a customer's account in the Bank goes over the approved credit limit, the Bank refuses to honor standing orders in the account, and even charges a fee, the amount of which exceeds the amount of the standing order that was not honored. On 22 February, 2017, the court approved a settlement arrangement in these proceedings. Thus, the claim was concluded.

Note 26 - Contingent liabilities and special commitments (cont'd)

G. On 6 January 2015, a petition was filed for approval of a class action for an amount claimed of NIS 400 million, claiming that the Bank charges interest on arrears is not to be charged on index-linked loans at a rate exceeding 17% per annum. On 20 December 2015, the Central District Court decided to dismiss the petition for approval of a class action. On 12 January, 2017, the Supreme Court handed down its verdict approving the agreement of the appellant to take back the appeal he submitted. Thus, the claim was concluded.

H. On 28 April 2015, a petition was filed for approval of a class action for NIS 360 million against the Bank and against an insurance company that insured the borrowers of the Bank that took a mortgage loan from the Bank. The petitioner claims that the Bank allegedly requires older mortgagees (over age 55) to purchase a life insurance policy while knowing that they are at an age that is not insurable under the policy. In addition, the petitioner claims that the Bank continues to require mortgagees to pay premiums for existing life insurance policies even after the borrowers reach the age of 65, even though insurance coverage ends at this age, and in some cases charges them insurance premiums even after their decease. On 18 January, 2017, a verdict was handed down approving the petitioner's withdrawal from the claim.

1.3 Claims pending that were filed in previous reporting periods

A. On 7 September 2011, a petition for approval of a class action was filed against the Bank (in respect of activity of Bank Leumi Mortgages Ltd.), and against other banks. The amount of the class action claimed against all the respondent banks is approximately NIS 927 million as at 1 January 2010, and the amount of the class action against the Bank is about NIS 327 million. The petitioners claim that the respondent banks charged housing-loan borrowers "compound interest in advance", contrary to the law and to the loan agreements. On 16 August 2015, the court rejected the petition for approval of claim as a class action because it was without grounds. On 7 December 2015, the plaintiffs filed an appeal against the decision of the Court to the Supreme Court.

B. In February and March 2013, the liquidator of two companies in a real-estate group filed claims against the Bank, against additional banks, and against additional entities and private individuals, by means of their special manager.
The special manager claims, *inter alia*, that the respondents allowed the leakage of funds from the accounts of the companies to other accounts related to the group, and that the Bank aided in the execution of "window dressing" at quarter ends in a manner facilitating the concealment of the thefts, as claimed by the special manager, from the companies, and the prevention of their exposure in the financial statements of the companies.
The amounts claimed are about NIS 63 million and NIS 102 million, including index-linkage and interest.
In addition, additional proceedings are taking place that were submitted by the special manager on behalf of another company in the group, on other grounds.

Note 26 - Contingent liabilities and special commitments (cont'd)

C. On 28 August 2013, a petition was filed to approve a class action against the Bank and other banks. The Supervisor of Banks, the Governor of the Bank of Israel, and the Antitrust Commissioner were joined as formal respondents. The subject of the petition is the allegedly unlawful charging of commissions regarding activities of conversion and delivery of foreign currency, without fair disclosure. As claimed by the petitioners, the damage caused to customers (according to an "abbreviated" petition filed by the petitioners, is about NIS 2.6 billion (the petitioners claim additional damages that were not quantified).

On 20 January 2015, the Court decided to transfer discussion of the petition for approval of a class action that was filed concerning a similar matter in the amount of NIS 200 million, also against the credit card companies (including against Leumi Card) to the court hearing the petition described in this paragraph.

D. On 2 December 2013, a petition was filed for approval of a class action against the Bank, on the matter of an early repayment fee non-housing loans. According to the petitioner, early repayment fee calculations by the Bank, both regarding loans for which calculation principles apply that are set out in Proper Conduct of Banking Business Directives, and regarding loans for which principles apply that were set by the Bank, are not made lawfully. The petitioner claims that she is unable at this stage to assess the amount of the overall claim.

E. On 9 March 2014, a petition was filed to approve a class action against the Bank without specifying the amount claimed. According to the plaintiff, the Bank collects money from customers unlawfully in two cases. The first is when the Bank allows customers to exceed the credit limit and debits customer accounts with a fee in the amount of NIS 53 in respect of delivering a warning letter of the deviation from the credit limit. Second, "non-approved" deviations from the credit limit are merged into the excess debit balance in the account resulting in the charging of the maximum rate of interest.

F. On 17 March 2014, a special manager of a company in liquidation filed a petition to issue instructions against the Bank, in which it requested that the Court declare that the Bank will bear the payment to the company (the liquidation fund) in an aggregate amount of NIS 1,200 million, of which an amount of NIS 635 million to cover all the company's debts to its creditors and an amount of NIS 565 million for repayment of the full value of the assets of the company. According to the special manager, the Bank is to bear individual responsibility for the liabilities of the company. It should be noted that as part of the motion, the special manager retained the right to file additional proceedings against the Bank and / or other officers of the company and / or individuals on behalf of the Bank and lawyers advising the Bank.

G. On 18 March 2014, a petition was filed for approval of a class action against the Bank for an asserted amount of about NIS 155 million, claiming that as part of the deducting of tax at source carried out by the Bank in securities transactions executed through it, the Bank's computer systems calculate long capital gains and / or short capital losses unlawfully.

H. On 11 February 2015, a petition was filed to approve a class action against the Bank for an amount claimed of about NIS 2.3 billion (later reduced to NIS 1.5 billion). According to the petition, the Bank allegedly managed a "black list" of customers according to which it marks customer with an asterisk in the Bank's systems, for an unlimited period, in a manner that harms or allegedly makes it difficult for them to get credit or otherwise conduct business with the Bank.

I. On 21 April 2015, a petition was filed for approval of a class action against the Bank. The petitioner claims that the Bank allegedly does not fulfill its duty to make a reasonable effort to locate holders of inactive accounts, to apprise them of the existence of the account and refund them the "dormant" funds, according to the petitioner, in these accounts. The petitioner also raises other claims regarding the charging of account management fees in these accounts, and the refunding of the monies to the account holders without index linkage and interest. It is not possible to assess the total damages to all the members of the group.

J. On 29 April 2015, a petition was filed for approval of a class action against the Bank. The amount of the claim is about NIS 150 million. The petitioner claims that funds of Holocaust survivors, which were deposited before the Second World War in the Anglo-Palestine Bank and not withdrawn by the customers during the war, were returned to the survivors or their heirs and allegedly were not revalued in real terms.

K. On 21 June 2015, a petition was filed against the Bank for approval of a class action, claiming that the Bank charges customers, allegedly, wishing to make a foreign currency transfer from their account to the credit of a foreign currency account in their names in another bank, with exchange commission, even though it is in the same currency and an exchange transaction was not carried out. In addition, the petitioner claims that the Bank charges customers, allegedly, with a correspondent fee whose amount is denominated in euros, at a rate higher than the representative, and that the Bank charges its customers, allegedly, when closing the account, fees exceeding the maximum amounts that can be charged by law when closing an account. The petitioner estimates that the amount of the group claim is in millions of shekels.

L. On 22 July 2015, the Bank received a petition for approval of a class action, filed against the Bank. The petitioner claims that payments made directly to the Bank on account of a debt in respect of which a collection process is being conducted by the Enforcement and Collection Authority, are reported late by the Bank to the Enforcement and Collection Authority, resulting in the creation of an alleged discrepancy between the actual debt and the debt recorded in the file of the Enforcement and Collection Authority. The petitioner estimates that the amount of the group claim is in millions of shekels.

2. In addition, there are legal claims pending against the Bank, including petitions for the approval of class actions, in which the amount claimed is material, which in the opinion of the Management of the Bank, based on legal opinions with regard to the chances of these legal proceedings, it is not possible, at this stage, to estimate the chances of the claims, and therefore no provision has been recorded in respect thereof.

A. On 17 August 2016, a petition was filed for approval of a class action against the Bank, and against nine other banks, for a total amount of about NIS 1 billion (principal) at the very least. The petitioners claim that the banks charge fees to persons not classified as individuals or small businesses that are not included in the statutory binding price list, pursuant to the Bank Law (Service to the Customer), 5741-1981) or not for the amount appearing in it, allegedly unlawfully.

B. On 29 September 2016, a petition for approval of a class action was filed against the Bank for about NIS 500 million for damages allegedly caused to the Bank's customers due to the closure of dozens of branches/teller stations. According to the plaintiff, the Bank has closed branches and teller stations over the past few years and has thusly harmed the customers' ability to receive services from the Bank. Furthermore, the plaintiff claims that the digital service solution is not suitable for some of the population.

C. On 8 December, 2016, a petition was filed for the approval of a class action against the Bank and other banks. The petitioner claimed that the banks charge minimum fees for a transfer of foreign currency by size, and not only one minimum fee, which according to the applicant is required by the banking regulations, and that this common violation of all the respondent banks is actually a restrictive practice contrary to Antitrust Law. The amount of the alleged damage was estimated by the petitioner, for all the respondents together, in the amount of about NIS 500 million.

D. On 4 January, 2017, a petition was filed for the approval of a class action against the Bank and other banks. According to the petitioners, when a file is opened by the Execution and Collection Authority, the debt is charged with compound interest at a frequency above that permitted by the agreement between the customer and the Bank and / or by the ruling under which the file is opened by the Execution and Collection Authority and / or by law. The group damage is estimated at about NIS 339 million from all the respondents, including approximately NIS 161 million from the Bank.

E. On 23 January, 2017, the Bank received a petition for the approval of a class action against the Bank. The claim alleges that the Bank apparently carries out conversion of credit balances in foreign currency deposited to the credit of accounts in Israeli currency of customers, even if the customers did not ask for this service. According to the petitioner, the damage allegedly caused to customers as a result is the conversion fee and the difference between conversion at the representative exchange rate and conversion at the rate at which the conversion was carried out in practice, which is lower. The petitioner claims that the amount of personal damage incurred by him is about NIS 38, and the damage to the group is estimated in millions of shekels, without details.

3. Below are details of claims and petitions for approval of class actions in material amounts filed against the Bank's subsidiary companies. In the opinion of the management of the Bank, based on the opinion of the management of the relevant subsidiaries that are based on the opinion of its legal counsel with regard to the chances of these legal proceedings, appropriate provisions have been included in the financial statements, where required, to cover damage resulting from the said claims:

A. On 23 June 2009, a petition for approval of a class action was filed against Standard & Poors Ma’alot Ltd., Keshet Debentures Ltd., Bank Leumi le-Israel Trust Company ("the Trust Company"), and six additional defendants. The amount of the class action claimed against all the respondents in the class action was some NIS 286 million. The petition for approval refers to debentures issued by Keshet, backed up by notes issued by Lehman Brothers Bankhaus AG. The petitioner claims that with the collapse of Lehman Brothers, the price of the debenture collapsed and trading was suspended. On 16 May 2016, the court approved a settlement arrangement in the action. Thus, the claim was concluded.

B. On 8 July 2014, a petition was submitted for approval of a class action against several credit card companies, including Leumi Card. For details on this petition, see paragraph C.1.3 above.

C. On 28 April 2014, a petition for approval of a class action was filed with the Central District Court against Leumi Card Ltd. and other credit card companies, in the amount of NIS 1.7 billion. The amount of the claim increased to about NIS 7.1 billion. The plaintiff alleges that the interchange fee charged in respect of transactions executed by means of debit cards and prepaid cards (as opposed to credit cards), did not receive approval from the Anti-Trust Court, and is a restrictive arrangement. In addition, the arrangement under which proceeds of transactions are transferred to vendors with a delay of some 20 days, is also a restrictive arrangement or a discriminating condition in a uniform contract.

Note 26 - Contingent liabilities and special commitments (cont'd)

D. On 17 November 2014, a petition for approval of a class action was filed, against Leumi Card for the amount of NIS 952 million. The amount of the claim was reduced to some NIS 267 million. The petitioner claims that Leumi Card is acting illegally in its conduct concerning identification of customers in the IVR system (call forwarding in service centers) which discloses personal details of customers. In addition, the petitioner claims that his request to block the possibility of hearing the information concerning his credit card after the identification was not accepted, on the grounds that there is no possibility of effecting such a block.

4. For details of legal proceedings on the matter of the US customers, see paragraph H.1 in this Note.

D. The Bank is a guarantor for members of some of the provident funds that were managed by Leumi Capital Market Services Ltd. (formerly Leumi Gemel Ltd.), whose operations were sold to Psagot Provident Funds Ltd. (“Prizma”). The guarantee secures the repayment of the original principal amounts that were deposited amounting on 31 December 2016 to some NIS 2,180 million in nominal values. The value of the assets of the above funds at 31 December 2016 amounts to about NIS 5,027 million. In addition, this guarantee does not apply to deposits in accounts that were opened in the above funds from 22 January 2007.
Against the aforesaid liability, Prizma undertook that, in the event the guarantees or any part of them are realized, it would pay the Bank participation in an amount not exceeding NIS 35 million per calendar year, this amount being linked to the Israeli CPI of 30 October 2006 - and until the payment date. A participation amount that is not utilized in a certain year will not be carried forward to future years.

E. Consolidated companies of the Bank which serve as trust companies, as well as a number of banking subsidiaries, perform trust operations. Such operations include mainly trusteeship over funds, securities and real estate; the handling of donations, gifts and bequests; acting as agent in regard to deposits and loans; handling of share transfers; and management of investment accounts. Some of these companies also act as trustees for debenture holders.

F. **Letters of indemnity**

1. The Bank has undertaken in advance to indemnify the directors, the other office holders in the Bank and personal managerial contract holders in the Bank who are not officers of the Bank (“the managerial contract holders”) with respect to the duties they fulfill with the Bank and in the investee companies on behalf of the Bank in respect of a list of events entitle for indemnification that according to the Remuneration Committee and the Board of Directors of the Bank, are to be expected considering the activity of the Bank and the circumstances that include, *inter alia*, the routine banking activity of the Bank, an offer of securities to the public pursuant to a prospectus, reports to the public and to the supervisory authorities, activity related to the Antitrust Law, Cyber events and any other activity associated with the activity of the Bank. In addition, *inter alia*, the Bank undertook in advance to indemnify the directors, the other office holders in the Bank and personal managerial contract holders in the Bank for reasonable litigation expenses including expenses incurred as a result of an investigation or proceeding that ended without an indictment being filed and without a financial liability being imposed as an alternative to criminal proceedings, or that ended without an indictment being filed but with a financial liability being imposed as an alternative to criminal proceedings for an infraction that does not require proof of criminal intent, or in connection with a monetary sanction. The letter of indemnity also includes a further obligation for indemnification for expenses and/or payment to the injured party of a breach in accordance with and subject to that stipulated in the Streamlining of Enforcement Proceedings in the Securities Authority Law (Legislative Amendments), 2011 ("the Streamlining of Enforcement Proceedings Law"), as well as expenses in connection with proceedings under Section G-1 of the Antitrust Law, 1988.

Note 26 - Contingent liabilities and special commitments (cont'd)

On 3 November, 2016 a Special Meeting of Shareholders of the Bank decided approve an amendment to the letter of indemnity (hereinafter: "the Amended Letter of Indemnity") for directors serving in the Bank, including those who will serve at the Bank from time to time and including the Chairman of the Board of Directors and the President & CEO, and to amend the Articles of the Bank accordingly. The Bank’s new remuneration policy for office holders that was approved at the same time by the General Meeting includes indemnification provisions that are compatible with the amended liability of indemnity that was approved as aforementioned.

The main amendments to the liability for indemnification: 1) the maximum indemnification amount in the previous letter of indemnity stood at 10% (ten percent) of the shareholders’ equity of the Bank as reflected in its last financial statements published before the date of the actual indemnification. The maximum indemnification amount was amended so that the Bank can provide indemnity for any indemnifiable event included in the list of events that entitle indemnity, up to 25% of the shareholders’ equity of the Bank, according to the latest financial statements (annual or quarterly) known before the actual payment of the indemnity (see above: "the maximum indemnification amount"). Furthermore, the condition was cancelled under which the indemnification amount will not impair the minimum capital ratio required under the directives of the Supervisor of Banks; 2) in addition to the letter of indemnity according to which the maximum amount of indemnification is in addition to amounts received from the insurance company, if any, within the framework of insurance purchased by the Bank, if it purchased and / or in the framework of insurance and / or indemnification of another party other than the Bank (so that the indemnification amount will not be less due to insurance payments and / or the said indemnification that was paid, if so paid); 3) a clarification was added that the amended letter of indemnity expands its commitments or prior agreements between the Bank and the Bank's directors; however, if the terms of the new letter of indemnity worsens the conditions of indemnification for those serving or who will serve in the role of director of the Bank, or if the letter of indemnity debt security will not be in force, the previous commitments or agreements shall apply to the new letter of indemnity; 4) the list of events that in the Bank's opinion are foreseeable events in light of its actual activity at the time of granting the letter of indemnity was updated and these are listed in Appendix A to the letter of indemnity.

The said amendment of the letter of indemnity also applies with respect to office holders of the Bank and for persons with managerial contracts, in accordance with the decision of the Remuneration Committee from 15 May, 2016, and of the Board of Directors dated 25 September, 2016.

In addition, on 15 February, 2004, the General Meeting of the Bank passed a resolution for granting exemption in advance exemption from liability for directors, for damages due to their breach of duty of care towards the Bank. The decision on granting the said exemption also applies with respect to other office holders of the Bank, in accordance with the decision of the Audit Committee and the Board of Directors of June 2003.

2. The Bank has undertaken to indemnify employees of the Bank for expenses and/or payment to the injured party of a breach or subject to that stipulated in the Streamlining of Enforcement Proceedings Law, in accordance with the usual terms appearing in letters of indemnity given by the Bank.

3. The Bank has undertaken to indemnify external advisors including in connection with plans for granting of offering securities to officeholders or employees of the Bank or subsidiary companies, as applicable, in respect of an obligation or loss, and in various cases including in respect of other legal expenses in connection with the services given by them to the Bank.

Note 26 - Contingent liabilities and special commitments (cont'd)

4. The Bank and subsidiary companies have undertaken to indemnify the international credit companies "Visa" and "MasterCard" in respect of fulfillment of the obligations of the subsidiaries concerning “Visa” and “MasterCard” credit card activity, whichever applicable.

5. The Bank and its subsidiaries, from time to time and in circumstances generally accepted in the normal course of business, are accustomed to give letters of indemnification, limited and unlimited as to amount and period, including in reference to debts applying to the Bank as a member of the Tel Aviv Securities Exchange.

6. From time to time, the Bank provides subsidiary companies with letters of indemnity, limited and unlimited as to amount and period, to secure indemnities granted by them to officer holders due to risks applicable to office holders in the companies, and for purposes of the subsidiary companies complying with regulatory directives. In addition, the Bank has given letters of indemnity to Bank employees and to office holders of subsidiaries in respect of a list of events which are specified therein.

7. In the framework of the transaction for the sale of the activity of Leumi Private Bank ("LPB") to Julius Baer, the bank gave a guarantee to Julius Baer, limited to the amount of CHF 250 million, in respect as a backup for the indemnification that was given by LPB to the events defined in the agreement to a period of two years from the closing date of the transaction (March 2015) (subject to irregular items for which the period will be five years).

8. In the framework of the transaction for the sale of the activity of Bank Leumi (Luxembourg) S.A. ("Leumi Luxembourg") to Banque J. Safra Sarasin (Luxemburg) S.A. ("the purchaser") in November 2015, Leumi Luxembourg undertook to indemnify the purchaser with various indemnities for a period of two years from the date of the closing (January 2016) (subject to irregular items for which the period will be five years). The amount of the indemnity is limited to an amount derived from the shareholders' equity of Bank Leumi Luxembourg (about $37.4 million). Leumi Luxembourg's undertaking to indemnify is backed by a guarantee of the Bank in the event that Bank Leumi Luxembourg will be unable to meet its obligations for the said indemnity.

G. Credit cards

1. On 7 March 2012, the Antitrust Tribunal gave its judicial approval to an agreement submitted by the credit card companies and the Commissioner regarding the rate of cross-commission, which will decrease gradually to 0.7% from July 2014, according to the outline plan for the reduction of cross-commission set forth in the judgment. The arrangement between the Commissioner and the credit card companies is in force until the end of 2018. However, regarding an immediate debit card, the Banking Order (Customer Service) (Supervision of service given by an issuer to a clearer in connection with cross-clearing of immediate debit transactions) (Temporary Order), 5775-2015, was published on 26 August, 2015. In the Order, the Governor of the Bank of Israel declared that service that the issuer gives the clearer regarding cross-clearing of immediate debit transactions, is a service subject to supervision regarding the fee charged in its connection, and determined that the fee will stand at 0.3% of the transaction amount. The validity of the Order is for the year starting 1 April, 2016 until 31 March, 2017.

2. The Bank has undertaken with regard to Visa International to take full responsibility for the proper execution by Leumi Card of all the provisions and requirements included in the Articles of Visa International as in effect from time to time, to perform all actions necessary in order to fulfill its commitment and to notify Visa International immediately in writing regarding any material change in the agreement between the Bank and Leumi Card.

Note 26 - Contingent liabilities and special commitments (cont'd)

3. The Bank has undertaken with regard to World MasterCard and to all other Mastercard members to take full responsibility for carrying out all Leumi Card's obligations under the Articles of World MasterCard and its principles and to indemnify these entities for any loss, cost, expense or debt in respect of an infringement of Leumi Card's aforesaid obligations.

Note 26 - Contingent liabilities and special commitments (cont'd)

H. Contingent liabilities and other special commitments

1. The US customers affair:

A. Arrangement with the U.S. authorities

On 22 December 2014, the Leumi Group signed arrangements with the US Department of Justice (the DOJ) and with the New York Department of Financial Services (NYDFS), in the framework of which it admitted, inter alia, that beginning in 2000 and up to 2010, the Group voluntarily aided in the preparation and filing of false tax reports to the US tax authorities.

On 4 January 2015, the Bank, in accordance with these agreements, paid a total of US$ 400 million (US$ 270 million to the DOJ and US$ 130 million to the NYDFS).

In the framework of the DPA (the arrangements signed with the DOJ), Leumi Group undertook, *inter alia*, to take certain actions related to the provision of services to US customers, and to develop and implement a compliance program with the FATCA provisions. In the framework of the agreement with the NYDFS also, certain obligations were imposed on the Bank including the appointment of a monitor to examine, inter alia, the Group's activities. The monitor commenced his duties on 15 July 2015 and ended them on 31 December 2016. On 23 January 2017 the monitor submitted his report to the NYDFS. On 17 January 2017 the Court in California canceled the DPA procedures against the Bank after the Bank met the two years' period set in the terms of the agreement. This concluded all proceedings with the DOJ.
In order to comply with the provisions of the arrangements as aforesaid, the Bank has appointed a special steering committee which supervises the fulfillment of the undertakings of the Bank and its offices in accordance with the arrangements, and submits regular reports thereon to the Bank's management and Board of Directors.

Pursuant to of the investigations of the US authorities, a number of actions have been served against the Bank and office holders who served and who are serving in the Bank and the Group:

The Board of Directors in February 2015 appointed an independent claims committee, for an overall review of the advisable course of legal action to the Bank in light of the totality of events including the claims filed in connection with the US customers affair.

On 14 September, 2016, the Tel Aviv District Court approved settlement arrangements submitted in two of the claims, according to which, without admitting any of the claims of the petitioner for approval, the office holder and manager respondents will pay, by means of the insurers under the Office Holders’ Insurance officers purchased by the Bank, a total of US$ 92 million in accordance with the contractual structure and composition of the insurers under the policy without mutual responsibility between the insurers (the amount includes the portion covered by the Bank's CAPTIVE in a total amount of US$ 26.25 million). In accordance with the provisions of the settlement agreement the amount of payment from the insurers is final and exhausts the rights of the Bank vis-à-vis all insured parties under the policy in connection with any matter related to US customers affair.

Further to the court decision, the insurance companies paid the Bank the amounts set out in the arrangement, and on 27 October, 2016 appeals were filed appeals against the judgment.

The remaining claims that were filed regarding the US customers were concluded.

Note 26 - Contingent liabilities and special commitments (cont'd)

B. Examination by the US Securities and Exchange Commission (SEC)

There was an investigation was pending by the United States Securities and Exchange Commission (SEC) in connection with the Group's activities in securities and securities counseling vis-à-vis US residents. On 18 October 2016 the SEC notified the Bank that an agreement for closing the aforementioned investigation is approved. As part of the agreement the Bank paid the SEC a total amount of about US$ 1.6 million.

2. Other proceedings

A. On 16 February 2014, a petition was filed against the Bank for discovery and perusal of documents. According to the petitioner, the purpose of the petition was in order to examine the possibility of filing a derivative action in the name of the Bank against the officers of the Bank in connection with credit extended by the Bank, according to the petitioner, to Ganden Holdings Ltd. in order to finance the purchase of shares in IDB Holdings Ltd. On 8 April, 2016, the court approved a mediation agreement between the parties, and the proceedings were completed.

B. On 29 June 2014, a petition was submitted to the Supreme Court, sitting as the High Court of Justice, against the Supervisor of Banks and the Governor of the Bank of Israel, and against four companies from the IDB Group, the Bank and other banks were also attached as respondents. According to the petitioners, they have applied to the Supervisor several times so that he would examine the conduct of the banking system vis-à-vis the IDB Group, but they allege that they were not answered, and therefore, they are requesting the grant of a conditional order that the Supervisor be instructed to explain why he would not respond to the issue of the petitioners' applications regarding the exercise of his powers in all matters relating to the debt arrangements with the large corporate groups in the economy, in particular, the IDB Group, and why he would not conduct a comprehensive investigation on the matter of the conduct of the banking system in granting credit to the IDB Group. On 28 June 2016 the Supreme Court decided the hearing in this case will be postpone until a ruling will be given on the appeal filed against the decision in the administrative appeal under the Freedom of Information Law submitted against the Band of Israel and the officer responsible for the Freedom of Information in the Bank of Israel.

C. On 19 July, 2015, a petition was filed against the Bank for discovery and perusal of documents in connection with the Bank’s treatment of the debt of Delek Real Estate Ltd. This petition was designed, according to the petitioner, in order to examine the need to submit a petition for approval of a derivative action in the name of the Bank against its office holders. The background to the petition is the petitioner's argument that during the years 2012-2013, the Bank wrote off the amount of NIS 120 million in the debts of Delek Real Estate Ltd., and this, according to the petitioner, without justification and although the value of the collateral made possible, allegedly, the collection of the entire debt. On 24 March, 2016, the Court decided to dismiss the petition after determining, among other things, that there was no evidential basis for the claim that the office holders violated their obligations to the Bank. On 6 September, 2016, the Supreme Court upheld in part the petition for leave to appeal filed by the petitioner and ordered the Bank to disclose certain documents. On 15 March 2017, the District Court agreed to most of the Bank's arguments, and ordered the Bank to disclose only a limited amount of additional data. The proceedings in the petition for disclosure of documents was thus concluded.

D. In March 2012, an indictment was filed against Bank Leumi Romania and against four managers at Leumi Romania, regarding the action of charging a customer account, which according to the General Prosecution in Romania was unlawful. On 7 October, 2015, a ruling was handed down whereby the court rejected some of the prosecution's case, but convicted Leumi Romania, as well as the four accused individuals, for the offense of abuse of office, in respect of performing the above charge. After the parties to the proceeding filed appeals against the judgment, a final decision of the Court in Romania was given on 2 November 2016, acquitting all the defendants of the criminal charges.

Note 27 – Liens and Restrictive Conditions

As at 31 December 2016 and 31 December 2015, debentures and notes issued by consolidated companies in Israel are not secured by floating charges on their assets. Consolidated companies have pledged securities and other assets as security for deposits received from the Federal Home Loan Bank (FHLB) and certain obligations pursuant to requirements of the authorities of the countries in which they operate. Pledged assets amount to NIS 2,698 million (31 December 2015 - NIS 796 million). Total liabilities in respect of which assets were pledged amount to NIS 2,089 million (31 December 2015 - NIS 749 million).

The Bank executes short-term lending of securities in foreign currency from the available portfolio, via the Euroclear clearing house, for other customers of the clearing house, without knowing the identity of the borrowers. The lending is carried out under a full guarantee of the Euroclear clearing house which is an AA+ rated financial institution. The value of the balance of the securities lent to the Euroclear clearing house as of 31 December 2016 was about NIS 65 million (31 December 2015 - NIS 75 million).

As a member of the Tel Aviv Stock Exchange, the Bank is a member of the Risk Fund of the Stock Exchange Clearing System.

The amount of the Risk Fund is to be the average highest debit balance that the member had in the six months ending in the calendar month prior to the update. The Fund updates the amounts 4 times a year.

In addition – the Bank has signed a credit facility of US$ 150 million with the Euroclear Clearing System to guarantee securities settlement by customers. The credit facility is backed up by securities held by the Bank in the Euroclear Clearing System.

Each of the members of the Risk Fund pledges securities in favor of the Stock Exchange Clearing System in the amount of its proportionate part in the fund, which secures the member's liabilities to the Clearing System and the member's share in the Risk Fund. Furthermore, such collateral also secures the liabilities of the other members of the Risk Fund, if the collateral that the other member provided is not sufficient to cover the other member's liabilities, and in accordance with the proportionate part of each of the members in the Fund, up to the amount of the collateral provided or up to the amount of the liabilities to the Stock Exchange Clearing System, whichever is the lower. At the date of the financial statements, the Bank's share of the Stock Exchange Clearing Fund was NIS 102 million (31 December 2015 – NIS 87 million). Total assets pledged by the Bank to the Stock Exchange Clearing System was NIS 127 million (31 December 2015 – NIS 99 million).

The Bank is a member of the Maof Clearing System Risk Fund. The Bank has undertaken to the Maof Clearing System to pay every charge deriving from its Maof transactions for its customers, its nostro, and for Maof transactions of a member of the TASE not clearing independently through the Maof Clearing System. The total of the Bank's liabilities is shown in Note 30.D - Off-Balance Sheet Financial Instruments.

The Bank pledges collateral in favor of the Maof Clearing System in the amount of its proportionate part in the Risk Fund and also in respect of its above-mentioned liabilities, which secures its liabilities to the Maof Clearing System and its share in the Risk Fund. Furthermore, such collateral also secures the liabilities of the other members of the Risk Fund. In the event that the collateral that another member provided was not sufficient to cover all of his liabilities, the Maof Clearing System is entitled to realize the collateral provided to it by the other members of the Risk Fund, in accordance with the proportionate part of each of the members in the fund, up to the amount of the collateral provided or up to the amount of the liabilities to the Maof Clearing System, whichever is the lower.

At the date of the financial statements, the Bank's share of the Maof Clearing System Risk Fund was NIS 100 million (about 12.2% of the Fund).

Note 27 – Liens and Restrictive Conditions (cont'd)

The Bank, like any other member of the Clearing System, is entitled to secure its liabilities to the Maof Clearing System risk fund by means of pledging government bonds and deposits. The total of the debentures and deposits pledged by the Bank to the Maof Clearing System in respect of the activity of the customers, the *nostro*, and risk fund as at 31 December 2016 was NIS 786 million (31 December 2015 – NIS 921 million).

The Bank participates in an arrangement for ensuring the finality of settlement in default situations in which there is an insufficient balance in the clearing account of one or more of the other participants, as a participant in the RTGS (*"Zahav"*) System, and a holder of a clearing account in the system and a member of the *Masav* payment system and the banking clearing system ("participant"). In the event of default, each non-defaulting participant ("surviving participant") is to bear the debit charges of the participant that defaulted, according to the relative share of the surviving participant divided by the difference between 100% and the relative share of the participant that defaulted. The relative share of the Bank at 31 December 2016 in the *Masav* system is 18.2% and in the check clearing system – 22.82% (this percentage is updated every six months according to the relative weighting of debit charges of each participant that were passed through the payment system relevant to the previous six months). The total ceiling for participation for all participants is NIS 300 million in the clearing system and NIS 150 million in the check clearing system. In the event of default, on the business day following the date of default, immediately after the system opens, the Bank of Israel will send a multi-party payment instruction debiting the clearing account of the defaulting participant and crediting the clearing accounts of the surviving participants with the amount that each surviving participant paid in the framework of the arrangement, with the addition of interest at the Bank of Israel rate. The default arrangement is not intended to deal with a situation of a known or probable insolvency. In the event of insolvency, the proceedings will be passed to the Banking Supervision Department.

The Bank and its consolidated companies engage with banks in CSA (Credit Support Annex) agreements that are intended to reduce mutual credit risks created between the banks during trading in derivatives. Under the agreements a measurement is made on a periodic basis of the value of all derivatives transactions carried out between the parties and if the net exposure of one of the parties exceeds the predetermined limit, that party is required to transfer to the other party deposits totaling the amount of exposure, until the next measurement date. At 31 December 2016, the Group had made deposits in favor of banks totaling NIS 1.6 billion (31 December 2015 – NIS 453 million).

The Bank and its consolidated companies engage with foreign banks into agreements under which amounts are deposited in the foreign banks for purposes of carrying out marketable futures transactions in exchanges abroad for them and their customers. As at 31 December 2016, the Group had deposited an amount of US$ 61 million in the above banks (31 December 2014 – US$ 102 million). In addition, the Group pledged bonds in the amount of US$ 340 million. It should be noted that at the end of 2016, most of the collaterals transferred were in respect of activity by customers in these transactions were customer funds in accordance with the CSA agreements we signed with them during the year.

The Bank has signed a debenture, in accordance with which the Bank has pledged by way of a first fixed charge and assignment by way of pledge, unlimited in amount, in favor of the Bank of Israel, all of the assets and rights in specific accounts held in the name of the Bank of Israel, in the Tel Aviv Stock Exchange Clearing house, in Euroclear Bank or in any other clearing house to which the Bank and the Bank of Israel must agree. The mortgaged assets in the accounts of Euroclear Bank, or in another account maintained in the clearing house outside Israel, are also mortgaged under a first ranking floating lien in favor of the Bank of Israel.

This pledge is to secure all the liabilities of the Bank in connection with credit that the Bank of Israel has extended or will extend and the placing of collateral to secure it, as detailed in the credit documents, except for credit according to a credit agreement between the Bank of Israel and the Bank and a secured debenture dated 21 May 2008.

Note 27 – Liens and Restrictive Conditions (cont'd)

On 21 May 2008, the Bank signed a debenture, by which the Bank pledged by way of a first floating charge, in favor of the Bank of Israel, its rights to receive monetary amounts and charges in shekels, which are due or will be due to the Bank from time to time from its customers, that are corporations (which were incorporated under the laws of the State of Israel) not being in arrears in repayment to the Bank of credits received from the Bank, in respect of credits in shekels of which the duration (average life) of each credit does not exceed three years, which were given or will be given by the bank to the above customers.

This pledge is to secure credits that the Bank of Israel will grant to the Bank for purposes of the Bank's activity as a supplier of liquidity services in shekels to the Continuous Linked Settlement Bank (CLS) Bank, with the addition of interest, costs and expenses involved in realizing the pledge, up to the amount of NIS 1.1 billion, in accordance with the terms of the credit agreement signed by the parties in this matter. Leumi did not avail itself of any such credit during 2010-2016.

	31 December 2016	31 December 2015
	NIS millions	
Sources of securities received which the Bank may sell or pledge, at fair value, before the effect of set-offs		
Securities received in securities borrowing transactions against cash	**1,284**	1,764
Uses of securities received as collateral and securities of the Bank, at fair value, before the effect of set-offs		
Securities loaned in securities lending transactions against cash	**539**	938

Apart from these securities, as at the date of the balance sheet, additional securities were given as collateral, shown under Securities above, which the lenders are not permitted to sell or pledge.

In addition, the bank deposits government bonds in HSBC as collateral instead of cash. These securities are held in the available for sale portfolio.

In September 2010, the Bank signed a deed of pledge, at the instructions of the Federal Reserve, under which it pledged monetary deposits in favor of Bank Leumi USA, in connection with loans given by Bank Leumi USA with collateral of obligations by Bank Leumi Le-Israel, in support of these obligations. The amount of the pledge at 31 December 2016 was US$ 34 million (31 December 2015 - US$ 37 million.

Note 28A – Derivative Instruments and Hedging Activities

General

The above activity involves taking risks, of which the main ones are:

- Credit risk which is measured according to the maximum expected loss amount if the counterparty does not meet the terms of the transaction. Covering the risk required collateral from the customer according to the risk deriving from the transactions. The collateral required is included in the facility required in respect of the total of all the customer's indebtedness.

- Market risks include risks deriving from changes in interest rates, exchange rates, the CPI Index, prices of securities / indices and commodity prices. Market risks emanating from transactions in derivative instruments are part of the total market risks of the derivative instruments. Activity in derivative instruments taxes place within the limits allowed for exposure to market risks, as determined by the Board of Directors of Group companies.

- Liquidity risk derives from uncertainty regarding the price the bank will have to pay to cover the transaction. This risk exists mainly in instruments whose marketability, or the marketability of the underlying asset, is low. In the framework of collateral requirements, this risk is taken into account.

- This activity does not refer to derivative instruments embedded in other activities.

- See Note 1.J.

Note 28B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates

a. Scope of activity on consolidated basis

31 December 2016	Interest rate contracts					
	Shekel – index	Other	Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts	Total
	NIS millions					
(1) Nominal amount of derivative instruments						
a. Hedging derivatives (a)						
Swaps	-	**3,480**	-	-	-	**3,480**
Total	-	**3,480**	-	-	-	**3,480**
Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest	-	**3,480**	-	-	-	**3,480**
b. ALM derivatives (a)(b)						
Futures contracts	-	**40,972**	**183**	**61,988**	**210**	**103,353**
Forward contracts	**12,187**	**4,850**	**189,374**	**407**	**11**	**206,829**
Exchange-traded options						
Options written	-	**299**	**15,131**	**9,719**	**67**	**25,216**
Options purchased	-	**299**	**14,556**	**9,719**	**67**	**24,641**
Other options						
Options written	-	**7,210**	**12,553**	**2,530**	**56**	**22,349**
Options purchased	-	**4,186**	**12,833**	**2,572**	**189**	**19,780**
Swaps	**572**	**265,043**	**26,796**	**29,441**	**253**	**322,105**
Total	**12,759**	**322,859**	**271,426**	**116,376**	**853**	**724,273**
Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest	-	**140,716**	-	-	-	**140,716**
c. Other derivatives (a)	-	-	-	-	-	-
d. Credit derivatives and foreign exchange spot contracts						
Credit derivatives in which the banking corporation is a beneficiary	-	-	-	-	**20**	**20**
Foreign exchange spot contracts	-	-	**8,667**	-	-	**8,667**
Total	-	-	**8,667**	-	**20**	**8,687**
Aggregate total	**12,759**	**326,339**	**280,093**	**116,376**	**873**	**736,440**

(a) Excluding credit derivatives and spot foreign currency exchange contracts.
(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

Note 28B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

a. Scope of activity on consolidated basis (cont'd)

	31 December 2016					
	Interest rate contracts					
	Shekel – index	Other	Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts	Total
	NIS millions					
(2) Gross fair value of derivative instruments						
a. Hedging derivatives (a)						
Gross positive fair value	**-**	**60**	**-**	**-**	**-**	**60**
Gross negative fair value	**-**	**108**	**-**	**-**	**-**	**108**
b. ALM derivatives (a)(b)						
Gross positive fair value	**339**	**5,590**	**3,075**	**1,571**	**24**	**10,599**
Gross negative fair value	**400**	**5,179**	**3,477**	**1,544**	**20**	**10,620**
c. Other derivatives (a)	**-**	**-**	**-**	**-**	**-**	**-**
d. Credit derivatives						
Credit derivatives in which the banking institution is a beneficiary						
Gross positive fair value	**-**	**-**	**-**	**-**	**-**	**-**
Gross negative fair value	**-**	**-**	**-**	**-**	**-**	**-**
e. Total						
Gross positive fair value (c)	**339**	**5,650**	**3,075**	**1,571**	**24**	**10,659**
Fair value amounts offset in the balance sheet	**-**	**-**	**-**	**-**	**-**	**-**
Book value of assets in respect of derivative instruments	**339**	**5,650**	**3,075**	**1,571**	**24**	**10,659**
Of which: book value of assets in respect of derivative instruments not subject to a master netting arrangement or similar arrangements	**41**	**394**	**53**	**-**	**-**	**488**
Gross negative fair value (c)	**400**	**5,287**	**3,477**	**1,544**	**20**	**10,728**
Fair value amounts offset in the balance sheet	**-**	**-**	**-**	**-**	**-**	**-**
Book value of liabilities in respect of derivative instruments	**400**	**5,287**	**3,477**	**1,544**	**20**	**10,728**
Of which: book value of liabilities in respect of derivative instruments not subject to a master netting arrangement or similar arrangements	**-**	**216**	**283**	**3**	**-**	**502**

(a) Excluding credit derivatives and spot foreign currency exchange contracts.

(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

(c) Of which: gross positive fair value of assets in respect of embedded derivative instruments in the amount of NIS 5 million (gross negative fair value of liabilities in respect of embedded derivative instruments in the amount of NIS 51 million).

Note 28B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

a. Scope of activity on consolidated basis (cont'd)

	31 December 2015					
	Interest rate contracts					
	Shekel – index	Other	Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts	Total
	NIS millions					
(1) Nominal amount of derivative instruments						
a. Hedging derivatives (a)						
Swaps	-	2,443	-	-	-	2,443
Total	-	2,443	-	-	-	2,443
Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest	-	2,443	-	-	-	2,443
b. ALM derivatives (a)(b)						
Futures contracts	-	14,589	10	58,799	217	73,615
Forward contracts	12,525	14,300	179,448	366	11	206,650
Exchange-traded options						
Options written	-	262	14,797	11,129	100	26,288
Options purchased	-	250	15,292	11,129	101	26,772
Other options						
Options written	-	10,797	15,997	3,144	139	30,077
Options purchased	-	8,037	16,567	3,245	139	27,988
Swaps	587	268,113	28,668	27,384	299	325,051
Total	13,112	316,348	270,779	115,196	1,006	716,441
Of which: interest-rate swap contracts in which the banking corporation agreed to pay a fixed rate of interest	-	137,675	-	-	-	137,675
c. Other derivatives (a)	-	-	-	-	-	-
d. Credit derivatives and foreign exchange spot contracts						
Credit derivatives in which the banking corporation is a beneficiary	-	-	-	-	40	40
Foreign exchange spot contracts	-	-	9,086	-	-	9,086
Total	-	-	9,086	-	40	9,126
Aggregate Total	13,112	318,791	279,865	115,196	1,046	728,010

(a) Excluding credit derivatives and spot foreign currency exchange contracts.
(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

Note 28B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

a. Scope of activity on consolidated basis (cont'd)

	31 December 2015					
	Interest rate contracts					
	Shekel – index	Other	Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts	Total
	NIS millions					
(2) Gross fair value of derivative instruments						
a. Hedging derivatives (a)						
Gross positive fair value	-	1	-	-	-	1
Gross negative fair value	-	146	-	-	-	146
b. ALM derivatives (a)(b)						
Gross positive fair value	344	6,375	3,245	1,245	46	11,255
Gross negative fair value	392	5,949	3,340	1,258	45	10,984
c. Other derivatives (a)	-	-	-	-	-	-
d. Credit derivatives						
Credit derivatives in which the banking institution is a beneficiary						
Gross positive fair value	-	-	-	-	-	-
Gross negative fair value	-	-	-	-	1	1
e. Total						
Gross positive fair value	344	6,376	3,245	1,245	46	11,256
Fair value amounts offset in the balance sheet	-	-	-	-	-	-
Book value of assets in respect of derivative instruments	344	6,376	3,245	1,245	46	11,256
Of which: book value of assets in respect of derivative instruments not subject to a master netting arrangement or similar arrangements	31	20	147	65	-	263
Gross negative fair value (c)	392	6,095	3,340	1,258	46	11,131
Fair value amounts offset in the balance sheet	-	-	-	-	-	-
Book value of liabilities in respect of derivative instruments	392	6,095	3,340	1,258	46	11,131
Of which: book value of liabilities in respect of derivative instruments not subject to a master netting arrangement or similar arrangements	-	6	482	37	-	525

(a) Excluding credit derivatives and spot foreign currency exchange contracts.
(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.
(c) Of which: gross positive fair value of assets in respect of embedded derivative instruments in the amount of NIS 6 million (gross negative fair value of liabilities in respect of embedded derivative instruments in the amount of NIS 33 million).

Note 28B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

b. Credit risk in respect of derivative instruments by counterparty to the contract on consolidated basis

	31 December 2016					
	Stock Exchanges	Banks	Dealers/ Brokers	Governments and central banks	Others	Total
	NIS millions					
Book balance of assets in respect of derivative instruments (a) (b)	**121**	**6,737**	**2,074**	**11**	**1,716**	**10,659**
Gross amounts not offset in the balance sheet:						
Mitigation of credit risk in respect of financial instruments	**-**	**5,264**	**1,365**	**11**	**767**	**7,407**
Mitigation of credit risk in respect of cash collateral received	**-**	**1,305**	**438**	**-**	**55**	**1,798**
Net amount of assets in respect of derivative instruments	**121**	**168**	**271**	**-**	**894**	**1,454**
Off-balance sheet credit risk in respect of derivative instruments (d)	**-**	**3,923**	**1,277**	**61**	**4,550**	**9,811**
Mitigation of off-balance sheet credit risk	**-**	**2,153**	**484**	**37**	**1,788**	**4,462**
Net off-balance sheet credit risk in respect of derivative instruments	**-**	**1,770**	**793**	**24**	**2,762**	**5,349**
Total credit risk in respect of derivative instruments	**121**	**1,938**	**1,064**	**24**	**3,656**	**6,803**
Book balance of liabilities in respect of derivative instruments (a)(c)	**132**	**5,921**	**1,692**	**31**	**2,952**	**10,728**
Gross amounts not offset in the balance sheet:						
Financial instruments	**-**	**5,264**	**1,365**	**11**	**767**	**7,407**
Cash collateral pledged	**-**	**509**	**53**	**7**	**963**	**1,532**
Net amount of liabilities in respect of derivative instruments	**132**	**148**	**274**	**13**	**1,222**	**1,789**

Note 28B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

b. Credit risk in respect of derivative instruments by counterparty to the contract on consolidated basis (cont'd)

	31 December 2015					
	Stock Exchanges	Banks	Dealers/ Brokers	Governments and central banks	Others	Total
	NIS millions					
Book balance of assets in respect of derivative instruments (a) (b)	169	6,653	1,880	6	2,548	11,256
Gross amounts not offset in the balance sheet:						
Mitigation of credit risk in respect of financial instruments	-	2,951	1,085	6	821	4,863
Mitigation of credit risk in respect of cash collateral received	-	731	252	-	96	1,079
Net amount of assets in respect of derivative instruments	169	2,971	543	-	1,631	5,314
Off-balance sheet credit risk in respect of derivative instruments (d)	-	3,551	1,220	71	4,963	9,805
Mitigation of off-balance sheet credit risk	-	379	97	43	2,392	2,911
Net off-balance sheet credit risk in respect of derivative instruments	-	3,172	1,123	28	2,571	6,894
Total credit risk in respect of derivative instruments	169	6,143	1,666	28	4,202	12,208
Book balance of liabilities in respect of derivative instruments (a)(c)	194	6,427	1,707	91	2,712	11,131
Gross amounts not offset in the balance sheet:						
Financial instruments	-	2,951	1,085	6	821	4,863
Cash collateral pledged	-	341	68	29	1	439
Net amount of liabilities in respect of derivative instruments	194	3,135	554	56	1,890	5,829

(a) The Bank did not set off net accounting arrangements.

(b) Of which a book balance of assets in respect of stand-alone derivative instruments in the sum of NIS 10,654 million (31 December 2015 – NIS 11,250 million).

(c) Of which a book balance of liabilities in respect of stand-alone derivative instruments in the sum of NIS 10,677 million (31 December 2015 – NIS 11,098 million).

(d) Off-balance sheet credit risk in respect of derivative instruments (including in respect of derivative instruments with negative fair value) as calculated for purposes of limitations on debts of borrowers.

Note:
In 2016 and 2015, no credit losses were recognized in respect of derivative instruments.

Note 28B – Derivative Instrument Activity - Scope, Credit Risks and Repayment Dates (cont'd)

c. Details of Repayment Dates – Nominal Values: Year-end balances on consolidated basis

	31 December 2016				
	Up to three months	From three months to one year	From one to five years	Over five years	Total
	NIS millions				
Interest contracts:					
Shekel – index	**2,928**	**2,486**	**5,230**	**2,115**	**12,759**
Other	**43,564**	**78,626**	**120,683**	**83,466**	**326,339**
Foreign currency contracts	**162,272**	**84,689**	**26,306**	**6,826**	**280,093**
Contracts in respect of shares	**92,258**	**22,479**	**1,635**	**4**	**116,376**
Commodities and other contracts	**464**	**381**	**28**	**-**	**873**
Total	**301,486**	**188,661**	**153,882**	**92,411**	**736,440**

	31 December 2015				
	Up to three months	From three months to one year	From one to five years	Over five years	Total
	NIS millions				
Interest contracts:					
Shekel – index	2,384	2,416	5,537	2,775	13,112
Other	30,712	72,142	133,621	82,316	318,791
Foreign currency contracts	173,995	69,908	26,429	9,533	279,865
Contracts in respect of shares	90,066	24,195	931	4	115,196
Commodities and other contracts	753	274	19	-	1,046
Total	297,910	168,935	166,537	94,628	728,010

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

A. General

On 3 November 2014, a circular regarding reporting on operating segments and a file of questions and answers for implementation was published. On 10 September 2015, an update to the file of questions and answers was published.

The circular updates the Public Reporting Directives in all matters related to the reporting requirements for regulatory operating segments.

With effect from the financial statements for the first quarter of 2016, full disclosure is required according to the new rules, except for disclosure of the Financial Management segment. Comparative figures were retroactively adjusted. Commencing with the financial statements for the first quarter of 2017, the requirements of the circular must be implemented in full.

B. Description of the main operating segments prescribed by the Bank of Israel directives:

1. Households segment - The provision of banking services to private individuals, except customers included in Private Banking.
2. Private Banking segment -The provision of banking services to private individuals whose balance of the financial asset portfolio they have in the Bank (including monetary deposits, securities portfolio and other monetary assets) exceeds NIS 3 million.
3. Micro-businesses segment - Businesses whose activity turnover (annual total sales or annual total income) is less than NIS 10 million.
4. Small businesses segment - Businesses whose activity turnover (annual total sales or annual total income) is larger or equal to NIS 10 million and less than NIS 50 million.
5. Mid-sized business segment - The provision of banking services to a business whose activity turnover is greater than or equal to NIS 50 million and less than NIS 250 million.
6. Large businesses segment - The provision of banking services to a business whose activity turnover is greater than or equal to NIS 250 million.
7. Financial management segment - includes the following activities:

    a. Trading activity – Investment in securities for trading, market-making activity in securities and derivative instruments, activity in derivative instruments non-designated for hedging and not part of the management of the assets and liabilities of the banking corporation, repurchase and lending transactions of securities for trading, short selling of securities, underwriting of securities services.

    b. Asset and liability management activity – Including investment in available-for-sale debentures and debentures held to maturity, that are not attributed to other activity segments (with a borrower having no indebtedness to the Bank, apart from securities), hedging derivative instruments and derivative instruments which are part of asset and liability management, deposits in banks and from banks in Israel and around the world, hedging or protective exchange rate differences of investments in overseas offices, deposits in and of governments.

    c. Non-bank investment activity – Investment in vas shares and investment in companies included on equity basis of businesses.

    d. Other – Management, operating, trust and custody services for banks, consultancy services, selling activity and credit portfolio management, and financial product development activities.

8. Other segment - Including discontinued activities, designated profits and other results connected to employee rights not attributed to the other activity segments, activities not attributed to other segments, and adjustments between the total of all the items attributed to the segments and the total of all the items in the consolidated financial statements.

Classification of customers

According to the circular, the classification of customers into the operating segments will be based on the turnover of their activity or their characteristics (private customers and other individuals). When a banking corporation has no information regarding the total income of business customers who have no liability towards the banking corporation (including credit lines, etc.), the banking corporation may classify them into the relevant regulatory segment according to their total financial assets after multiplying them by a factor of 10. Furthermore, when the Bank believes that the total income does not represent the volume of activity of the customer, the customer will be classified as follows: a customer whose indebtedness is less than NIS 100 million, according to the total assets in the business balance sheet, as stated in the FAQ file, and a customer whose indebtedness exceeds NIS 100 million will be classified into the large business segment.
During the period, actions were taken to complete information that is missing mainly regarding the turnover of business customers. In cases where the information has not yet been completed, the customers were classified according to the estimates and other information that the Bank has. The Bank is working to complete the information and improve the data.

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

C. Information on regulatory operating segments

	For the year ended 31 December 2016														
	Activity in Israel									Activity abroad					
	Households	Private banking	Small and micro businesses	Mid-sized businesses	Large businesses	Instiitut-ional entities	Financial manage-ment segment	Other segment	Total activity in Israel	Private persons	Business activity	Other	Total activity abroad	Total
Interest income from outside entities	**3,434**	**11**	**1,840**	**683**	**1,640**	**19**	**847**	**-**	**8,474**	**60**	**892**	**126**	**1,078**	**9,552**
Interest expense to outside entities	**404**	**157**	**61**	**80**	**175**	**419**	**588**	**-**	**1,884**	**35**	**97**	**10**	**142**	**2,026**
Interest income, net:														
From outside entities	**3,030**	**(146)**	**1,779**	**603**	**1,465**	**(400)**	**259**	**-**	**6,590**	**25**	**795**	**116**	**936**	**7,526**
Intersegmental	**(452)**	**232**	**(179)**	**(32)**	**(303)**	**457**	**317**	**(10)**	**30**	**117**	**(83)**	**(64)**	**(30)**	**-**
Total interest income (expenses), net	**2,578**	**86**	**1,600**	**571**	**1,162**	**57**	**576**	**(10)**	**6,620**	**142**	**712**	**52**	**906**	**7,526**
Total non-interest income (expenses)	**1,737**	**161**	**682**	**318**	**657**	**163**	**1,308**	**139**	**5,165**	**98**	**100**	**45**	**243**	**5,408**
Total income	**4,315**	**247**	**2,282**	**889**	**1,819**	**220**	**1,884**	**129**	**11,785**	**240**	**812**	**97**	**1,149**	**12,934**
Expenses (income) in respect of credit losses	**521**	**1**	**222**	**(120)**	**(687)**	**(33)**	**(64)**	**-**	**(160)**	**2**	**36**	**(3)**	**35**	**(125)**
Operating and other expenses:														
To outside entities	**4,089**	**131**	**1,333**	**501**	**645**	**284**	**204**	**448**	**7,635**	**272**	**511**	**162**	**945**	**8,580**
Intersegmental	**23**	**-**	**-**	**-**	**1**	**1**	**(26)**	**-**	**(1)**	**-**	**-**	**1**	**1**	**-**
Total operating and other expenses	**4,112**	**131**	**1,333**	**501**	**646**	**285**	**178**	**448**	**7,634**	**272**	**511**	**163**	**946**	**8,580**
Profit (loss) before taxes	**(318)**	**115**	**727**	**508**	**1,860**	**(32)**	**1,770**	**(319)**	**4,311**	**(34)**	**265**	**(63)**	**168**	**4,479**
Provision for taxes	**(146)**	**42**	**257**	**179**	**662**	**(11)**	**641**	**(11)**	**1,613**	**(19)**	**98**	**25**	**104**	**1,717**
Profit (loss) after taxes	**(172)**	**73**	**470**	**329**	**1,198**	**(21)**	**1,129**	**(308)**	**2,698**	**(15)**	**167**	**(88)**	**64**	**2,762**
Share of the banking corporation in profits of companies included on equity basis	**-**	**-**	**-**	**-**	**-**	**-**	**66**	**-**	**66**	**-**	**-**	**-**	**-**	**66**
Net profit (loss) before attribution to non-controlling interests	**(172)**	**73**	**470**	**329**	**1,198**	**(21)**	**1,195**	**(308)**	**2,764**	**(15)**	**167**	**(88)**	**64**	**2,828**
Net profit (loss) attributed to non-controlling interests	**42**	**-**	**4**	**2**	**4**	**-**	**(1)**	**(14)**	**37**	**-**	**-**	**-**	**-**	**37**
Net profit (loss) attributed to shareholders of the banking corporation	**(214)**	**73**	**466**	**327**	**1,194**	**(21)**	**1,196**	**(294)**	**2,727**	**(15)**	**167**	**(88)**	**64**	**2,791**

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

	For the year ended 31 December 2016													
	Activity in Israel									Activity abroad				
	Households	Private banking	Small and micro businesses	Mid-sized businesses	Large businesses	Instiitut-ional entities	Financial manage-ment segment	Other segment	Total activity in Israel	Private persons	Business activity	Other	Total activity abroad	Total
Average balance of assets (a)	**116,601**	**601**	**45,718**	**24,835**	**59,208**	**2,526**	**137,192**	**10,432**	**397,113**	**2,031**	**21,273**	**12,388**	**35,692**	**432,805**
Of which: Investments in companies included on equity basis (a)	**-**	**-**	**-**	**-**	**-**	**-**	**1,341**	**-**	**1,341**	**-**	**-**	**-**	**-**	**1,341**
Average balance of credit to the public (a)	**115,714**	**585**	**45,211**	**24,777**	**58,639**	**891**	**-**	**-**	**245,817**	**2,032**	**21,386**	**8**	**23,426**	**269,243**
Balance of credit to the public at the end of the reporting period	**114,516**	**615**	**47,572**	**24,178**	**53,137**	**1,486**	**-**	**-**	**241,504**	**890**	**23,019**	**37**	**23,946**	**265,450**
Balance of impaired debts	**108**	**-**	**492**	**368**	**1,626**	**451**	**-**	**-**	**3,045**	**50**	**558**	**-**	**608**	**3,653**
Balance of debts in arrears of more than 90 days	**841**	**-**	**76**	**3**	**19**	**-**	**-**	**-**	**939**	**1**	**63**	**-**	**64**	**1,003**
Average balance of liabilities (a)	**115,202**	**29,199**	**34,468**	**33,279**	**52,658**	**59,267**	**39,565**	**11,482**	**375,120**	**8,699**	**17,437**	**1,580**	**27,716**	**402,836**
Of which: Average balance of deposits of the public (a)	**114,884**	**29,188**	**31,565**	**31,891**	**48,570**	**54,836**	**-**	**-**	**310,934**	**8,633**	**17,196**	**446**	**26,275**	**337,209**
Balance of deposits of the public at the end of the reporting period	**117,863**	**28,696**	**36,535**	**33,026**	**48,151**	**55,862**	**-**	**-**	**320,133**	**6,070**	**19,779**	**872**	**26,721**	**346,854**
Average balance of risk assets (a)(b)	**85,860**	**892**	**71,344**	**25,973**	**44,780**	**558**	**21,880**	**16,338**	**267,625**	**1,420**	**26,716**	**2,678**	**30,814**	**298,439**
Balance of risk assets at the end of the reporting period (b)	**85,810**	**893**	**59,027**	**24,378**	**55,248**	**1,111**	**17,219**	**17,002**	**260,688**	**873**	**27,757**	**2,847**	**31,477**	**292,165**
Average balance of assets under management (a)(c)	**79,493**	**50,439**	**25,949**	**19,999**	**68,049**	**499,364**	**37,557**	**-**	**780,850**	**14,475**	**2,547**	**2,852**	**19,874**	**800,724**
Distribution of interest income (expenses), net:														
Margin on credit granting activity	**2,317**	**6**	**1,544**	**526**	**1,117**	**15**	**2,230**	**-**	**7,755**	**19**	**381**	**542**	**942**	**8,697**
Margin on deposit taking activity	**261**	**80**	**56**	**45**	**44**	**39**	**(1,623)**	**-**	**(1,098)**	**123**	**331**	**(580)**	**(126)**	**(1,224)**
Other	**-**	**-**	**-**	**-**	**1**	**3**	**(31)**	**(10)**	**(37)**	**-**	**-**	**90**	**90**	**53**
Total interest income (expense), net	**2,578**	**86**	**1,600**	**571**	**1,162**	**57**	**576**	**(10)**	**6,620**	**142**	**712**	**52**	**906**	**7,526**

(a) Average balances to be calculated on the basis of daily balances at the beginning of the quarter or at the beginning of the month.
(b) Risk assets – as calculated for capital adequacy purposes.
(c) Assets under management – including provident assets, supplementary training funds, mutual funds, and securities of customers.

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

C. Information on regulatory operating segments (cont'd)

	For the year ended 31 December 2015													
	Activity in Israel									Activity abroad				
	Households	Private banking	Small and micro businesses	Mid-sized businesses	Large businesses	Instiitut-ional entities	Financial manage-ment segment	Other segment	Total activity in Israel	Private persons	Business activity	Other	Total activity abroad	Total
Interest income from outside entities	3,051	6	2,189	688	1,284	7	557	-	7,782	80	826	96	1,002	8,784
Interest expense to outside entities	288	112	48	38	171	346	535	-	1,538	45	61	22	128	1,666
Interest income (expenses), net:														
From outside entities	2,763	(106)	2,141	650	1,113	(339)	22	-	6,244	35	765	74	874	7,118
Intersegmental	(315)	168	(466)	(67)	(179)	375	490	14	20	121	(104)	(37)	(20)	-
Total interest income (expenses), net	2,448	62	1,675	583	934	36	512	14	6,264	156	661	37	854	7,118
Total non-interest income	1,673	172	828	372	499	163	1,654	197	5,558	132	127	480	739	6,297
Total income (expenses)	4,121	234	2,503	955	1,433	199	2,166	211	11,822	288	788	517	1,593	13,415
Expenses (income) in respect of credit losses	297	(7)	218	(82)	(250)	23	(44)	-	155	6	42	(4)	44	199
Operating and other expenses:														
To outside entities	3,987	150	1,500	488	537	259	163	553	7,637	311	514	374	1,199	8,836
Intersegmental	(71)	-	-	-	1	1	69	-	-	-	-	-	-	-
Total operating and other expenses	3,916	150	1,500	488	538	260	232	553	7,637	311	514	374	1,199	8,836
Profit (loss) before taxes	(92)	91	785	549	1,145	(84)	1,978	(342)	4,030	(29)	232	147	350	4,380
Provision for (benefit from) taxes on the profit	(63)	33	279	192	409	(30)	663	(22)	1,461	(18)	86	162	230	1,691
Profit (loss) after taxes	(29)	58	506	357	736	(54)	1,315	(320)	2,569	(11)	146	(15)	120	2,689
Share of the banking corporation in profits of companies included on equity basis	-	-	-	-	-	-	177	-	177	-	-	-	-	177
Net profit (loss) before attribution to non-controlling interests	(29)	58	506	357	736	(54)	1,492	(320)	2,746	(11)	146	(15)	120	2,866
Net profit (loss) attributed to non-controlling interests	34	-	3	1	3	-	(1)	(4)	36	-	-	(5)	(5)	31
Net profit (loss) attributed to shareholders of the banking corporation	(63)	58	503	356	733	(54)	1,493	(316)	2,710	(11)	146	(10)	125	2,835

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

	For the year ended 31 December 2015														
	Activity in Israel									Activity abroad					
	Households	Private banking	Small and micro businesses	Mid-sized businesses	Large businesses	Instiitut-ional entities	Financial manage-ment segment	Other segment	Total activity in Israel	Private persons	Business activity	Other	Total activity abroad	Total
Average balance of assets (a)	112,260	539	55,210	25,520	47,134	1,237	119,794	11,159	372,853	2,771	19,935	11,824	34,530	407,383
Of which: Investments in companies included on equity basis (a)	-	-	-	-	-	-	1,343	-	1,343	-	-	-	-	1,343
Average balance of credit to the public (a)	111,027	516	54,285	23,975	45,450	517	-	-	235,770	2,799	20,073	38	22,910	258,680
Balance of credit to the public at the end of the reporting period	116,005	613	57,773	24,588	41,590	713	-	-	241,282	2,384	21,350	54	23,788	265,070
Balance of impaired debts	48	-	1,026	368	1,639	60	-	-	3,141	35	745	-	780	3,921
Balance of debts in arrears of more than 90 days	858	-	48	-	12	-	-	-	918	18	6	-	24	942
Average balance of liabilities (a)	105,236	25,402	39,834	25,989	48,019	57,238	40,136	8,941	350,795	12,272	15,266	1,441	28,979	379,774
Of which: Average balance of deposits of the public (a)	104,757	25,398	36,566	24,081	43,582	52,934	-	21	287,339	12,255	15,016	127	27,398	314,737
Balance of deposits of the public at the end of the reporting period	110,674	26,097	41,581	25,950	41,939	55,889	-	-	302,130	9,697	16,468	398	26,563	328,693
Average balance of risk assets (a)(b)	82,652	870	70,320	27,068	50,298	665	26,518	13,682	272,073	1,557	25,962	2,713	30,232	302,305
Balance of risk assets at the end of the reporting period	85,040	902	63,461	26,952	58,408	692	21,087	14,631	271,173	1,058	28,035	2,367	31,460	302,633
Average balance of assets under management (a)(c)	89,027	53,958	38,356	21,482	81,815	465,195	44,175	-	794,008	22,338	3,410	1,883	27,631	821,639
Distribution of interest income (expenses), net:														
Margin on credit granting activity	2,214	5	1,627	558	909	7	1,942	-	7,262	32	369	507	908	8,170
Margin on deposit taking activity	234	57	48	25	25	26	(1,235)	-	(820)	124	292	(541)	(125)	(945)
Other	-	-	-	-	-	3	(195)	14	(178)	-	-	71	71	(107)
Total interest income (expense), net	2,448	62	1,675	583	934	36	512	14	6,264	156	661	37	854	7,118

(a) Average balances to be calculated on the basis of daily balances at the beginning of the quarter or at the beginning of the month.
(b) Risk assets – as calculated for capital adequacy purposes.
(c) Assets under management – including provident assets, supplementary training funds, mutual funds, and securities of customers.
(d) Restated. For a description of the method of identifying segments in previous years, see Note 28 to the 2015 financial statements.

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

C. Information on regulatory operating segments (cont'd)

	For the year ended 31 December 2016								
	Household segment				Private banking segment				
	Housing loans	Credit cards	Other	Total	Housing loans	Credit cards	Other	Total	Total
Interest income from outside entities	**1,677**	**246**	**1,511**	**3,434**	**3**	**-**	**8**	**11**	**3,445**
Interest expense to outside entities	**-**	**-**	**404**	**404**	**-**	**-**	**157**	**157**	**561**
Interest income, net:									
From outside entities	**1,677**	**246**	**1,107**	**3,030**	**3**	**-**	**(149)**	**(146)**	**2,884**
Intersegmental	**(961)**	**(4)**	**513**	**(452)**	**(2)**	**-**	**234**	**232**	**(220)**
Total interest income, net	**716**	**242**	**1,620**	**2,578**	**1**	**-**	**85**	**86**	**2,664**
Total non-interest income	**45**	**876**	**816**	**1,737**	**-**	**3**	**158**	**161**	**1,898**
Total income	**761**	**1,118**	**2,436**	**4,315**	**1**	**3**	**243**	**247**	**4,562**
Expenses (income) in respect of credit losses	**(3)**	**76**	**448**	**521**	**-**	**1**	**-**	**1**	**522**
Operating and other expenses:									
To outside entities	**280**	**719**	**3,090**	**4,089**	**1**	**3**	**127**	**131**	**4,220**
Intersegmental	**1**	**22**	**-**	**23**	**-**	**-**	**-**	**-**	**23**
Total operating and other expenses	**281**	**741**	**3,090**	**4,112**	**1**	**3**	**127**	**131**	**4,243**
Profit (loss) before taxes	**483**	**301**	**(1,102)**	**(318)**	**-**	**(1)**	**116**	**115**	**(203)**
Provision for (benefit from) taxes on the profit	**171**	**78**	**(395)**	**(146)**	**-**	**-**	**42**	**42**	**(104)**
Profit (loss) after taxes	**312**	**223**	**(707)**	**(172)**	**-**	**(1)**	**74**	**73**	**(99)**
Share of the banking corporation in profits of companies included on equity basis	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Net profit (loss) before attribution to non-controlling interests	**312**	**223**	**(707)**	**(172)**	**-**	**(1)**	**74**	**73**	**(99)**
Net profit (loss) attributed to non-controlling interests	**-**	**42**	**-**	**42**	**-**	**-**	**-**	**-**	**42**
Net profit (loss) attributed to shareholders of the banking corporation	**312**	**181**	**(707)**	**(214)**	**-**	**(1)**	**74**	**73**	**(141)**

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

	For the year ended 31 December 2016								
	Household segment				Private banking segment				
	Housing loans	Credit cards	Other	Total	Housing loans	Credit cards	Other	Total	Total
Average balance of assets (a)	**76,150**	**10,967**	**29,484**	**116,601**	**152**	**98**	**351**	**601**	**117,202**
Of which: Investments in companies included on equity basis (a)	-	-	-	-	-	-	-	-	-
Average balance of credit to the public (a)	**76,150**	**10,950**	**28,614**	**115,714**	**152**	**98**	**335**	**585**	**116,299**
Balance of credit to the public at the end of the reporting period	**73,928**	**11,337**	**29,251**	**114,516**	**144**	**98**	**373**	**615**	**115,131**
Balance of impaired debts	-	**17**	**91**	**108**	-	-	-	-	**108**
Balance of debts in arrears of more than 90 days	**715**	-	**126**	**841**	-	-	-	-	**841**
Average balance of liabilities (a)	-	**141**	**115,061**	**115,202**	-	-	**29,199**	**29,199**	**144,401**
Of which: Average balance of deposits of the public (a)	-	**79**	**114,805**	**114,884**	-	-	**29,188**	**29,188**	**144,072**
Balance of deposits of the public at the end of the reporting period	-	**68**	**117,795**	**117,863**	-	-	**28,696**	**28,696**	**146,559**
Average balance of risk assets (a)(b)	**54,532**	**9,751**	**21,577**	**85,860**	**209**	**142**	**541**	**892**	**86,752**
Balance of risk assets at the end of the reporting period (b)	**54,500**	**9,746**	**21,564**	**85,810**	**209**	**142**	**542**	**893**	**86,703**
Average balance of assets under management (a)(c)	-	-	**79,493**	**79,493**	-	-	**50,439**	**50,439**	**129,932**
Distribution of interest income, net:									
Margin on credit granting activity	**716**	**242**	**1,359**	**2,317**	**1**	-	**5**	**6**	**2,323**
Margin on deposit taking activity	-	-	**261**	**261**	-	-	**80**	**80**	**341**
Other	-	-	-	-	-	-	-	-	-
Total interest income, net	**716**	**242**	**1,620**	**2,578**	**1**	-	**85**	**86**	**2,664**

(a) Average balances to be calculated on the basis of daily balances at the beginning of the quarter or at the beginning of the month.
(b) Risk assets – as calculated for capital adequacy purposes.
(c) Assets under management – including provident assets, supplementary training funds, mutual funds, and securities of customers.

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

	For the year ended 31 December 2015								
	Household segment				Private banking segment				
	Housing loans	Credit cards	Other	Total	Housing loans	Credit cards	Other	Total	Total
Interest income from outside entities	1,335	237	1,479	3,051	-	-	6	6	3,057
Interest expense to outside entities	-	2	286	288	-	-	112	112	400
Interest income (expenses), net:									
From outside entities	1,335	235	1,193	2,763	-	-	(106)	(106)	2,657
Intersegmental	(671)	(7)	363	(315)	-	-	168	168	(147)
Total interest income, net	664	228	1,556	2,448	-	-	62	62	2,510
Total non-interest income	46	730	897	1,673	-	2	170	172	1,845
Total income	710	958	2,453	4,121	-	2	232	234	4,355
Expenses (income) in respect of credit losses	12	42	243	297	-	1	(8)	(7)	290
Operating and other expenses:									
To outside entities	313	729	2,945	3,987	1	2	147	150	4,137
Intersegmental	-	(71)	-	(71)	-	-	-	-	(71)
Total operating and other expenses	313	658	2,945	3,916	1	2	147	150	4,066
Profit (loss) before taxes	385	258	(735)	(92)	(1)	(1)	93	91	(1)
Provision for (benefit from) taxes on the profit	136	69	(268)	(63)	-	-	33	33	(30)
Profit (loss) after taxes	249	189	(467)	(29)	(1)	(1)	60	58	29
Share of the banking corporation in profits of companies included on equity basis	-	-	-	-	-	-	-	-	-
Net profit (loss) before attribution to non-controlling interests	249	189	(467)	(29)	(1)	(1)	60	58	29
Net profit attributed to non-controlling interests	-	34	-	34	-	-	-	-	34
Net profit (loss) attributed to shareholders of the banking corporation	249	155	(467)	(63)	(1)	(1)	60	58	(5)

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

	For the year ended 31 December 2015								
	Household segment				Private banking segment				
	Housing loans	Credit cards	Other	Total	Housing loans	Credit cards	Other	Total	Total
Average balance of assets (a)	74,247	10,369	27,644	112,260	129	94	316	539	112,799
Of which: Investments in companies included on equity basis (a)	-	-	-	-	-	-	-	-	-
Average balance of credit to the public (a)	74,196	10,200	26,631	111,027	129	94	293	516	111,543
Balance of credit to the public at the end of the reporting period	76,781	10,633	28,591	116,005	153	98	362	613	116,618
Balance of impaired debts	-	-	48	48	-	-	-	-	48
Balance of debts in arrears of more than 90 days	750	-	108	858	-	-	-	-	858
Average balance of liabilities (a)	-	288	104,948	105,236	-	-	25,402	25,402	130,638
Of which: Average balance of deposits of the public (a)	-	69	104,688	104,757	-	-	25,398	25,398	130,155
Balance of deposits of the public at the end of the reporting period	-	65	110,609	110,674	-	-	26,097	26,097	136,771
Average balance of risk assets (a)(b)	52,844	8,899	20,909	82,652	204	139	527	870	83,522
Balance of risk assets at the end of the reporting period	54,371	9,156	21,513	85,040	211	144	547	902	85,942
Average balance of assets under management (a)(c)	-	-	89,027	89,027	-	-	53,958	53,958	142,985
Distribution of interest income, net:									
Margin on credit granting activity	664	226	1,324	2,214	-	-	5	5	2,219
Margin on deposit taking activity	-	2	232	234	-	-	57	57	291
Other	-	-	-	-	-	-	-	-	-
Total interest income, net	664	228	1,556	2,448	-	-	62	62	2,510

(a) Average balances to be calculated on the basis of daily balances at the beginning of the quarter or at the beginning of the month.
(b) Risk assets – as calculated for capital adequacy purposes.
(c) Assets under management – including provident assets, supplementary training funds, mutual funds, and securities of customers.

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

C. Information on regulatory operating segments (cont'd)

	For the year ended 31 December 2016									
	Small and micro-business segment			Mid-size business segment			Large business segment			
	Construction and real estate	Other	Total	Construction and real estate	Other	Total	Construction and real estate	Other	Total	Total
Interest income from outside entities	**582**	**1,258**	**1,840**	**221**	**462**	**683**	**650**	**990**	**1,640**	**4,163**
Interest expense to outside entities	**11**	**50**	**61**	**6**	**74**	**80**	**10**	**165**	**175**	**316**
Interest income, net:										
From outside entities	**571**	**1,208**	**1,779**	**215**	**388**	**603**	**640**	**825**	**1,465**	**3,847**
Intersegmental	**(87)**	**(92)**	**(179)**	**(38)**	**6**	**(32)**	**(155)**	**(148)**	**(303)**	**(514)**
Total interest income, net	**484**	**1,116**	**1,600**	**177**	**394**	**571**	**485**	**677**	**1,162**	**3,333**
Total non-interest income	**112**	**570**	**682**	**57**	**261**	**318**	**302**	**355**	**657**	**1,657**
Of which: Total income from credit cards	**6**	**110**	**116**	**-**	**36**	**36**	**-**	**83**	**83**	**235**
Total income	**596**	**1,686**	**2,282**	**234**	**655**	**889**	**787**	**1,032**	**1,819**	**4,990**
Expenses (income) in respect of credit losses	**19**	**203**	**222**	**(44)**	**(76)**	**(120)**	**(281)**	**(406)**	**(687)**	**(585)**
Operating and other expenses:										
To outside entities	**217**	**1,116**	**1,333**	**68**	**433**	**501**	**154**	**491**	**645**	**2,479**
Intersegmental	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**1**	**1**	**1**
Total operating and other expenses	**217**	**1,116**	**1,333**	**68**	**433**	**501**	**154**	**492**	**646**	**2,480**
Profit before taxes	**360**	**367**	**727**	**210**	**298**	**508**	**914**	**946**	**1,860**	**3,095**
Provision for taxes	**129**	**128**	**257**	**75**	**104**	**179**	**326**	**336**	**662**	**1,098**
Profit after taxes	**231**	**239**	**470**	**135**	**194**	**329**	**588**	**610**	**1,198**	**1,997**
Share of the banking corporation in profits of companies included on equity basis	-	-	-	-	-	-	-	-	-	-
Net profit before attribution to non-controlling interests	**231**	**239**	**470**	**135**	**194**	**329**	**588**	**610**	**1,198**	**1,997**
Net profit attributed to non-controlling interests	**-**	**4**	**4**	**-**	**2**	**2**	**-**	**4**	**4**	**10**
Net profit attributed to shareholders of the banking corporation	**231**	**235**	**466**	**135**	**192**	**327**	**588**	**606**	**1,194**	**1,987**

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

	For the year ended 31 December 2016									
	Small and micro-business segment			Mid-size business segment			Large business segment			
	Construction and real estate	Other	Total	Construction and real estate	Other	Total	Construction and real estate	Other	Total	Total
Average balance of assets (a)	**14,473**	**31,245**	**45,718**	**8,066**	**16,769**	**24,835**	**20,275**	**38,933**	**59,208**	**129,761**
Of which: Investments in companies included on equity basis (a)	-	-	-	-	-	-	-	-	-	-
Average balance of credit to the public (a)	**14,330**	**30,881**	**45,211**	**8,038**	**16,739**	**24,777**	**20,225**	**38,414**	**58,639**	**128,627**
Balance of credit to the public at the end of the reporting period	**15,598**	**31,974**	**47,572**	**7,219**	**16,959**	**24,178**	**17,962**	**35,175**	**53,137**	**124,887**
Balance of impaired debts	**209**	**283**	**492**	**83**	**285**	**368**	**623**	**1,003**	**1,626**	**2,486**
Balance of debts in arrears of more than 90 days	**15**	**61**	**76**	**3**	-	**3**	**12**	**7**	**19**	**98**
Average balance of liabilities (a)	**6,789**	**27,679**	**34,468**	**4,516**	**28,763**	**33,279**	**8,718**	**43,940**	**52,658**	**120,405**
Of which: Average balance of deposits of the public (a)	**6,605**	**24,960**	**31,565**	**4,435**	**27,456**	**31,891**	**8,153**	**40,417**	**48,570**	**112,026**
Balance of deposits of the public at the end of the reporting period	**8,151**	**28,384**	**36,535**	**4,657**	**28,369**	**33,026**	**8,093**	**40,058**	**48,151**	**117,712**
Average balance of risk assets (a)(b)	**23,188**	**48,156**	**71,344**	**7,742**	**18,231**	**25,973**	**15,290**	**29,490**	**44,780**	**142,097**
Balance of risk assets at the end of the reporting period (b)	**19,185**	**39,842**	**59,027**	**7,266**	**17,112**	**24,378**	**18,866**	**36,382**	**55,248**	**138,653**
Average balance of assets under management (a)(c)	**3,239**	**22,710**	**25,949**	**2,701**	**17,298**	**19,999**	**13,858**	**54,191**	**68,049**	**113,997**
Distribution of interest income, net:										
Margin on credit granting activity	**472**	**1,072**	**1,544**	**172**	**354**	**526**	**478**	**639**	**1,117**	**3,187**
Margin on deposit taking activity	**12**	**44**	**56**	**5**	**40**	**45**	**7**	**37**	**44**	**145**
Other	-	-	-	-	-	-	-	**1**	**1**	**1**
Total interest income, net	**484**	**1,116**	**1,600**	**177**	**394**	**571**	**485**	**677**	**1,162**	**3,333**

(a) Average balances to be calculated on the basis of daily balances at the beginning of the quarter or at the beginning of the month.
(b) Risk assets – as calculated for capital adequacy purposes.
(c) Assets under management – including provident assets, supplementary training funds, mutual funds, and securities of customers.

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

	For the year ended 31 December 2015									
	Small and micro-business segment			Mid-size business segment			Large business segment			
	Construction and real estate	Other	Total	Construction and real estate	Other	Total	Construction and real estate	Other	Total	Total
Interest income from outside entities	759	1,430	2,189	229	459	688	377	907	1,284	4,161
Interest expense to outside entities	11	37	48	3	35	38	8	163	171	257
Interest income (expenses), net:										
From outside entities	748	1,393	2,141	226	424	650	369	744	1,113	3,904
Intersegmental	(167)	(299)	(466)	(40)	(27)	(67)	(63)	(116)	(179)	(712)
Total interest income, net	581	1,094	1,675	186	397	583	306	628	934	3,192
Total non-interest income	192	636	828	111	261	372	206	293	499	1,699
Of which: Total income from credit cards	6	109	115	-	33	33	-	76	76	224
Total income	773	1,730	2,503	297	658	955	512	921	1,433	4,891
Expenses (income) in respect of credit losses	97	121	218	(26)	(56)	(82)	(109)	(141)	(250)	(114)
Operating and other expenses:	-	-	-	-	-	-	-	-	-	-
To outside entities	278	1,222	1,500	72	416	488	90	447	537	2,525
Intersegmental	-	-	-	-	-	-	-	1	1	1
Total operating and other expenses	278	1,222	1,500	72	416	488	90	448	538	2,526
Profit before taxes	398	387	785	251	298	549	531	614	1,145	2,479
Provision for taxes on the profit	143	136	279	90	102	192	191	218	409	880
Profit after taxes	255	251	506	161	196	357	340	396	736	1,599
Share of the banking corporation in profits of companies included on equity basis	-	-	-	-	-	-	-	-	-	-
Net profit before attribution to non-controlling interests	255	251	506	161	196	357	340	396	736	1,599
Net profit attributed to non-controlling interests	-	3	3	-	1	1	-	3	3	7
Net profit attributed to shareholders of the banking corporation	255	248	503	161	195	356	340	393	733	1,592

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

	For the year ended 31 December 2015									
	Small and micro-business segment			Mid-size business segment			Large business segment			
	Construction and real estate	Other	Total	Construction and real estate	Other	Total	Construction and real estate	Other	Total	Total
Average balance of assets (a)	22,070	33,140	55,210	7,516	18,004	25,520	11,774	35,360	47,134	127,864
Of which: Investments in companies included on equity basis (a)	-	-	-	-	-	-	-	-	-	-
Average balance of credit to the public (a)	21,786	32,499	54,285	7,405	16,570	23,975	11,401	34,049	45,450	123,710
Balance of credit to the public at the end of the reporting period	23,955	33,818	57,773	7,361	17,227	24,588	10,709	30,881	41,590	123,951
Balance of impaired debts	723	303	1,026	82	286	368	686	953	1,639	3,033
Balance of debts in arrears of more than 90 days	11	37	48	-	-	-	4	8	12	60
Average balance of liabilities (a)	8,735	31,099	39,834	3,956	22,033	25,989	5,716	42,303	48,019	113,842
Of which: Average balance of deposits of the public (a)	8,446	28,120	36,566	3,714	20,367	24,081	5,338	38,244	43,582	104,229
Balance of deposits of the public at the end of the reporting period	9,596	31,985	41,581	3,804	22,146	25,950	4,961	36,978	41,939	109,470
Average balance of risk assets (a)(b)	22,842	47,478	70,320	8,069	18,999	27,068	16,911	33,387	50,298	147,686
Balance of risk assets at the end of the reporting period (b)	20,614	42,847	63,461	8,034	18,918	26,952	19,638	38,770	58,408	148,821
Average balance of assets under management (a)(c)	7,006	31,350	38,356	2,948	18,534	21,482	14,705	67,110	81,815	141,653
Distribution of interest income, net:										
Margin on credit granting activity	569	1,058	1,627	182	376	558	302	607	909	3,094
Margin on deposit taking activity	12	36	48	4	21	25	4	21	25	98
Other	-	-	-	-	-	-	-	-	-	-
Total interest income, net	581	1,094	1,675	186	397	583	306	628	934	3,192

(a) Average balances to be calculated on the basis of daily balances at the beginning of the quarter or at the beginning of the month.
(b) Risk assets – as calculated for capital adequacy purposes.
(c) Assets under management – including provident assets, supplementary training funds, mutual funds, and securities of customers.

Note 29A – Regulatory Operating Segments and Geographical Areas (cont'd)

Information on regulatory operating segments (cont'd)

D. Information on regulatory operating segments and geographical areas

As at 31 December 2016

	Israel	USA	UK	Switzer -land	Luxem -bourg	Romania	Others	Total abroad	Total consolidated
	NIS million								
Total income (expense) (b)	11,675	856	311	(4)	35	61	-	1,259	12,934
Net profit (loss) attributed to shareholders of the banking corporation	2,727	107	(16)	(58)	24	(2)	9	64	2,791
Total assets	400,708	28,430	8,224	73	21	1,133	14	37,895	438,603

As at 31 December 2015

	Israel	USA	UK	Switzer -land	Luxem -bourg	Romania	Others	Total abroad	Total consolidated
	NIS million								
Total income (b)	11,792	1,126	332	69	27	63	6	1,623	13,415
Net profit (loss) attributed to shareholders of the banking corporation	2,710	242	81	(127)	(35)	(51)	15	125	2,835
Total assets	381,377	23,685	9,149	609	505	1,158	16	35,122	416,499

As at 31 December 2014

	Israel	USA	UK	Switzer -land	Luxem -bourg	Romania	Others	Total abroad	Total consolidated
	NIS million								
Total income (expense) (b)	11,111	673	423	251	(36)	63	19	1,393	12,504
Net profit (loss) attributed to shareholders of the banking corporation	2,138	(182)	83	(554)	(29)	(58)	15	(725)	1,413
Total assets	360,685	20,225	8,778	5,105	756	1,249	186	36,299	396,984

(a) The classification is made by the location of the office.
(b) Interest income, net and non-interest income.

Note 29B –Operating Segments by Management Approach

A. General

Reporting operating segments according to the management's approach presents the Bank's results according to business lines, in accordance with the Bank's organizational structure.

The business lines specialize in providing service to customer segments having similar characteristics and needs.

The Bank in Israel is organized into six business lines:

1. Banking – providing banking services to private and small business customers. The business line includes the mortgage department and private banking department.
2. Commercial - providing banking and financial services to middle-market companies and interested parties in these companies.
3. Corporate - providing banking and financial services to large companies and international corporations in the economy, with their activity in Israel and abroad.
4. Real estate - providing banking and financial services to the real estate and construction segment.
5. Capital market – managing the Bank's nostro, managing assets and commitments, and managing investments and financial assets.
6. Other – activities not attributed to other business lines.

Operational results are attributed to the business line in which the customer's account is managed.

1. Net interest income - the business line is credited with interest received from loans that it made available, less the cost of raising the sources (transfer cost). In addition, the business line is credited with the transfer cost for deposits that were raised less the interest that was paid to the customer.
2. Noninterest incomes (financing incomes that are not from interest, commissions and other income) – are attributed to the business line according to the customer's activity.
3. Business line expenses – include the direct expenses of the business line, and also expenses of headquarters' units providing services are charged to the business line.

The results of the business lines' activity, both on the side of the balance sheet and on the profit and loss side, are regularly examined by the Board of Directors and management. Examination of the results is done using targets set within the framework of the annual work plan and against data from the corresponding period in the previous year. In addition, an examination is carried out of a variety of additional metrics relating to the business line's activity.

Note 29B –Operating Segments by Management Approach (cont'd)

B. Information on Operating Segments by Management Approach

	For the year ended 31 December 2016								
	NIS millions								
	Bank						Subsidiaries in Israel	Subsidiaries abroad	
	Banking	Commercial	Corporate	Real Estate	Financial Management	Other and adjustments			Total
Interest income, net	**3,761**	**895**	**521**	**526**	**650**	**(1)**	**237**	**937**	**7,526**
Non-interest income	**1,768**	**401**	**209**	**343**	**863**	**686**	**1,130**	**8**	**5,408**
Total income	**5,529**	**1,296**	**730**	**869**	**1,513**	**685**	**1,367**	**945**	**12,934**
Expenses (income) in respect of credit losses	**755**	**(72)**	**(376)**	**(392)**	**(55)**	**(20)**	**37**	**(2)**	**(125)**
Total operating and other expenses	**4,505**	**701**	**356**	**176**	**368**	**625**	**905**	**944**	**8,580**
Profit before tax	**269**	**667**	**750**	**1,085**	**1,200**	**80**	**425**	**3**	**4,479**
Tax expenses (income)	**96**	**240**	**269**	**389**	**431**	**5**	**218**	**69**	**1,717**
Net profit (loss) attributed to shareholders of the banking corporation*	**173**	**427**	**481**	**696**	**774**	**75**	**231**	**(66)**	**2,791**
Credit to the public, net	**138,638**	**34,089**	**30,238**	**21,229**	**3,779**	**2,966**	**7,407**	**23,567**	**261,913**
Deposits of the public	**191,156**	**41,698**	**19,772**	**7,702**	**59,696**	**40**	**68**	**26,722**	**346,854**
Assets under management	**176,638**	**26,781**	**18,607**	**1,814**	**362,413**	**25,503**	**189,681**	**19,244**	**820,681**

	For the year ended 31 December 2015								
	NIS millions								
	Bank						Subsidiaries in Israel	Subsidiaries abroad	
	Banking	Commercial	Corporate	Real Estate	Financial Management	Other and adjustments			Total
Interest income, net	3,482	822	573	536	644	-	191	870	7,118
Non-interest income	1,848	416	205	361	431	948	1,461	627	6,297
Total income	5,330	1,238	778	897	1,075	948	1,652	1,497	13,415
Expenses (income) in respect of credit losses	470	(126)	(140)	78	(24)	(84)	13	12	199
Total operating and other expenses	4,537	741	360	173	316	644	864	1,201	8,836
Profit before tax	323	623	558	646	783	388	775	284	4,380
Tax expenses (income)	124	224	201	232	279	174	238	219	1,691
Net profit (loss) attributed to shareholders of the banking corporation*	199	399	357	414	632	214	550	70	2,835
Credit to the public, net	137,904	33,109	30,762	24,275	2,887	2,945	6,173	23,344	261,399
Deposits of the public	173,809	41,720	20,150	6,859	59,350	178	65	26,562	328,693
Assets under management	183,037	28,470	17,613	1,419	333,278	28,824	185,883	19,382	797,906

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses

A. Debts[a] and off-balance sheet credit instruments

1. Change in balance of credit loss allowance

	31 December 2016					
	Allowance for credit losses					
	Credit to the public					
	Commercial	Residential	Other private	Total	Banks and governments	Total
	(NIS millions)					
Balance of allowance for credit losses at beginning of year	**2,981** (b)	**513**	**659** (b)	**4,153**	**3**	**4,156**
Expenses (income) in respect of credit losses	**(571)**	**(9)**	**457**	**(123)**	**(2)**	**(125)**
Accounting write-offs	**(524)**	**(31)**	**(691)**	**(1,246)**	**-**	**(1,246)**
Collection of debts written off in previous years	**843**	**-**	**400**	**1,243**	**-**	**1,243**
Net accounting write-offs	**319**	**(31)**	**(291)**	**(3)**	**-**	**(3)**
Adjustments from translation of financial statements	**(2)**	**-**	**-**	**(2)**	**-**	**(2)**
Balance of allowance for credit losses at end of year[1]	**2,727**	**473**	**825**	**4,025**	**1**	**4,026**
[1]Of which: in respect of off-balance sheet credit instruments	**452**	**-**	**36**	**488**	**-**	**488**

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) Reclassified

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

A. Debts[(a)] and off-balance sheet credit instruments (cont'd)

1. Change in balance of credit loss allowance (cont'd)

	31 December 2015					
	Allowance for credit losses					
	Credit to the public					
	Commercial	Residential	Other private	Total	Banks and governments	Total
	(NIS millions)					
Balance of allowance for credit losses at beginning of year	3,365(b)	513	604(b)	4,482	4	4,486
Expenses in respect of credit losses	(123)	14	309	200	(1)	199
Accounting write-offs	(676)	(12)	(614)	(1,302)	-	(1,302)
years	410	-	361	771	-	771
Net accounting write-offs	(266)	(12)	(253)	(531)	-	(531)
Adjustments from translation of financial statements	5	(2)	(1)	2	-	2
Balance of allowance for credit losses at end of year[1]	2,981	513	659	4,153	3	4,156
[1]Of which: in respect of off-balance sheet credit instruments	449	-	33	482	-	482

	31 December 2014					
	Allowance for credit losses					
	Credit to the public					
	Commercial	Residential	Other private	Total	Banks and governments	Total
	(NIS millions)					
Balance of allowance for credit losses at beginning of year	3,349 (b)	498	448(b)	4,295	2	4,297
Expenses in respect of credit losses	90	24	356	470	2	472
Accounting write-offs	(578)	(10)	(560)	(1,148)	-	(1,148)
Collection of debts written off in previous years	479	-	364	843	-	843
Net accounting write-offs	(99)	(10)	(196)	(305)	-	(305)
Adjustments from translation of financial statements	25	1	(4)	22	-	22
Balance of allowance for credit losses at end of year[1]	3,365	513	604	4,482	4	4,486
[1]Of which: in respect of off-balance sheet credit instruments	446	1	47	494	-	494

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) Reclassified.

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Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

A. Debts[(a)] and off-balance sheet credit instruments (cont'd)

2. Additional information on the method of calculating the credit loss allowance in respect of debts[a] and on the debts[a] on which it was calculated

	31 December 2016					
	Allowance for credit losses					
	Credit to the public					
	Commercial	Residential	Other private	Total	Banks and governments	Total
	(NIS millions)					
Recorded debt balance of debts[a]:						
Examined on an individual basis	**112,550**	**45**	**512**	**113,107**	**7,890**	**120,997**
Examined on a collective basis[1]	**35,212**	**79,086**	**38,045**	**152,343**	**4,148**	**156,491**
[1]Of which: the allowance was calculated by extent of arrears	**909** (c)	**78,656**	**-**	**79,565**	**-**	**79,565**
Total debts[a]	**147,762**	**79,131**	**38,557**	**265,450**	**12,038**	**277,488**
Allowance for credit losses in respect of debts[a]:						
Examined on an individual basis	**1,913**	**6**	**214**	**2,133**	**1**	**2,134**
Examined on a collective basis[2]	**362**	**467**	**575**	**1,404**	**-**	**1,404**
[2]Of which: the allowance was calculated by extent of arrears	**-**	**462** (b)	**-**	**462**	**-**	**462**
Total allowance for credit losses	**2,275**	**473**	**789**	**3,537**	**1**	**3,538**
Of which: in respect of impaired debts	**671**	**-**	**12**	**683**	**-**	**683**

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) Including balance of allowance in excess of that required by the extent of arrears method calculated on a collective basis in the amount of NIS 294 million.

(c) Including housing loans granted to purchasing groups under construction.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

A. Debts[(a)] and off-balance sheet credit instruments (cont'd)

2. Additional information on the method of calculating the credit loss allowance in respect of debts[a] and on the debts[a] on which it was calculated

	31 December 2015					
	Allowance for credit losses					
	Credit to the public					
	Commercial	Residential	Other private	Total	Banks and governments	Total
	(NIS millions)					
Recorded debt balance of debts[a]:						
Examined on an individual basis	107,182 (d)	45	1,438 (d)	108,665	7,515	116,180
Examined on a collective basis[1]	38,097	81,760	36,548	156,405	3,254	159,659
[1]Of which: the allowance was calculated by extent of arrears	1,014 (c)	80,616	-	81,630	-	81,630
Total debts[a]	145,279	81,805	37,986	265,070	10,769	275,839
Allowance for credit losses in respect of debts[a]:						
Examined on an individual basis	2,177	15	45 (d)	2,237	3	2,240
Examined on a collective basis[2]	355 (d)	498	581	1,434	-	1,434
[2]Of which: the allowance was calculated by extent of arrears	1	497 (b)	-	498	-	498
Total allowance for credit losses	2,532	513	626	3,671	3	3,674
Of which: in respect of impaired debts	816 (e)	-	51 (e)	867	-	867

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Including balance of allowance in excess of that required by the extent of arrears method calculated on a collective basis in the amount of NIS 310 million.
(c) Including housing loans granted to purchasing groups under construction.
(d) Reclassified.
(e) Restated.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)]

1. Credit quality and arrears

	31 December 2016					
		Problem debts (b)			Unimpaired debts - additional information	
	Non-problem debts	Not impaired	Impaired (c)	Total	In arrears of 90 days or more (d)(h)	In arrears of 30 to 89 days (e)
	NIS millions					
Activity of borrowers in Israel						
Public - commercial						
Construction & real estate - construction (g)	**15,037**	**275**	**264**	**15,576**	**19**	**58**
Construction & real estate - real estate activities (g)	**22,881**	**360**	**637**	**23,878**	**12**	**35**
Financial services	**10,390**	**5**	**459**	**10,854**	**2**	**2**
Commercial - other	**65,119**	**1,745**	**1,550**	**68,414**	**65**	**144**
Total commercial	**113,427**	**2,385**	**2,910**	**118,722**	**98**	**239**
Private individuals - housing loans(f)	**77,926**	**719**(i)	**-**	**78,645**	**719**	**530**
Private individuals - other	**37,502**	**531**	**108**	**38,141**	**122**	**252**
Total public - activity in Israel	**228,855**	**3,635**	**3,018**	**235,508**	**939**	**1,021**
Israeli banks	**1,742**	**-**	**-**	**1,742**	**-**	**-**
Government of Israel	**206**	**-**	**-**	**206**	**-**	**-**
Total activity in Israel	**230,803**	**3,635**	**3,018**	**237,456**	**939**	**1,021**
Activity of borrowers abroad						
Public - commercial						
Construction & real estate (g)	**9,210**	**5**	**325**	**9,540**	**3**	**14**
Other commercial	**18,835**	**405**	**260**	**19,500**	**60**	**56**
Total commercial	**28,045**	**410**	**585**	**29,040**	**63**	**70**
Private individuals	**851**	**1**	**50**	**902**	**1**	**3**
Total public - activity abroad	**28,896**	**411**	**635**	**29,942**	**64**	**73**
Foreign banks	**9,654**	**-**	**-**	**9,654**	**-**	**-**
Foreign governments	**436**	**-**	**-**	**436**	**-**	**-**
Total activity abroad	**38,986**	**411**	**635**	**40,032**	**64**	**73**
Total public	**257,751**	**4,046**	**3,653**	**265,450**	**1,003**	**1,094**
Total banks	**11,396**	**-**	**-**	**11,396**	**-**	**-**
Total governments	**642**	**-**	**-**	**642**	**-**	**-**
Total	**269,789**	**4,046**	**3,653**	**277,488**	**1,003**	**1,094**

See notes on page 291.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[a] (cont'd)

1. Credit quality and arrears (cont'd)

	31 December 2015					
		Problem debts(b)			Unimpaired debts - additional information	
	Non-problem debts	Not impaired	Impaired (c)	Total	In arrears of 90 days or more (d)	In arrears of 30 to 89 days (e)
	NIS millions					
Activity of borrowers in Israel						
Public - commercial						
Construction & real estate - construction	14,705	420	563	15,688	11	33
Construction & real estate - real estate activities	23,182	553	918	24,653	6	13
Financial services	9,495	13	62	9,570	2	1
Commercial - other	64,014	1,798	1,502	67,314	42	108
Total commercial	111,396	2,784	3,045	117,225	61	155
Private individuals - housing loans	79,852	781 (f)	-	80,633	753	481
Private individuals - other	36,546	385	60	36,991	105	187
Total public - activity in Israel	227,794	3,950	3,105	234,849	919	823
Israeli banks	2,146	-	-	2,146	-	-
Government of Israel	262	-	-	262	-	-
Total activity in Israel	230,202	3,950	3,105	237,257	919	823
Activity of borrowers abroad						
Public - commercial						
Construction & real estate	9,071 (i)	66	434	9,571	4	113
Other commercial	17,785 (i)	368	330	18,483	2	128
Total commercial	26,856	434	764	28,054	6	241
Private individuals	2,096 (i)	19	52	2,167	17	4
Total public - activity abroad	28,952	453	816	30,221	23	245
Foreign banks	8,170	-	-	8,170	-	-
Foreign governments	191	-	-	191	-	-
Total activity abroad	37,313	453	816	38,582	23	245
Total public	256,746	4,403	3,921	265,070	942	1,068
Total banks	10,316	-	-	10,316	-	-
Total governments	453	-	-	453	-	-
Total	267,515	4,403	3,921	275,839	942	1,068

See notes on page 291.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

1. Credit quality and arrears (cont'd)

Notes:

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) Impaired, substandard or special mention credit risk, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans for which there is no provision that are in arrears of 90 days or more.

(c) As a rule, impaired debts do not accrue interest income. For information on certain impaired debts under troubled debt restructuring, see Note 30B.2.C below.

(d) Classified as problem debts that are not impaired, accruing interest income.

(e) Accruing interest income. Debts in arrears of 30 to 89 days in the amount of NIS 674 million (31 December 2015 – NIS 503 million) were classified as problem debts that are not impaired.

(f) Including housing loans in the amount of NIS 114 million (31 December 2015 – NIS 144 million) with a provision by extent of arrears, in which an arrangement was signed for the repayment of arrears by the borrower, with a change made to the repayment schedule in respect of the loan balance of which the repayment date has not yet arrived.

(g) In 2016, 3% of the credit for income-generating assets given by the Construction and Real Estate Division is at LTV rates above 85% (2015 – 5.3%%).

(h) The balance of unimpaired debits in arrears of 90 days or more, as at 31 December 2016, NIS 1,003 million, is credit given by the Bank, of which about NIS 219 million is in respect of non-housing loans, and about NIS 719 million is in respect of housing loans, of which NIS 166 million is in arrears of up to 149 days, NIS 127 million is in arrears of 150-249 days, and the balance is in respect of a loan in arrears of 250 days or more.

(i) Reclassified.

Credit quality – status of debts in arrears[a]

The status of debts in arrears is monitored routinely, and serves as one of the key indicators of credit quality. The status of debts in arrears is determined based on actual days of arrears. Debts are treated as nonperforming (not accruing interest income) after 90 days of arrears, as is any debt that has undergone troubled debt restructuring and has resumed accruing interest when it is one day of arrears relative to the new terms of the debt. With regard to debts evaluated on a collective basis, the status of arrears affects the classification of the debt (the classification is more severe for more extensive arrears) and after 150 days of arrears, the Bank performs a charge-off of the debt. With regard to housing loans, with the exception of loans without quarterly or monthly payments, the Bank establishes an allowance according to the method of the extent of arrears.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)] (cont'd)

2. Additional information on impaired debts
A. Impaired debts and individual allowance

	31 December 2016				
	Balance (b) of impaired debts in respect of which there is an individual allowance (c)	Balance of individual allowance (c)	Balance (b) of impaired debts in respect of which there is no individual allowance (c)	Total balance (b) of impaired debts	Contractual principal balance of impaired debts
	NIS millions				
Activity of borrowers in Israel					
Public - commercial					
Construction & real estate - construction	**54**	**24**	**210**	**264**	**790**
Construction & real estate - real estate activities	**132**	**76**	**505**	**637**	**1,773**
Financial services	**1**	**1**	**458**	**459**	**958**
Commercial - other	**638**	**390**	**912**	**1,550**	**4,630**
Total commercial	**825**	**491**	**2,085**	**2,910**	**8,151**
Private individuals - housing loans	**-**	**-**	**-**	**-**	**-**
Private individuals - other	**20**	**3**	**88**	**108**	**2,199**
Total public - activity in Israel	**845**	**494**	**2,173**	**3,018**	**10,350**
Israeli banks	**-**	**-**	**-**	**-**	**-**
Government of Israel	**-**	**-**	**-**	**-**	**-**
Total activity in Israel	**845**	**494**	**2,173**	**3,018**	**10,350**
Activity of borrowers abroad					
Public - commercial					
Construction & real estate	**216**	**107**	**109**	**325**	**467**
Other commercial	**180**	**73**	**80**	**260**	**587**
Total commercial	**396**	**180**	**189**	**585**	**1,054**
Private individuals	**16**	**9**	**34**	**50**	**108**
Total public - activity abroad	**412**	**189**	**223**	**635**	**1,162**
Foreign banks	**-**	**-**	**-**	**-**	**-**
Foreign governments	**-**	**-**	**-**	**-**	**-**
Total activity abroad	**412**	**189**	**223**	**635**	**1,162**
Total public	**1,257**	**683**	**2,396**	**3,653**	**11,512**
Total banks	**-**	**-**	**-**	**-**	**-**
Total governments	**-**	**-**	**-**	**-**	**-**
Total	**1,257**	**683**	**2,396**	**3,653**	**11,512**
Of which:					
Measured by present value of cash flows	**938**	**481**	**1,545**	**2,483**	
Debts under troubled debt restructuring	**302**	**109**	**1,756**	**2,058**	

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Balance of recorded debt.
(c) Individual allowance for credit losses.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)] (cont'd)

2. Additional information on impaired debts (cont'd)
A. Impaired debts and individual allowance (cont'd)

	31 December 2015				
	Balance (b) of impaired debts in respect of which there is an individual allowance (c)	Balance of individual allowance (c)	Balance (b) of impaired debts in respect of which there is no individual allowance (c)	Total balance (b) of impaired debts	Contractual principal balance of impaired debts
	NIS millions				
Activity of borrowers in Israel					
Public - commercial					
Construction & real estate - construction	149	33	414	563	1,084
Construction & real estate - real estate activities	666	178 (d)	252	918	2,214
Financial services	1	1	61	62	589
Commercial - other	1,103	333	399	1,502	4,856
Total commercial	1,919	545	1,126	3,045	8,743
Private individuals - housing loans	-	-	-	-	-
Private individuals - other	51	33(d)	9	60	1,958
Total public - activity in Israel	1,970	578	1,135	3,105	10,701
Israeli banks	-	-	-	-	-
Government of Israel	-	-	-	-	-
Total activity in Israel	1,970	578	1,135	3,105	10,701
Activity of borrowers abroad					
Public - commercial					
Construction & real estate	295	146	139	434	634
Other commercial	261	125	69	330	599
Total commercial	556	271	208	764	1,233
Private individuals	29	18	23	52	96
Total public - activity abroad	585	289	231	816	1,329
Foreign banks	-	-	-	-	1
Foreign governments	-	-	-	-	-
Total activity abroad	585	289	231	816	1,330
Total public	2,555	867	1,366	3,921	12,030
Total banks	-	-	-	-	1
Total governments	-	-	-	-	-
Total	2,555	867	1,366	3,921	12,031
Of which:					
Measured by present value of cash flows	1,549	572	950	2,499	
Debts under troubled debt restructuring	1,425	308	853	2,278	

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Balance of recorded debt.
(c) Individual allowance for credit losses.
(d) Reclassified.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)] (cont'd)

2. Additional information on impaired debts (cont'd)
B. Average balance and interest income

	For the year ended 31 December 2016		
	Average balance (b) of impaired debts	Interest income recorded (c)	Of which: recorded on cash basis
	(NIS millions)		
Activity of borrowers in Israel			
Public - commercial			
Construction & real estate - construction	**288**	**2**	**1**
Construction & real estate - real estate activities	**684**	**6**	**3**
Financial services	**226**	**1**	**-**
Commercial - other	**1,657**	**33**	**25**
Total commercial	**2,855**	**42**	**29**
Private individuals - housing loans	**-**	**-**	**-**
Private individuals - other	**137**	**3**	**1**
Total public - activity in Israel	**2,992**	**45**	**30**
Israeli banks	**-**	**-**	**-**
Government of Israel	**-**	**-**	**-**
Total activity in Israel	**2,992**	**45**	**30**
Activity of borrowers abroad			
Public - commercial			
Construction & real estate	**353**	**7**	**6**
Other commercial	**299**	**8**	**7**
Total commercial	**652**	**15**	**13**
Private individuals	**40**	**4**	**4**
Total public - activity abroad	**692**	**19**	**17**
Foreign banks	**-**	**-**	**-**
Foreign governments	**-**	**-**	**-**
Total activity abroad	**692**	**19**	**17**
Total public	**3,684**	**64**	**47**
Total banks	**-**	**-**	**-**
Total governments	**-**	**-**	**-**
Total	**3,684**	**64 (d)**	**47**

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Average debt balance recorded of impaired debts in the reporting period.
(c) Interest income recorded in the reporting period in respect of the average balance of impaired debts, for the period in which the debts were classified as impaired.
(d) If the impaired debts had accrued interest under their original terms, interest income would have been recorded in the amount of NIS 326 million.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)] (cont'd)

2. Additional information on impaired debts (cont'd)
B. Average balance and interest income (cont'd)

	For the year ended 31 December 2015		
	Average balance (b) of impaired debts	Interest income recorded (c)	Of which: recorded on cash basis
	(NIS millions)		
Activity of borrowers in Israel			
Public - commercial			
Construction & real estate - construction	582	12	12
Construction & real estate - real estate activities	1,208	16	16
Financial services	36	7	7
Commercial - other	1,512	49	32
Total commercial	3,338	84	67
Private individuals - housing loans	-	-	-
Private individuals - other	86	21	21
Total public - activity in Israel	3,424	105	88
Israeli banks	-	-	-
Government of Israel	-	-	-
Total activity in Israel	3,424	105	88
Activity of borrowers abroad			
Public - commercial			
Construction & real estate	517	12	12
Other commercial	450	9	9
Total commercial	967	21	21
Private individuals	55	2	2
Total public - activity abroad	1,022	23	23
Foreign banks	-	-	-
Foreign governments	-	-	-
Total activity abroad	1,022	23	23
Total public	4,446	128	111
Total banks	-	-	-
Total governments	-	-	-
Total	4,446	128 (d)	111

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Average debt balance recorded of impaired debts in the reporting period.
(c) Interest income recorded in the reporting period in respect of the average balance of impaired debts, for the period in which the debts were classified as impaired.
(d) If the impaired debts had accrued interest under their original terms, interest income would have been recorded in the amount of NIS 361 million.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)] (cont'd)

2. Additional information on impaired debts (cont'd)

B. Average balance and interest income (cont'd)

	For the year ended 31 December 2014		
	Average balance (b) of impaired debts	Interest income recorded (c)	Of which: recorded on cash basis
	(NIS millions)		
Activity of borrowers in Israel			
Public - commercial			
Construction & real estate - construction	501	10	10
Construction & real estate - real estate activities	1,404	13	13
Financial services	150	2	2
Commercial - other	1,612	39	38
Total commercial	3,667	64	63
Private individuals - housing loans	-	-	-
Private individuals - other	105	20	20
Total public - activity in Israel	3,772	84	83
Israeli banks	-	-	-
Government of Israel	-	-	-
Total activity in Israel	3,772	84	83
Activity of borrowers abroad			
Public - commercial			
Construction & real estate	674	8	8
Other commercial	804	14	14
Total commercial	1,478	22	22
Private individuals	71	1	1
Total public - activity abroad	1,549	23	23
Foreign banks	-	-	-
Foreign governments	-	-	-
Total activity abroad	1,549	23	23
Total public	5,321	107	106
Total banks	-	-	-
Total governments	-	-	-
Total	5,321	107 (d)	106

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Average debt balance recorded of impaired debts in the reporting period.
(c) Interest income recorded in the reporting period in respect of the average balance of impaired debts, for the period in which the debts were classified as impaired.
(d) If the impaired debts had accrued interest under their original terms, interest income would have been recorded in the amount of NIS 401 million.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)] (cont'd)

2. Additional information on impaired debts (cont'd)
C. Impaired debts under restructuring[(d)]

	31 December 2016				31 December 2015			
	Not accruing interest income	Accruing arrears of 30 to 89 days (b)(d)	Accruing (b) not in arrears	Total (c)	Not accruing interest income	Accruing arrears of 30 to 89 days (b)(d)	Accruing (b) not in arrears	Total (c)
	NIS millions				NIS millions			
Activity of borrowers in Israel								
Public - commercial								
Construction & real estate - construction	**199**	**-**	**13**	**212**	456	-	14	470
Construction & real estate - real estate activities	**346**	**4**	**44**	**394**	613	-	4	617
Financial services	**405**	**-**	**-**	**405**	1	-	-	1
Commercial - other	**395**	**2**	**217**	**614**	519	-	29	548
Total commercial	**1,345**	**6**	**274**	**1,625**	1,589	-	47	1,636
Private individuals - housing loans	**-**	**-**	**-**	**-**	-	-	-	-
Private individuals - other	**52**	**2**	**23**	**77**	56	-	-	56
Total public - activity in Israel	**1,397**	**8**	**297**	**1,702**	1,645	-	47	1,692
Israeli banks	**-**	**-**	**-**	**-**	-	-	-	-
Government of Israel	**-**	**-**	**-**	**-**	-	-	-	-
Total activity in Israel	**1,397**	**8**	**297**	**1,702**	1,645	-	47	1,692
Activity of borrowers abroad								
Public - commercial								
Construction & real estate	**152**	**-**	**83**	**235**	146	-	267	413
Other commercial	**62**	**-**	**49**	**111**	40	-	103	143
Total commercial	**214**	**-**	**132**	**346**	186	-	370	556
Private individuals	**5**	**-**	**5**	**10**	8	-	22	30
Total public - activity abroad	**219**	**-**	**137**	**356**	194	-	392	586
Foreign banks	**-**	**-**	**-**	**-**	-	-	-	-
Foreign governments	**-**	**-**	**-**	**-**	-	-	-	-
Total activity abroad	**219**	**-**	**137**	**356**	194	-	392	586
Total public	**1,616**	**8**	**434**	**2,058**	1,839	-	439	2,278
Total banks	**-**	**-**	**-**	**-**	-	-	-	-
Total governments	**-**	**-**	**-**	**-**	-	-	-	-
Total	**1,616**	**8**	**434**	**2,058**	1,839	-	439	2,278

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) Accruing interest income.

(c) Included in impaired debts.

(d) Until 30 June 2016, troubled debts under restructuring in arrears of 30-89 days did not accrue interest. On 30 June 2016, the methodology was updated so that accrual of interest is made possible in these cases. The Bank applied the directive in a prospective manner.

(e) For details on first-time implementation of the update to the directives of the Banking Supervision Department on troubled debt restructuring, see Note 1H.

Commitments to grant additional credit to borrowers for whom there was a troubled debt restructuring that included changes in the credit terms amounted at 31 December 2016 to NIS 16 million (31 December 2015 – NIS 43 million).

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)] (cont'd)

2. Additional information on impaired debts (cont'd)
C. Impaired debts under restructuring (cont'd)(b)

1. Restructurings carried out

	31 December 2016			31 December 2015		
	Number of contracts	Recorded debt balance before restructuring	Recorded debt balance after restructuring	Number of contracts	Recorded debt balance before restructuring	Recorded debt balance after restructuring
	NIS millions			NIS millions		
Activity of borrowers in Israel						
Public - commercial						
Construction & real estate - construction	**195**	**183**	**179**	33	72	70
Construction & real estate - real estate activities	**29**	**146**	**144**	4	28	26
Financial services	**14**	**410**	**405**	-	-	-
Commercial - other	**918**	**85**	**75**	105	109	102
Total commercial	**1,156**	**824**	**803**	142	209	198
Private individuals - housing loans	-	-	-	-	-	-
Private individuals - other	**5,471**	**72**	**57**	961	9	9
Total public - activity in Israel	**6,627**	**896**	**860**	1,103	218	207
Israeli banks	-	-	-	-	-	-
Government of Israel	-	-	-	-	-	-
Total activity in Israel	**6,627**	**896**	**860**	1,103	218	207
Activity of borrowers abroad						
Public - commercial						
Construction & real estate	**5**	**28**	**27**	21	42	41
Other commercial	**17**	**58**	**58**	25	75	73
Total commercial	**22**	**86**	**85**	46	117	114
Private individuals	**5**	**1**	**1**	6	2	2
Total public - activity abroad	**27**	**87**	**86**	52	119	116
Foreign banks	-	-	-	-	-	-
Foreign governments	-	-	-	-	-	-
Total activity abroad	**27**	**87**	**86**	52	119	116
Total public	**6,654**	**983**	**946**	1,155	337	323
Total banks	-	-	-	-	-	-
Total governments	-	-	-	-	-	-
Total	**6,654**	**983**	**946**	1,155	337	323

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) For details on first-time implementation of the update to the directives of the Banking Supervision Department on troubled debt restructuring, see Note 1H.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)] (cont'd)

2. Additional information on impaired debts (cont'd)

C. Impaired debts under restructuring (cont'd)(b)

1. Restructurings carried out (cont'd)

	31 December 2014		
	Number of contracts	Recorded debt balance before restructuring	Recorded debt balance after restructuring
	(NIS millions)		
Activity of borrowers in Israel			
Public - commercial			
Construction & real estate - construction	27	241	241
Construction & real estate - real estate activities	11	385	379
Financial services	-	-	-
Commercial - other	96	150	144
Total commercial	134	776	764
Private individuals - housing loans	-	-	-
Private individuals - other	855	10	10
Total public - activity in Israel	989	786	774
Israeli banks	-	-	-
Government of Israel	-	-	-
Total activity in Israel	989	786	774
Activity of borrowers abroad			
Public - commercial			
Construction & real estate	12	142	142
Other commercial	49	211	205
Total commercial	61	353	347
Private individuals	12	2	2
Total public - activity abroad	73	355	349
Foreign banks	-	-	-
Foreign governments	-	-	-
Total activity abroad	73	355	349
Total public	1,062	1,141	1,123
Total banks	-	-	-
Total governments	-	-	-
Total	1,062	1,141	1,123

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) For details on first-time implementation of the update to the directives of the Banking Supervision Department on troubled debt restructuring, see Note 1H.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[(a)] (cont'd)

2. Additional information on impaired debts (cont'd)

C. Impaired debts under restructuring (cont'd)

2. Failed restructurings[b]

	31 December 2016		31 December 2015		31 December 2014	
	Number of contracts	Recorded debt balance (c)	Number of contracts	Recorded debt balance (c)	Number of contracts	Recorded debt balance (c)
		NIS millions		NIS millions		NIS millions
Activity of borrowers in Israel						
Public - commercial						
Construction & real estate - construction	**67**	**6**	27	14	30	19
Construction & real estate - real estate activities	**6**	**6**	10	7	12	106
Financial services	**6**	**-**	-	-	1	-
Commercial - other	**309**	**19**	128	37	109	43
Total commercial	**388**	**31**	165	58	152	168
Private individuals - housing loans	**-**	**-**	-	-	-	-
Private individuals - other	**2,114**	**10**	564	10	437	4
Total public - activity in Israel	**2,502**	**41**	729	68	589	172
Israeli banks	**-**	**-**	-	-	-	-
Government of Israel	**-**	**-**	-	-	-	-
Total activity in Israel	**2,502**	**41**	729	68	589	172
Activity of borrowers abroad						
Public - commercial	**-**	**-**	-	-	-	-
Construction & real estate	**4**	**10**	8	13	3	16
Other commercial	**10**	**44**	9	4	25	69
Total commercial	**14**	**54**	17	17	28	85
Private individuals	**-**	**-**	4	1	8	1
Total public - activity abroad	**14**	**54**	21	18	36	86
Foreign banks	**-**	**-**	-	-	-	-
Foreign governments	**-**	**-**	-	-	-	-
Total activity abroad	**14**	**54**	21	18	36	86
Total public	**2,516**	**95**	750	86	625	258
Total banks	**-**	**-**	-	-	-	-
Total governments	**-**	**-**	-	-	-	-
Total	**2,516**	**95**	750	86	625	258

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.
(b) Debts that during the reporting year went into arrears of 30 days or more and underwent a troubled debt restructuring during the 12 months preceding the date they became debts in arrears.
(c) Recorded debt balance at the end of the period when the failure occurred.
(d) As of 1 July, 2015, the Bank applies the update to the FAQ file on impaired debts, credit risk and allowance for credit losses, which requires, inter alia, that the debts evaluated on a collective basis that were restructured and a failed restructuring will be written off within 60 days at the latest The Bank applied the directive on a prospective basis.
(e) For details on first-time implementation of the update to the directives of the Banking Supervision Department on troubled debt restructuring, see Note 1H.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

B. Debts[a] (cont'd)

3. Additional information on housing loans
Year-end balances by LTV[b], type of repayment and type of interest

		31 December 2016			
		Balance of housing loans			
		Total[1]	[1]Of which: bullet and balloon	[1]Of which: variable interest	Total off-balance sheet credit risk
		NIS millions			
First charge: financing ratio	Up to 60%	**50,306**	**2,738**	**33,256**	**1,681**
	Above 60%	**28,740**	**879**	**20,339**	**216**
Second charge or without charge		**85**	**24**	**56**	**27**
Total		**79,131**	**3,641**	**53,651**	**1,924**

		31 December 2015 (c)			
		Balance of housing loans			
		Total[1]	[1]Of which: bullet and balloon	[1]Of which: variable interest	Total off-balance sheet credit risk
		NIS millions			
First charge: financing ratio	Up to 60%	51,388	3,768	35,715	3,695
	Above 60%	30,372	1,151	21,898	466
Second charge or without charge		45	1	10	56
Total		81,805	4,920	57,623	4,217

(a) Credit to the public, credit to governments, deposits in banks and other debts, excluding bonds and securities borrowed or purchased under agreements to resell.

(b) The ratio between the approved facility when the facility was granted and the value of the property, as approved by the Bank when the facility was granted.
The LTV ratio is another indication of the Bank as to the assessment of customer risk when the facility was granted. On a quarterly basis, the minimum collective allowance of 0.35% is examined as required in Bank of Israel directives against the ratio of 0.75% required on credit with an LTV higher than 60%. It should be noted that the collective allowance is higher than the allowance required according to the LTV.

(c) Restated.

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

C. Credit to the public and off-balance sheet credit risk by size of credit of borrower

		31 December 2016		
Credit limit		Number of borrowers (c)	Credit (a)	Off-balance sheet credit risk (a)(b)
(NIS thousands)			(NIS millions)	
From	To			
0	**10**	**708,310**	**698**	**2,122**
10	**20**	**375,681**	**1,859**	**3,879**
20	**40**	**391,419**	**4,494**	**6,971**
40	**80**	**300,325**	**9,034**	**7,976**
80	**150**	**169,217**	**12,751**	**5,531**
150	**300**	**96,854**	**16,452**	**3,783**
300	**600**	**68,448**	**26,257**	**3,196**
600	**1,200**	**54,083**	**41,003**	**4,201**
1,200	**2,000**	**14,588**	**19,361**	**2,503**
2,000	**4,000**	**6,174**	**14,126**	**2,688**
4,000	**8,000**	**2,516**	**11,126**	**2,924**
8,000	**20,000**	**1,855**	**18,097**	**5,108**
20,000	**40,000**	**798**	**16,746**	**5,614**
40,000	**200,000**	**815**	**46,667**	**19,520**
200,000	**400,000**	**86**	**12,674**	**11,011**
400,000	**800,000**	**42**	**10,403**	**12,573**
800,000	**1,200,000**	**9**	**3,849**	**4,690**
1,200,000	**1,600,000**	**1**	**869**	**432**
1,600,000	**1,888,678**	**2**	**2,895**	**789**
Total		**2,191,223**	**269,361**	**105,511**

(a) Before the effect of allowances for credit losses, and before the effect of collateral permitted for deduction for purposes of single borrower and group of borrowers' indebtedness; with the addition of the fair value of derivative instruments in the amount of NIS 4,597 million.
(b) Credit risk in off-balance sheet financial instruments as calculated for purposes of single borrower restrictions.
(c) Number of borrowers by total credit and credit risk.

General comments:
Commencing with a credit level of NIS 8,000 thousand, the classification is set out by the specific consolidation method; with respect to the other borrowers, credit has been classified by the category consolidation method.
The definition of "borrower" and the definition of debt, including off-balance sheet credit risk, are in accordance with the directives of the Banking Supervision Department for amendment of Proper Conduct of Banking Business Directive No. 313 - "Restrictions on the Debt of a Single Borrower and of a Group of Borrowers".

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

C. Credit to the public and off-balance sheet credit risk by size of credit of borrower (cont'd)

Credit limit		31 December 2015 Number of borrowers (c)	Credit (a)	Off-balance sheet credit risk (a)(b)
(NIS thousands)			(NIS millions)	
From	To			
0	10	717,725	794	1,952
10	20	363,771	1,882	3,697
20	40	377,455	4,514	6,565
40	80	291,379	8,720	7,805
80	150	163,182	12,190	5,437
150	300	91,885	15,649	3,640
300	600	66,366	25,692	2,964
600	1,200	54,691	41,477	4,234
1,200	2,000	14,731	19,461	2,687
2,000	4,000	6,256	14,264	2,665
4,000	8,000	2,612	11,549	3,211
8,000	20,000	1,784	17,899	4,599
20,000	40,000	812	16,961	5,807
40,000	200,000	784	42,292	20,175
200,000	400,000	109	17,200	13,491
400,000	800,000	45	11,892	12,589
800,000	1,200,000	8	1,926	5,226
1,200,000	1,600,000	2	2,205	615
1,600,000	2,000,000	1	35	1,613
2,000,000	2,184,979	2	3,065	1,193
Total		2,153,600	269,667	110,165

(a) Before the effect of allowances for credit losses, and before the effect of collateral permitted for deduction for purposes of single borrower and group of borrowers' indebtedness; with the addition of the fair value of derivative instruments in the amount of NIS 4,597 million.
(b) Credit risk in off-balance sheet financial instruments as calculated for purposes of single borrower restrictions.
(c) Number of borrowers by total credit and credit risk.

General comments
Commencing with a credit level of NIS 8,000 thousand, the classification is set out by the specific consolidation method; with respect to the other borrowers, credit has been classified by the category consolidation method.
The definition of "borrower" and the definition of debt, including off-balance sheet credit risk, are in accordance with the directives of the Banking Supervision Department for amendment of Proper Conduct of Banking Business Directive No. 313 - "Restrictions on the Debt of a Single Borrower and of a Group of Borrowers".

Note 30 – Additional information on credit risk, credit to the public and the allowance for credit losses (cont'd)

D. Off-balance sheet financial instruments

	31 December 2016		31 December 2015	
	Contract balances (a)	Balance of allowance for credit losses	Contract balances (a)	Balance of allowance for credit losses
	NIS millions			
A. Off-balance sheet financial instruments				
Balances of contracts or their stated amounts as at the end of the period **Transactions in which the balance reflects a credit risk:**				
Documentary credits	**1,419**	**1**	1,759	4
Credit guarantees	**5,843**	**113**	6,136	78
Guarantees to apartment purchasers	**19,555**	**17**	19,313	21
Other guarantees and liabilities (b)	**15,859**	**236**	17,131	228
Unutilized credit card facilities	**25,522**	**26**	24,090	30
Other unutilized revolving credit facilities and credit facilities in accounts on demand	**12,492**	**24**	13,607	37
Irrevocable commitments to provide credit which has been approved and not yet granted[1]	**23,209**	**51**	25,350	68
Commitments to issue guarantees	**13,833**	**20**	14,423	16
Unutilized facilities for activity in derivative instruments	**2,912**	**-**	4,115	-
Approval in principle for a guaranteed rate of interest	**2,725**	**-**	3,874	-

[1] Of which: credit exposures in respect of the obligation to provide liquidity to securitization structures under the auspices of others not utilized in the amount of NIS 231 million (31 December 2015 – NIS 234 million). This commitment is only made in a situation where financing difficulties do not facilitate securitization.

(a) The balances of the contracts or their stated amounts at the year-end, before the effect of the allowance for credit losses.
(b) Including the Bank's liabilities in respect of its share in the risk fund of the Maof Clearing House in the amount of NIS 100 million (31 December 2015 – NIS 218 million).

E. Information on loans sold

Proceeds of NIS 1,623 million and NIS 1,100 million were received for housing loans and commercial loans, respectively, sold in 2016 (NIS 317 million in 2015).

For further information regarding transactions for the sale of loans, see Note 26B.4 below.

Note 31 - Assets and Liabilities by Linkage Basis

	31 December 2016						
	Israeli currency		Foreign currency (a)				
	Unlinked	Linked to the CPI	In US dollars	In Euros	In other currencies	Non-monetary items (b)	Total
	NIS millions						
Assets							
Cash and deposits with banks	**63,306**	**247**	**7,059**	**1,245**	**2,615**	**285**	**74,757**
Securities	**35,314**	**3,701**	**31,710**	**2,934**	**1,599**	**1,943**	**77,201**
Securities borrowed or purchased under agreements to resell	**1,284**	**-**	**-**	**-**	**-**	**-**	**1,284**
Credit to the public, net (c)	**179,553**	**44,374**	**29,299**	**3,931**	**4,576**	**180**	**261,913**
Credit to governments	**57**	**149**	**382**	**54**	**-**	**-**	**642**
Investments in companies included on equity basis	**-**	**-**	**-**	**-**	**-**	**901**	**901**
Buildings and equipment	**-**	**-**	**-**	**-**	**-**	**3,147**	**3,147**
Assets in respect of derivative instruments	**5,601**	**98**	**3,031**	**257**	**131**	**1,536**	**10,654**
Intangible assets and goodwill	**-**	**-**	**-**	**-**	**-**	**17**	**17**
Other assets	**6,035**	**4**	**914**	**4**	**27**	**1,103**	**8,087**
Total assets	**291,150**	**48,573**	**72,395**	**8,425**	**8,948**	**9,112**	**438,603**
Liabilities							
Deposits of the public	**216,180**	**20,389**	**88,469**	**14,582**	**6,726**	**508**	**346,854**
Deposits from banks	**987**	**18**	**1,640**	**710**	**39**	**-**	**3,394**
Deposits from governments	**68**	**-**	**824**	**8**	**-**	**-**	**900**
Securities loaned or sold under agreements to repurchase	**534**	**-**	**5**	**-**	**-**	**-**	**539**
Debentures, bonds and subordinated notes	**6,292**	**16,348**	**-**	**-**	**-**	**-**	**22,640**
Liabilities in respect of derivative instruments	**5,842**	**230**	**2,729**	**279**	**132**	**1,465**	**10,677**
Other liabilities	**9,152**	**10,603**	**727**	**27**	**184**	**1,192**	**21,885**
Total liabilities	**239,055**	**47,588**	**94,394**	**15,606**	**7,081**	**3,165**	**406,889**
Difference (d)	**52,095**	**985**	**(21,999)**	**(7,181)**	**1,867**	**5,947**	**31,714**
Effect of non-hedging derivative instruments:							
Derivative instruments (except options)	**(26,208)**	**(1,469)**	**22,376**	**7,593**	**(2,433)**	**141**	**-**
Options in the money, net (in terms of underlying asset)	**1,425**	**-**	**(1,318)**	**(214)**	**(31)**	**138**	**-**
Options out of the money, net (in terms of underlying asset)	**641**	**-**	**(180)**	**(476)**	**15**	**-**	**-**
Total	**27,953**	**(484)**	**(1,121)**	**(278)**	**(582)**	**6,226**	**31,714**
Effect of non-hedging derivative instruments:							
Options in the money, net (discounted par value)	**2,101**	**-**	**(2,012)**	**(253)**	**(37)**	**201**	**-**
Options out of the money, net (discounted par value)	**1,903**	**-**	**(500)**	**(1,447)**	**44**	**-**	**-**

(a) Including linked to foreign currency.
(b) Including derivative instruments whose underlying asset is a non-monetary item.
(c) After deduction of credit loss allowances attributable to linkage bases in the amount of NIS 3,537 million.
(d) Shareholders' equity includes non-controlling interests.

Note 31 - Assets and Liabilities by Linkage Basis (cont'd)

	31 December 2015						
	Israeli currency		Foreign currency (a)				
	Unlinked	Linked to the CPI	In US dollars	In Euros	In other currencies	Non-monetary items (b)	Total
	NIS millions						
Assets							
Cash and deposits with banks	50,912	246	5,951	763	2,407	176	60,455
Securities	32,331	1,933	28,228	2,023	1,640	3,320	69,475
Securities borrowed or purchased under agreements to resell	1,764	-	-	-	-	-	1,764
Credit to the public, net (c)	172,545	49,178	28,768	4,809	5,849	250	261,399
Credit to governments	67	195	130	61	-	-	453
Investments in companies included on equity basis	-	-	-	-	-	924	924
Buildings and equipment	-	-	-	-	-	3,095	3,095
Assets in respect of derivative instruments	6,402	115	3,466	308	243	716	11,250
Intangible assets and goodwill	-	-	-	-	-	18	18
Other assets	6,138	5	896	6	44	577	7,666
Total assets	270,159	51,672	67,439	7,970	10,183	9,076	416,499
Liabilities							
Deposits of the public	195,425	25,583	84,646	13,709	8,866	464	328,693
Deposits from banks	1,886	72	1,470	385	46	-	3,859
Deposits from governments	39	1	703	7	-	-	750
Securities loaned or sold under agreements to repurchase	938	-	-	-	-	-	938
Debentures, bonds and subordinated notes	5,704	15,604	-	-	-	-	21,308
Liabilities in respect of derivative instruments	6,356	222	3,266	305	247	702	11,098
Other liabilities	9,170	9,515	964	51	215	831	20,746
Total liabilities	219,518	50,997	91,049	14,457	9,374	1,997	387,392
Difference (d)	50,641	675	(23,610)	(6,487)	809	7,079	29,107
Effect of non-hedging derivative instruments:							
Derivative instruments (except options)	(26,357)	(1,308)	23,871	5,617	(1,427)	(396)	-
Options in the money, net (in terms of underlying asset)	616	-	(654)	102	(64)	-	-
Options out of the money, net (in terms of underlying asset)	533	-	(483)	(9)	(41)	-	-
Total	25,433	(633)	(876)	(777)	(723)	6,683	29,107
Effect of non-hedging derivative instruments:							
Options in the money, net (discounted par value)	1,425	-	(1,257)	(100)	(68)	-	-
Options out of the money, net (discounted par value)	1,305	-	(1,112)	(416)	223	-	-

(a) Including linked to foreign currency.
(b) Including derivative instruments whose underlying asset is a non-monetary item.
(c) After deduction of credit loss allowances attributable to linkage bases in the amount of NIS 3,671 million.
(d) Shareholders' equity includes non-controlling interests.

Note 32 - Assets and Liabilities by Maturities and Linkage Basis [(a)]

	31 December 2016			
	Estimated future contractual cash flows			
	Upon demand and up to one month (f)	One month to three months (f)	Three months to one year (f)	One year to two years
	NIS millions			
Israeli currency (including linked to foreign currency):				
Assets[1]	**101,865**	**22,636**	**60,972**	**30,831**
Liabilities[2]	**177,895**	**22,668**	**46,914**	**9,016**
Difference	**(76,030)**	**(32)**	**14,058**	**21,815**
[1]Of which: credit to the public	**34,836**	**17,171**	**39,633**	**28,021**
[2]Of which: deposits of the public	**168,219**	**21,775**	**35,696**	**6,810**
Derivative instruments (except options)	**(13,323)**	**(605)**	**(16,102)**	**184**
Options (in terms of underlying asset)	**34**	**205**	**140**	**193**
Difference after effect of derivative instruments	**(89,319)**	**(432)**	**(1,904)**	**22,192**
Foreign currency (c)				
Assets[1]	**21,469**	**11,636**	**16,742**	**11,629**
Liabilities[2]	**83,160**	**12,753**	**18,939**	**3,062**
Difference	**(61,691)**	**(1,117)**	**(2,197)**	**8,567**
[1]Of which: credit to the public	**8,639**	**5,363**	**7,616**	**5,193**
[2]Of which: deposits of the public	**79,229**	**11,274**	**16,754**	**2,608**
Of which difference in $	**(50,028)**	**1,590**	**(2,463)**	**4,368**
Of which: difference in respect of foreign operations	**(4,707)**	**719**	**(876)**	**2,765**
Derivative instruments (except options)	**13,323**	**605**	**16,102**	**(184)**
Options (in terms of underlying asset)	**(34)**	**(205)**	**(140)**	**(193)**
Difference after effect of derivative instruments	**(48,402)**	**(717)**	**13,765**	**8,190**
Total				
Assets[1]	**123,334**	**34,272**	**77,714**	**42,460**
Liabilities[2]	**261,055**	**35,421**	**65,853**	**12,078**
Difference (g)	**(137,721)**	**(1,149)**	**11,861**	**30,382**
[1]Of which: credit to the public	**43,475**	**22,534**	**47,249**	**33,214**
[2]Of which: deposits of the public	**247,448**	**33,049**	**52,450**	**9,418**

Notes:

(a) In this Note, forecast contractual future cash flows in respect of assets and liabilities are shown according to linkage basis, in accordance with the remaining contractual period to maturity of each cash flow. The data is presented after deduction of allowance for credit losses.

(b) Assets without a fixed maturity include assets in the amount of NIS 693 million that are overdue.

(c) Not including Israeli currency linked to foreign currency.

(d) As included in Note 31 "Assets and Liabilities by Linkage Basis", including off-balance sheet amounts in respect of derivatives that are not settled net.

(e) The contractual rate of return is the interest rate discounting future anticipated contractual cash flows reported in this Note in respect of a monetary item to the balance sheet figure.

(f) Credit with current loan conditions classified in accordance with the period of the facility is in the amount of NIS 9.6 billion. Over-limit credit in the amount of NIS 0.9 billion is classified as without repayment date.

(g) The above difference does not necessarily reflect the exposure to interest and/or linkage basis.

Note: Total memorandum liabilities against which short-term credit was granted in the Bank amount to NIS 4.9 billion.

Note 32 - Assets and Liabilities by Maturities and Linkage Basis [(a)] (cont'd)

							Book balance (d)		
Two years to three years	Three years to four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total cash flows	Without fixed maturity (b)	Total	Contractual rate of return (e) in %
26,813	**20,289**	**18,560**	**47,213**	**40,073**	**13,938**	**383,190**	**4,048**	**341,590**	**2.90**
6,526	**12,402**	**5,137**	**8,276**	**2,954**	**3,781**	**295,569**	**879**	**288,443**	**1.43**
20,287	**7,887**	**13,423**	**38,937**	**37,119**	**10,157**	**87,621**	**3,169**	**53,147**	
23,103	**18,565**	**13,747**	**39,764**	**38,128**	**11,592**	**264,560**	**2,126**	**223,926**	**3.61**
3,647	**1,414**	**1,651**	**2,638**	**554**	**-**	**242,404**	**68**	**236,637**	**1.99**
1,638	**(465)**	**(790)**	**448**	**(147)**	**-**	**(29,162)**	**-**	**(27,723)**	
920	**708**	**-**	**-**	**-**	**-**	**2,200**	**-**	**2,066**	
22,845	**8,130**	**12,633**	**39,385**	**36,972**	**10,157**	**60,659**	**3,169**	**27,490**	
6,653	**6,808**	**4,782**	**13,346**	**4,188**	**1,075**	**98,328**	**1,649**	**87,901**	**3.40**
1,425	**556**	**380**	**354**	**55**	**4**	**120,688**	**70**	**115,281**	**1.88**
5,228	**6,252**	**4,402**	**12,992**	**4,133**	**1,071**	**(22,360)**	**1,579**	**(27,380)**	
3,499	**2,599**	**2,264**	**2,815**	**689**	**157**	**38,834**	**1,642**	**37,807**	**3.60**
731	**237**	**160**	**322**	**-**	**1**	**111,316**	**29**	**109,709**	**1.91**
7,146	**4,990**	**3,999**	**12,067**	**3,535**	**1,030**	**(13,766)**	**1,775**	**(16,521)**	
2,834	**2,692**	**2,579**	**3,455**	**1,288**	**258**	**11,007**	**55**	**8,908**	
(1,638)	**465**	**790**	**(448)**	**147**	**-**	**29,162**	**-**	**27,582**	
(920)	**(708)**	**-**	**-**	**-**	**-**	**(2,200)**	**-**	**(2,204)**	
2,670	**6,009**	**5,192**	**12,544**	**4,280**	**1,071**	**4,602**	**1,579**	**(2,002)**	
33,466	**27,097**	**23,342**	**60,559**	**44,261**	**15,013**	**481,518**	**5,697**	**429,491**	**3.00**
7,951	**12,958**	**5,517**	**8,630**	**3,009**	**3,785**	**416,257**	**949**	**403,724**	**1.56**
25,515	**14,139**	**17,825**	**51,929**	**41,252**	**11,228**	**65,261**	**4,748**	**25,767**	
26,602	**21,164**	**16,011**	**42,579**	**38,817**	**11,749**	**303,394**	**3,768**	**261,733**	**3.61**
4,378	**1,651**	**1,811**	**2,960**	**554**	**1**	**353,720**	**97**	**346,346**	**1.96**

Note 32 - Assets and Liabilities by Maturities and Linkage Basis [(a)] (cont'd)

	31 December 2015			
	Estimated future contractual cash flows			
	Upon demand and up to one month (f)	One month to three months (f)	Three months to one year (f)	One year to two years
	NIS millions			
Israeli currency (including linked to foreign currency):				
Assets[1(h)]	93,336	20,412	57,288	30,828
Liabilities[2(h)]	170,116	18,473	38,210	16,970
Difference	(76,780)	1,939	19,078	13,858
[1]Of which: credit to the public	37,901	16,285	37,463	27,640
[2]Of which: deposits of the public	159,358	16,220	32,677	7,581
Derivative instruments (except options)	(7,869)	(408)	(16,775)	145
Options (in terms of underlying asset)	(808)	298	(231)	4
Difference after effect of derivative instruments	(85,457)	1,829	2,072	14,007
Foreign currency (c)				
Assets[1]	19,977	7,970	14,934	9,356
Liabilities[2]	77,142	12,502	20,547	3,428
Difference	(57,165)	(4,532)	(5,613)	5,928
[1]Of which: credit to the public	8,839	6,626	8,808	4,483
[2]Of which: deposits of the public	73,220	11,771	18,450	2,745
Of which difference in $	(44,941)	(5,462)	(4,680)	5,444
Of which: difference in respect of foreign operations	(6,228)	1,805	(1,303)	2,208
Derivative instruments (except options)	7,869	408	16,775	(145)
Options (in terms of underlying asset)	808	(298)	231	(4)
Difference after effect of derivative instruments	(48,488)	(4,422)	11,393	5,779
Total				
Assets[1]	113,313	28,382	72,222	40,184
Liabilities[2]	247,258	30,975	58,757	20,398
Difference (g)	(133,945)	(2,593)	13,465	19,786
[1]Of which: credit to the public	46,740	22,911	46,271	32,123
[2]Of which: deposits of the public	232,578	27,991	51,127	10,326

Notes:

(a) In this Note, forecast contractual future cash flows in respect of assets and liabilities are shown according to linkage basis, in accordance with the remaining contractual period to maturity of each cash flow. The data is presented after deduction of allowance for credit losses.

(b) Assets without a fixed maturity include assets in the amount of NIS 568 million that are overdue.

(c) Not including Israeli currency linked to foreign currency.

(d) As included in Note 31 "Assets and Liabilities by Linkage Basis", including off-balance sheet amounts in respect of derivatives that are not settled net.

(e) The contractual rate of return is the interest rate discounting future anticipated contractual cash flows reported in this Note in respect of a monetary item to the balance sheet figure.

(f) Credit with current loan account conditions is classified in accordance with the period of the credit facility in the amount of NIS 10.6 billion. Over-limit credit in the amount of NIS 0.9 billion is classified as without repayment date.

(g) The above difference does not necessarily reflect the exposure to interest and/or linkage basis.

Note: Total memorandum liabilities against which short-term credit was granted in the Bank amount to NIS 4.9 billion.

Note 32 - Assets and Liabilities by Maturities and Linkage Basis [a] (cont'd)

							Book balance (d)		
Two years to three years	Three years to four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total cash flows	Without fixed maturity (b)	Total	Contractual rate of return (e) in %
23,518	18,928	18,061	47,720	41,126	13,987	365,204	2,538	324,041	2.03
4,759	4,686	8,514	10,529	4,094	2,386	278,737	1,468	272,832	1.65
18,759	14,242	9,547	37,191	37,032	11,601	86,467	1,070	51,209	
21,885	17,154	14,141	38,663	37,861	12,168	261,161	749	221,725	3.52
2,839	2,032	1,311	3,759	525	-	226,302	-	221,301	1.18
596	1,697	(823)	(758)	(195)	-	(24,390)	-	(22,179)	
188	930	726	-	-	-	1,107	-	1,055	
19,543	16,869	9,450	36,433	36,837	11,601	63,184	1,070	30,085	
6,464	5,573	5,865	11,465	5,797	4,375	91,776	472	83,382	2.45
1,404	1,300	438	97	417	1	117,276	3	112,563	1.51
5,060	4,273	5,427	11,368	5,380	4,374	(25,500)	469	(29,181)	
3,576	2,694	2,993	2,252	733	177	41,181	449	39,424	3.48
931	771	159	97	356	1	108,501	-	106,928	1.10
3,629	3,232	3,302	9,925	4,696	3,761	(21,094)	914	(21,477)	
2,382	2,238	2,958	2,023	583	74	6,740	23	5,872	
(596)	(1,697)	823	758	195	-	24,390	-	22,574	
(188)	(930)	(726)	-	-	-	(1,107)	-	(1,055)	
4,276	1,646	5,524	12,126	5,575	4,374	(2,217)	469	(7,662)	
29,982	24,501	23,926	59,185	46,923	18,362	456,980	3,010	407,423	2.12
6,163	5,986	8,952	10,626	4,511	2,387	396,013	1,471	385,395	1.61
23,819	18,515	14,974	48,559	42,412	15,975	60,967	1,539	22,028	
25,461	19,848	17,134	40,915	38,594	12,345	302,342	1,198	261,149	3.51
3,770	2,803	1,470	3,856	881	1	334,803	-	328,229	1.16

Note 33A – Balances and fair value assessments of financial instruments

A. General

This note includes information regarding the determination of the fair value of financial instruments according to directives of the Supervisor of Banks. Most of the financial instruments of the Bank do not have a "market value" because they do not have an active trading market. Their fair value is therefore determined on the basis of the present value of future cash flows, discounted at an interest rate that reflects the interest at which the Bank would have effected a similar transaction on the reporting date. The estimated fair value is calculated by means of estimating future cash flows and a subjective determination of the discount rate. Therefore, in respect of most financial instruments, the reported fair value does not necessarily indicate the realizable value of the financial instrument on the reporting date. The estimate of fair value is made on the basis of interest rates in effect on the reporting date and does not take into account interest rate fluctuations. Under different interest rates the fair value calculated may be significantly different. This is true especially in respect of financial instruments with interest at fixed rates or those which are non-interest bearing. Furthermore, the determination of fair value does not take into account commissions that will be received or paid over the course of business. In addition, the difference between the balance sheet value and the fair value may not be realized because in most cases the Bank may hold the financial instrument until maturity. Therefore, it should be noted that the data included in this note do not purport to reflect the value of the Bank as a going concern. Furthermore, because of the wide range of valuation techniques and estimates that can be applied in the calculation of fair value, caution must be exercised when comparing fair values of different banks.

B. Principal methods and assumptions used in estimating the fair value of financial instruments

Financial assets:

Credit to the public - the fair value of credit to the public is determined on the basis of the present value of future cash flows discounted at an appropriate discount rate. The balance of credit was classified into a number of categories according to the operating segment and the credit rating of the borrowers. Future cash flows (principal and interest) were calculated in respect of each category according to the various linkage bases. These receipts were discounted at an interest rate that reflects the rate of risk and average margin inherent in that category of credit and the term of the credit.

The interest rate is usually determined according to the interest rate used in similar transactions on the reporting date.

The fair value of debit balances in current accounts was valued at book value.
The fair value of impaired debts was calculated using interest rates that reflect the inherent high credit risk. In any case, these interest rates reflect the highest rates of interest used by the Group in transactions on the reporting date in the same segment.

The fair value of current account balances classified as impaired loans was calculated in accordance with an estimate of their average duration and based on maximum interest rates in the Bank.

The future cash flows in respect of impaired debts were calculated after deducting the effect of accounting write-offs and allowances for credit losses.

Note 33A – Balances and fair value assessments of financial instruments (cont'd)

Deposits with banks and credit to governments - by the discounted future cash flows method, at interest rates at which similar transactions were executed on the reporting date.

Securities – Quoted securities at their market value. Unquoted securities, shares at cost, and debentures according to a model which takes into account the present value of future cash flows discounted at the appropriate discount rate, and which also takes into account the probability of default and market value.

Financial liabilities:

Deposits of the public - The balance of the deposits is classified according to a number of categories according to operating segments, adjustment basis and the terms of deposit. Future cash flows (principal and interest) were calculated in respect of each category. These payments were discounted at an interest rate that reflects the average interest rate the Group pays on similar deposits in the same category for the period remaining until maturity. The balance sheet amount of current accounts and deposits without a repayment date is considered to be an estimate of their fair value.

Deposits from banks and deposits from governments - The fair value estimated by the discounted future cash flows method, at the rate of interest at which the Group raises similar deposits on the reporting date.

Debentures, bonds and subordinated notes - At their fair value or by the discounted future cash flows method, at the rate of interest at which the Group raises similar deposits or at the rate at which it issues similar bonds on the reporting date.

Other financial assets and liabilities:

Derivative financial instruments:

Derivative financial instruments that have an active market were valued according to the market value determined in the principal market. When there are a number of markets in which the instrument is traded, the value is determined according to the most active market.

Derivative financial instruments that are not traded on an active market were valued on the basis of models the Bank uses in its current operations as at the reporting date, which take into account the risks inherent in the financial instrument (market risk, credit risk, etc.).

Note 33A – Balances and fair value assessments of financial instruments (cont'd)

	31 December 2016				
	Book	Fair value			
	value	Level 1 (a)	Level 2 (a)	Level 3 (a)	Total
	NIS millions				
Financial assets					
Cash and deposits with banks	**74,757**	**65,326**	**7,134**	**2,301**	**74,761**
Securities (b)	**77,201**	**50,337**	**24,457**	**2,407**	**77,201**
Securities borrowed or purchased under agreements to resell	**1,284**	**1,284**	**-**	**-**	**1,284**
Credit to the public, net	**261,913**	**2,522**	**73,382**	**184,726**	**260,630**
Credit to governments	**642**	**-**	**27**	**642**	**669**
Assets in respect of derivative instruments	**10,654**	**727**	**8,960**	**967**	**10,654**
Other financial assets	**1,755**	**980**	**-**	**776**	**1,756**
Total financial assets	**428,206** (c)	**121,176**	**113,960**	**191,819**	**426,955**
Financial liabilities					
Deposits of the public	**346,854**	**2,379**	**232,144**	**113,396**	**347,919**
Deposits from banks	**3,394**	**-**	**3,302**	**76**	**3,378**
Deposits from governments	**900**	**-**	**833**	**86**	**919**
Securities loaned or sold under agreements to repurchase	**539**	**539**	**-**	**-**	**539**
Debentures, bonds and subordinated notes	**22,640**	**17,795**	**12**	**6,119**	**23,926**
Liabilities in respect of derivative instruments	**10,677**	**728**	**9,542**	**407**	**10,677**
Other financial liabilities	**8,446**	**1,746**	**5,294**	**1,407**	**8,447**
Total financial liabilities	**393,450** (c)	**23,187**	**251,127**	**121,491**	**395,805**
Off-balance sheet financial instruments					
Transactions in which the balance reflects a credit risk	**353**	**-**	**-**	**353**	**353**
In addition, the liability in respect of employee rights, gross - pension and severance pay (d)	**16,948**	**-**	**183**	**16,765**	**16,948**

(a) Level 1 - Fair value measurements using prices quoted in an active market.
Level 2 – Fair value measurements using other significant observable inputs.
Level 3 – Fair value measurements using significant unobservable inputs.

(b) For further details of the book value and fair value of securities, see Note 12 on Securities.

(c) Of which assets and liabilities of NIS 120,850 million and NIS 156,667 million, respectively, whose book value is the same as fair value (instruments that are shown in the balance sheet at fair value) or are an approximation of fair value (instruments for an original period of 3 months for which the book value is used as an approximation of fair value). For further information on instruments measured for fair value on a recurring basis and on a non-recurring basis, see Notes 33B-33D.

(d) The liability is shown gross, without taking into account the plan assets managed against it.

Note 33A – Balances and fair value assessments of financial instruments (cont'd)

	31 December 2015				
	Book value	Fair value			
		Level 1 (a)	Level 2 (a)	Level 3 (a)	Total
	NIS millions				
Financial assets					
Cash and deposits with banks	60,455	52,418	6,431	1,656	60,505
Securities (b)	69,475	46,931	19,491	3,053	69,475
Securities borrowed or purchased under agreements to resell	1,764	1,764	-	-	1,764
Credit to the public, net	261,399	2,246	68,534	190,601	261,381
Credit to governments	453	-	26	441	467
Assets in respect of derivative instruments	11,250	916	8,931	1,403	11,250
Other financial assets	1,643	551	-	1,093	1,644
Total financial assets	406,439 (c)	104,826	103,413	198,247	406,486
Financial liabilities					
Deposits of the public	328,693	2,666	203,012	124,612	330,290
Deposits from banks	3,859	-	3,777	56	3,833
Deposits from governments	750	-	688	86	774
Securities loaned or sold under agreements to repurchase	938	938	-	-	938
Debentures, bonds and subordinated notes	21,308	17,880	340	4,724	22,944
Liabilities in respect of derivative instruments	11,098	914	9,932	252	11,098
Other financial liabilities	7,871	1,363	5,025	1,480	7,868
Total financial liabilities	374,517 (c)	23,761	222,774	131,210	377,745
Off-balance sheet financial instruments					
Transactions in which the balance reflects a credit risk	347	-	-	347	347
In addition, liabilities in respect of employee rights, gross - pension and severance (d)	15,764	-	194	15,570	15,764

(a) Level 1 - Fair value measurements using prices quoted in an active market.
Level 2 – Fair value measurements using other significant observable inputs.
Level 3 – Fair value measurements using significant unobservable inputs.

(b) For further details of the book value and fair value of securities, see Note 12 on Securities.

(c) Of which assets and liabilities of NIS 113,254 million and NIS 130,250 million, respectively, whose book value is the same as fair value (instruments that are shown in the balance sheet at fair value) or are an approximation of fair value (instruments for an original period of 3 months for which the book value is used as an approximation of fair value). For further information on instruments measured for fair value on a recurring basis and on a non-recurring basis, see Notes 33B-33D.

(d) The liability is shown gross, without taking into account the plan assets managed against it.

Note 33B – Items measured for fair value

(a) Items measured for fair value on a recurring basis

	31 December 2016			
	Fair value measurements using:			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
	NIS millions			
Assets				
Securities available for sale:				
Israeli government bonds	**33,382**	**2,027**	**-**	**35,409**
Foreign government bonds	**9,994**	**1,935**	**-**	**11,929**
Bonds of Israeli financial institutions	**-**	**23**	**-**	**23**
Bonds of financial institutions abroad	**44**	**7,416**	**-**	**7,460**
Asset-backed (ABS) or mortgage-backed (MBS) bonds	**-**	**8,323**	**1,426**	**9,749**
Other bonds in Israel	**68**	**228**	**-**	**296**
Other bonds abroad	**-**	**1,882**	**-**	**1,882**
Shares and mutual funds available for sale	**961**	**-**	**-**	**961**
Total securities available for sale	**44,449**	**21,834**	**1,426**	**67,709**
Securities held for trading:				
Israeli government bonds	**5,091**	**-**	**-**	**5,091**
Foreign government bonds	**505**	**1,953**	**-**	**2,458**
Bonds of Israeli financial institutions	**159**	**-**	**-**	**159**
Bonds of financial institutions abroad	**-**	**104**	**-**	**104**
Asset-backed (ABS) or mortgage-backed (MBS) bonds	**-**	**280**	**-**	**280**
Other bonds in Israel	**132**	**-**	**-**	**132**
Other bonds abroad	**-**	**286**	**-**	**286**
Shares and mutual funds held for trading	**1**	**-**	**-**	**1**
Total securities held for trading	**5,888**	**2,623**	**-**	**8,511**
Assets in respect of derivative instruments:				
Shekel-index contracts	**-**	**137**	**202**	**339**
Interest contracts	**33**	**5,482**	**130**	**5,645**
Foreign currency contracts	**1**	**2,368**	**575**	**2,944**
Share contracts	**432**	**958**	**57**	**1,447**
Commodity and other contracts	**6**	**15**	**3**	**24**
Activity in the Maof market	**255**	**-**	**-**	**255**
Total assets in respect of derivative instruments	**727**	**8,960**	**967**	**10,654**
Others:				
Credit and deposits in respect of the lending of securities	**2,522**	**5**	**-**	**2,527**
Securities borrowed or purchased under agreements to resell	**1,284**	**-**	**-**	**1,284**
Other	**980**	**-**	**-**	**980**
Total others	**4,786**	**5**	**-**	**4,791**
Total assets	**55,850**	**33,422**	**2,393**	**91,665**

Note 33B – Items measured for fair value (cont'd)

(a) Items measured for fair value on a recurring basis (cont'd)

	31 December 2016			
	Fair value measurements using:			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
	NIS millions			
Liabilities:				
Liabilities in respect of derivative instruments:				
Shekel-index contracts	**-**	**238**	**162**	**400**
Interest contracts	**37**	**5,250**	**-**	**5,287**
Foreign currency contracts	**1**	**3,058**	**245**	**3,304**
Share contracts	**432**	**983**	**-**	**1,415**
Commodity and other contracts	**7**	**13**	**-**	**20**
Activity in the Maof market	**251**	**-**	**-**	**251**
Total liabilities in respect of derivative instruments	**728**	**9,542**	**407**	**10,677**
Others:				
Deposits in respect of the lending of securities	**2,379**	**16**	**34**	**2,429**
Securities loaned or sold under agreements to repurchase	**539**	**-**	**-**	**539**
Other	**1,746**	**-**	**-**	**1,746**
Total others	**4,664**	**16**	**34**	**4,714**
Total liabilities	**5,392**	**9,558**	**441**	**15,391**

Note 33B – Items measured for fair value (cont'd)

(a) Items measured for fair value on a recurring basis on consolidated basis (cont'd)

	31 December 2015			
	Fair value measurements using:			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
	NIS millions			
Assets				
Securities available for sale:				
Israeli government bonds	26,954	1,599	-	28,553
Foreign government bonds	7,339	789	-	8,128
Bonds of Israeli financial institutions	-	35	-	35
Bonds of financial institutions abroad	157	6,105	-	6,262
Asset-backed (ABS) or mortgage-backed (MBS) bonds	-	7,563	2,003	9,566
Other bonds in Israel	113	473	-	586
Other bonds abroad	20	1,674	-	1,694
Shares and mutual funds available for sale	1,653	-	-	1,653
Total securities available for sale	36,236	18,238	2,003	56,477
Securities held for trading:				
Israeli government bonds	6,632	32	-	6,664
Foreign government bonds	3,056	2	-	3,058
Bonds of Israeli financial institutions	238	-	-	238
Bonds of financial institutions abroad	-	148	-	148
Asset-backed (ABS) or mortgage-backed (MBS) bonds	-	751	-	751
Other bonds in Israel	152	-	-	152
Other bonds abroad	-	320	-	320
Shares and mutual funds held for trading	617	-	-	617
Total securities held for trading	10,695	1,253	-	11,948
Assets in respect of derivative instruments:				
Shekel-index contracts	-	170	174	344
Interest contracts	30	6,043	297	6,370
Foreign currency contracts	-	2,292	770	3,062
Share contracts	517	420	129	1,066
Commodity and other contracts	7	6	33	46
Activity in the Maof market	362	-	-	362
Total assets in respect of derivative instruments	916	8,931	1,403	11,250
Others:				
Credit and deposits in respect of the lending of securities	2,246	6	-	2,252
Securities borrowed or purchased under agreements to resell	1,764	-	-	1,764
Other	551	-	-	551
Total others	4,561	6	-	4,567
Total assets	52,408	28,428	3,406	84,242

Note 33B – Items measured for fair value (cont'd)

(a) Items measured for fair value on a recurring basis on consolidated basis (cont'd)

	31 December 2015			
	Fair value measurements using:			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value
	NIS millions			
Liabilities:				
Liabilities in respect of derivative instruments:				
Shekel-index contracts	-	339	53	392
Interest contracts	30	6,065	-	6,095
Foreign currency contracts	-	2,930	199	3,129
Share contracts	517	559	-	1,076
Commodity and other contracts	7	39	-	46
Activity in the Maof market	360	-	-	360
Total liabilities in respect of derivative instruments	914	9,932	252	11,098
Others:				
Deposits in respect of the lending of securities	2,666	20	13	2,699
Securities loaned or sold under agreements to repurchase	938	-	-	938
Other	1,363	-	-	1,363
Total others	4,967	20	13	5,000
Total liabilities	5,881	9,952	265	16,098

(b) Items measured for fair value on a non-recurring basis

	31 December 2016				
	Fair value measurements using:				
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value	Total profit (loss) from changes in value for the period
	NIS millions				
Collateral-dependent impaired credit	-	-	**968**	**968**	**291**
Total	-	-	**968**	**968**	**291**

	31 December 2015				
	Fair value measurements using:				
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total fair value	Total profit (loss) from changes in value for the period
	NIS millions				
Collateral-dependent impaired credit	-	-	1,132	1,132	14
Total	-	-	1,132	1,132	14

Note 33C – Changes in items measured for fair value on a recurring basis included in Level 3

	For the year ended 31 December 2016										
		Total realized and unrealized profits (losses) included:									
	Fair value at beginning of the year	In profit and loss (a)	In other comprehensive profit (b)	Acquisitions and issues	Sales	Extinguish-ments	Adjustments from translation of financial statements	Transfers to Level 3 (c)	Transfers from Level 3 (c)	Fair value at 31 December 2015	Unrealized profits (losses) in respect of instruments held at 31 December 2015
	NIS millions										
Assets											
Securities available for sale:											
ABS / MBS	**2,003**	**(61)**	**10**	**130**	**(378)**	**(278)**	**-**	**-**	**-**	**1,426**	**14**
Total bonds available for sale	**2,003**	**(61)**	**10**	**130**	**(378)**	**(278)**	**-**	**-**	**-**	**1,426**	**14**
Shares available for sale	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total bonds for trading	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Shares for trading	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Assets in respect of derivative instruments:											
Shekel-index contracts	**174**	**17**	**-**	**-**	**-**	**-**	**-**	**35**	**(24)**	**202**	**32**
Interest contracts	**297**	**(4)**	**-**	**-**	**-**	**(163)**	**-**	**-**	**-**	**130**	**(160)**
Foreign currency contracts	**770**	**(767)**	**-**	**572**	**-**	**-**	**-**	**-**	**-**	**575**	**299**
Share contracts	**129**	**(72)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**57**	**36**
Commodity and other contracts	**33**	**(30)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**3**	**1**
Activity in the Maof market	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total assets in respect of derivative instruments	**1,403**	**(856)**	**-**	**572**	**-**	**(163)**	**-**	**35**	**(24)**	**967**	**208**
Total others	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total assets	**3,406**	**(917)**	**10**	**702**	**(378)**	**(441)**	**-**	**35**	**(24)**	**2,393**	**222**
Liabilities											
Liabilities in respect of derivative instruments:											
Shekel-index contracts	**53**	**110**	**-**	**-**	**-**	**-**	**-**	**37**	**(38)**	**162**	**159**
Foreign currency contracts	**199**	**46**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**245**	**56**
Total liabilities in respect of derivative	**252**	**156**	**-**	**-**	**-**	**-**	**-**	**37**	**(38)**	**407**	**215**
Total others	**13**	**21**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**34**	**13**
Total liabilities	**265**	**177**	**-**	**-**	**-**	**-**	**-**	**37**	**(38)**	**441**	**228**

(a) Realized profits (losses) are included in the statement of profit and loss under non-interest financing income.

(b) Unrealized profits (losses) are included in the statement of changes in equity under accumulated other comprehensive income (loss).

(c) Transfers from Level 2 to Level 3 – forward contracts for the period of more than a year and less than 5 years have been transferred, and as at the date of the financial statements, the period remaining to maturity is less than a year.
Transfers from Level 3 to Level 2 – index forward contracts for the period of more than 5 years have been transferred, and as at the date of the financial statements, the period remaining to maturity is less than 5 years.

Note 33C – Quantitative information on items measured for fair value included in Level 3 (cont'd)

	For the year ended 31 December 2015										
		unrealized profits (losses) included:									
	Fair value at beginning of the year	In profit and loss (a)	In other comprehensive profit (b)	Acquisitions and issues	Sales	Extinguish-ments	Adjustments from translation of financial statements	Transfers to Level 3	Transfers from Level 3	Fair value at 31 December 2016	Unrealized profits (losses) in respect of instruments held at 31 December 2016
	NIS millions										
Assets											
Securities available for sale:											
ABS / MBS	2,009	48	(11)	508	(138)	(413)	-	-	-	2,003	(250)
Others in Israel	-	-	-	-	-	-	-	-	-	-	-
Total bonds available for sale	2,009	48	(11)	508	(138)	(413)	-	-	-	2,003	(250)
Shares available for sale	-	-	-	-	-	-	-	-	-	-	-
Total bonds for trading	-	-	-	-	-	-	-	-	-	-	-
Shares for trading	-	-	-	-	-	-	-	-	-	-	-
Assets in respect of derivative instruments:											
Shekel-index contracts	145	(23)	-	-	-	-	-	52	-	174	66
Interest contracts	423	(11)	-	-	-	(115)	-	-	-	297	(83)
Foreign currency contracts	2,307	(3,478)	-	1,941	-	-	-	-	-	770	230
Share contracts	64	65	-	-	-	-	-	-	-	129	108
Commodity and other contracts	64	(31)	-	-	-	-	-	-	-	33	32
Total assets in respect of derivative instruments	3,003	(3,478)	-	1,941	-	(115)	-	52	-	1,403	353
Total others	-	-	-	-	-	-	-	-	-	-	-
Total assets	5,012	(3,430)	(11)	2,449	(138)	(528)	-	52	-	3,406	103
Liabilities											
Liabilities in respect of derivative instruments:											
Shekel-index contracts	41	(37)	-	-	-	-	-	49	-	53	49
Foreign currency contracts	110	89	-	-	-	-	-	-	-	199	123
Total liabilities in respect of derivative	151	52	-	-	-	-	-	49	-	252	172
Total others	11	2	-	-	-	-	-	-	-	13	13
Total liabilities	162	54	-	-	-	-	-	49	-	265	185

(a) Realized profits (losses) are included in the statement of profit and loss under non-interest financing income.
(b) Unrealized profits (losses) are included in the statement of changes in equity under accumulated other comprehensive income (loss).

Note 33D – Quantitative information on items measured for fair value included in Level 3

Quantitative information regarding fair value measurement in Level 3 (in NIS millions)

	31 December 2016				
	Fair value	**Assessment technique**	**Unobservable inputs**	**Range**	**Average (3)**
A. Items measured for fair value on a recurring basis					
Assets					
Securities available for sale (1)					
Asset-backed securities (ABS) or Mortgage-backed securities (MBS)	1,426	Discounting cash flows	Margin	125-190 bp	157 bp
			Probability of default	2.5%-3.8%	3.15%
			Rate of early repayment	20%	20%
			Loss rate	30%	30%
Assets in respect of derivative instruments (2)					
Shekel-index interest contracts	162	Discounting cash flows	Inflation forecasts	0%-0.33%	0.17%
	40	Discounting cash flows	Transaction counterparty risk	0.2%-100% (*)	2.67%
Interest contracts	130	Discounting cash flows	Transaction counterparty risk	0.2%-100% (*)	2.67%
Foreign currency contracts	76	Discounting cash flows	Inflation forecasts	0%-0.33%	0.17%
	499	Discounting cash flows	Transaction counterparty risk	0.2%-100% (*)	2.67%
Shares contracts	57	Discounting cash flows	Transaction counterparty risk	0.2%-100% (*)	2.67%
Commodities contracts	3	Discounting cash flows	Transaction counterparty risk	0.2%-100% (*)	2.67%
Liabilities					
Liabilities in respect of derivative instruments (2)					
Shekel-index interest contracts	162	Discounting cash flows	Inflation forecasts	0%-0.33%	0.17%
Foreign currency contracts	245	Discounting cash flows	Inflation forecasts	0%-0.33%	0.17%
B. Items measured for fair value on a non-recurring basis					
Collateral-contingent impaired debt	968	Fair value of collateral			

* In respect of a failed counterparty.

Qualitative information regarding fair value measurement in Level 3

1. Unobservable inputs used for the fair value measurement of asset-backed or mortgage-backed securities are margin rates, probability of default, early repayment rate, and the severity of a loss in the event of default.
   Any significant increase/decrease in unobservable parameters will be reflected in a significantly lower/higher fair value.
2. Unobservable inputs used for the fair value measurement of derivatives are the credit risk of the counterparty to the transaction and the forecast rate of inflation. The higher/lower the credit risk of the counterparty to the transaction, the lower/higher will be the fair value of the transaction.
   Any change in the forecast rate of inflation will affect the fair value of transactions in accordance with the indexation position of the Bank for these transactions. The more the inflation forecast increases (decreases), and the Bank is committed to pay the amount linked to the index, the fair value of the transactions will decrease (increase). The more the inflation forecast increases (decreases), and the counterparty to the transaction is committed to pay the Bank the amount linked to the index, the fair value of the transactions will increase (decrease).
3. The average figure referring to the unobservable parameter of "Transaction counterparty risk" reflects a weighted average.

Note 33D – Quantitative information on items measured for fair value included in Level 3 (cont'd)

Quantitative information regarding fair value measurement in Level 3 (cont'd)

	31 December 2015				
	Fair value	**Assessment technique**	**Unobservable inputs**	**Range**	**Average (3)**
A. Items measured for fair value on a recurring basis					
Assets					
Securities available for sale (1)					
Asset-backed securities (ABS) or Mortgage-backed securities (MBS)	2,003	Discounting cash flows	Margin	70-160 bp	115 bp
			Probability of default	2.5%-6%	4.25%
			Rate of early repayme	20%	20%
			Loss rate	30%	30%
Assets in respect of derivative instruments (2)					
Shekel-index interest contracts	85	Discounting cash flows	Inflation forecasts	0.0%-(0.2)%	(0.10%)
	89	Discounting cash flows	Transaction counterparty risk	0.52%-100% (*)	1.49%
Interest contracts	297	Discounting cash flows	Transaction counterparty risk	0.52%-100% (*)	1.49%
Foreign currency contracts	95	Discounting cash flows	Inflation forecasts	0.0%-(0.2)%	(0.10%)
	675	Discounting cash flows	Transaction counterparty risk	0.52%-100% (*)	1.49%
Shares contracts	129	Discounting cash flows	Transaction counterparty risk	0.52%-100% (*)	1.49%
Commodities contracts	33	Discounting cash flows	Transaction counterparty risk	0.52%-100% (*)	1.49%
Liabilities					
Liabilities in respect of derivative instruments (2)					
Shekel-index interest contracts	53	Discounting cash flows	Inflation forecasts	0.0%-(0.2)%	(0.10%)
Foreign currency contracts	199	Discounting cash flows	Inflation forecasts	0.0%-(0.2)%	(0.10%)
B. Items measured for fair value on a non-recurring basis					
Collateral-contingent impaired debt	1,132	Fair value of collateral			

* In respect of a failed counterparty.

Qualitative information regarding fair value measurement in Level 3

1. Unobservable inputs used for the fair value measurement of asset-backed or mortgage-backed securities are margin rates, probability of default, early repayment rate, and the severity of a loss in the event of default. Any significant increase/decrease in unobservable parameters will be reflected in a significantly lower/higher fair value.
2. Unobservable inputs used for the fair value measurement of derivatives are the credit risk of the counterparty to the transaction and the forecast rate of inflation. The more the credit risk of the counterparty to the transaction increases (decreases), the fair value of the transactions will decrease (increase).
   Any change in the forecast rate of inflation will affect the fair value of transactions in accordance with the indexation position of the Bank for these transactions. The more the inflation forecast increases (decreases), and the Bank is committed to pay the amount linked to the index, the fair value of the transactions will decrease (increase). The more the inflation forecast increases (decreases), and the counterparty to the transaction is committed to pay the Bank the amount linked to the index, the fair value of the transactions will increase (decrease).
3. The average figure relating to the unobservable parameter of "transaction counterparty risk" reflects a weighted average.

Note 34 - Interested Parties and Related Parties of the Bank and its Consolidated Companies

Control of the Bank

Bank without a controlling core

As of 24 March 2012, the Bank is defined, pursuant to the provisions of the law, as a banking corporation without a controlling core and with no shareholder specified as the controlling shareholder in the Bank.

A. Balance sheet and off-balance sheet balances

	31 December 2016			
	Interested parties (f) (h)			
	Controlling owners		Key management personnel (a)	
	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)
	NIS millions			
Assets:				
Deposits in banks	-	-	-	-
Securities (e)	-	-	-	-
Credit to the public	-	-	13	14
Allowance for credit losses	-	-	-	-
Credit to the public, net	-	-	13	14
Investments in companies included on equity basis (e)	-	-	-	-
Other assets	-	-	-	-
Liabilities:				
Deposits of the public	-	-	41	44
Deposits from banks	-	-	-	-
Debentures, bonds and subordinated notes	-	-	-	1
Other liabilities	-	-	-	-
Credit risk in off-balance sheet items (g)	-	-	12	12

(a) Including their close relatives as defined in Section 80.D(3) in the Public Reporting Directives.
(b) In accordance with Section 80.D(4) in the Public Reporting Directives and corporations in which a person or a corporation included in one of the groups on the interested parties under the Securities Law, holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of the Boards of Directors.
(c) In accordance with Section 80.D(8) in the Public Reporting Directives
(d) Based on end of month balances.
(e) For details, see Note 12 - Securities and Note 15 - Investments in Companies Included on Equity Basis.
(f) At 31 December 2016, holdings of interested parties and related parties in the equity of the Bank were NIS 2,344,749 nominal value of shares in the Bank.
(g) Credit risk in off-balance sheet financial instruments as calculated for purposes of single borrower debt limitations.
(h) Interested party, related party, as defined in Section 80.D in the Public Reporting Directives.
(i) Companies included on equity bases or investee companies under joint ownership, in accordance with Section 80.D(7) in the Public Reporting Directives.

Note 34 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

Interested parties (f) (h)				Related parties held by the Bank					
Others (b)		Interested party at time of transaction		Unconsolidated subsidiaries		Companies included on equity basis(i)		Others (c)	
Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)
-	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
-	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**376**	**520**
-	**-**	**-**	**-**	**-**	**-**	**881**	**937**	**162**	**1,077**
-	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
-	**-**	**-**	**-**	**-**	**-**	**881**	**937**	**162**	**1,077**
-	**-**	**-**	**-**	**-**	**-**	**901**	**923**	**-**	**-**
-	**-**	**-**	**-**	**-**	**-**	**-**	**6**	**-**	**-**
3	**3**	**-**	**3**	**3**	**3**	**45**	**114**	**43**	**785**
-	**-**	**-**	**-**	**-**	**-**	**2**	**3**	**-**	**-**
-	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
-	**1**	**-**	**-**	**-**	**-**	**12**	**13**	**1**	**3**
1	**1**	**-**	**1**	**-**	**-**	**48**	**74**	**95**	**405**

A. Balance sheet and off-balance sheet balances (cont'd)

	31 December 2015			
	Interested parties (f)			
	Controlling owners		Key management personnel (a)	
	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)
	NIS millions			
Assets:				
Deposits in banks	-	-	-	-
Securities (e)	-	-	-	-
Credit to the public	-	-	12	12
Allowance for credit losses	-	-	-	-
Credit to the public, net	-	-	12	12
Investments in companies included on equity basis (e)	-	-	-	-
Other assets	-	-	-	-
Liabilities:				
Deposits of the public	-	-	42	47
Deposits from banks	-	-	-	-
Debentures, bonds and subordinated notes	-	-	1	1
Other liabilities	-	-	1	1
Credit risk in off-balance sheet items (g)	-	-	12	14

(a) Including their close relatives as defined in Section 80.D(3) of the Public Reporting Directives.
(b) Pursuant to Section 80.D of the Public Reporting Directives, corporations in which a person or a corporation included in one of the groups on the interested parties, controls them or has joint control in them, has significant influence or holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.
(c) Pursuant to Section 80.D(8) of the Public Reporting Directives.
(d) Based on end-of-month balances.
(e) For details, see Note 12 - Securities and Note 15 - Investments in Companies Included on Equity Basis.
(f) At 31 December 2015, holdings of interested parties in the equity of the Bank were NIS 463,732 nominal value of shares in the Bank.
(g) Credit risk in off-balance sheet financial instruments as calculated for purposes of single borrower debt limitations.
(h) Interested party, related party, as defined in Section 80.D of the Public Reporting Directives
(i) Companies included on equity basis or investee companies under joint control, as defined in Section 80.D(7) of the Public Reporting Directives

Interested parties (f)				Related parties held by the Bank					
Others (b)		Interested party at time of transaction		Unconsolidated subsidiaries		Companies included on equity basis		Others (c)	
Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)	Balance as at 31 December	Highest balance (d)
-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	482	1,162
-	-	-	5	-	-	913	1,935	928	1,334
-	-	-	-	-	-	-	-	-	-
-	-	-	5	-	-	913	1,935	928	1,334
-	-	-	-	-	-	924	948	-	-
-	-	-	-	-	-	5	11	-	6
2	3	-	15	4	4	71	2,279	648	1,456
-	-	-	-	-	-	1	1	-	-
-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	11	54	1	1
1	1	-	2	-	-	92	113	100	589

Note 34 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

B. Condensed results of operations with interested and related parties

	For the year ended 31 December					
	2016					
	Interested parties (i)			Related parties held by the banking corporation		Others (c)
	Shareholders Controlling owners	Key management personnel (a)	Others (b)	Subsidiaries (unconsolidated)	Companies on equity basis or companies held under joint control (j)	
	NIS millions					
Net interest income (expenses) (d)	-	-	-	-	**21**	**22**
Non-interest income	-	-	-	-	**3**	**2**
Of which: management fees and services	-	-	-	-	**3**	**2**
Operating and other expenses (e)	-	**(74)**	**(1)**	-	**(38)**	**(44)**
Total	-	**(74)**	**(1)**	-	**(14)**	**(20)**

	For the year ended 31 December					
	2015					
	Interested parties			Related parties held by the banking corporation		Others (c)
	Shareholders Controlling owners	Key management personnel (h)	Others (b)	Subsidiaries (unconsolidated)	Companies on equity basis or companies held under joint control (j)	
	NIS millions					
Net interest income (expenses) (d)	-	-	-	-	33	41
Non-interest income	-	-	-	-	(11)	(4)
Of which: management fees and services	-	-	-	-	4	3
Operating and other expenses (e)	-	(48)	(1)	-	(7)	(36)
Total	-	(48)	(1)	-	15	1

(a) Including their close relatives as defined in Section 80.D (3) in the Public Reporting Directives.
(b) In accordance to Section 80.D (4) in the Public Reporting Directives, Corporations in which a person or a corporation included in one of the groups on the interested parties, controls them or has joint control in them, has significant influence or holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.
(c) Pursuant to Section 80.D (7) of the Public Reporting Directives.
(d) See details in paragraph D below.
(e) See details in paragraph C below.
(f) Interested party, related party, related person as defined in Section 80.D in the Public Reporting Directives.
(g) Companies included on equity basis or investee companies held under joint control, pursuant to Section 80.D(7) of the Public Reporting Directives.

Note 34 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

	For the year ended 31 December					
	2014					
	Interested parties			Related parties held by the banking corporation		Others (c)
	Shareholders Controlling owners	Key management personnel (a)	Others (b)	Subsidiaries (unconsolidated)	Companies on equity basis or companies held under joint control (j)	
	NIS millions					
Net interest income (expenses) (d)	-	-	(16)	-	5	70
Non-interest income (expenses)	(1)	-	(54)	-	(38)	53
Of which: management fees and services	-	-	14	-	-	8
Operating and other expenses (e)	-	(49)	1	-	(26)	-
Total	(1)	(49)	(69)	-	(59)	123

(a) Including their close relatives as defined in IAS 24.
(b) Corporations in which a person or a corporation included in one of the groups on the interested parties, controls them or has joint control in them, has significant influence or holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.
(c) Parties meeting the definition of a related party according to IAS 24 that were not included in other columns, and a party on whose business the activity of the Bank and its consolidated companies is significantly dependent.
(d) See details in paragraph D below.
(e) See details in paragraph C below.
(f) Comparative figures have not been restated, pursuant to the circular of the Supervisor of Banks on disclosure of interested parties and related parties, dated 10 June 2015.

Note 34 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

C. Remuneration and all other benefits

	For the year ended 31 December					
	2016		2015		2014	
	Office holders		Key management personnel			
	Total benefits	Number of recipients	Total benefits	Number of recipients	Total benefits	Number of recipients
	NIS millions		NIS millions		NIS millions	
Interested parties employed in the banking corporation or on its behalf (a) (b) (c)	**57**	**21**	33	18	36	23
Directors not employed by the banking corporation or on its behalf (a)	**9**	**15**	9	17	10	16

D. Interest income, net in transactions by the banking corporation and its consolidated companies with interested parties and related parties

	For the year ended 31 December					
	2016		2015		2014	
	Consolidated	**Of which: companies included on equity basis**	Consolidated	Of which: companies included on equity basis	Consolidated	Of which: companies included on equity basis
	NIS millions					
a) In respect of assets						
From credit to the public	**43**	**21**	78	35	101	11
b) In respect of liabilities						
On deposits of the public	-	-	(4)	(2)	(37)	(6)
On deposits from banks	-	-	-	-	-	-
On other liabilities	-	-	-	-	(5)	-
Total interest income, net	**43**	**21**	74	33	59	5

(a) Does not include payroll tax expenses.
(b) Of which: short term employee benefits NIS 27 million, post-retirement benefits NIS 30 million.
(2015 short term employee benefits NIS 25 million, post-retirement benefits NIS 2 million, and (4) other long term benefits - 2014 - short term employee benefits NIS 27 million, post-retirement benefits NIS 9 million, and no other long term benefits).
(c) In 2016 no share-based payments were made (In 2015 NIS 10 million were paid, in 2014 - no share-based payments were made).
(d) Comparative figures have not been restated pursuant to the circular of the Supervisor of Banks on disclosure of interested parties and related parties as of 10 June 2015.

Directors and officers have been insured by the Bank under a policy for insuring the liability of directors and other officers of the Bank and investee companies. The aggregate insurance premium amounted to NIS 4,844 thousand (2015 – NIS 4,262 thousand, 2014 – NIS 3,219 thousand).

E. Information regarding terms of transactions and balances with related parties and interested parties

Transactions and balances with related parties and interested parties were all made during the normal course of business and on terms similar to the terms of transactions with entities not related to the Bank and its investee companies.

Interest debited and interest paid in respect of balances with interested parties and related parties are at normal rates of interest for transactions during the normal course of business with parties that are not related to the Bank.

Note 35 - Condensed Financial Statements of the Bank

A. Condensed Statement of Profit and Loss for the year ended 31 December

	2016	2015	2014
	NIS millions		
Interest income	**8,299**	7,313	8,508
Interest expenses	**1,898**	1,549	2,546
Net interest income	**6,401**	5,764	5,962
Expenses in respect of credit losses	**(160)**	149	195
Net interest income after expenses in respect of credit losses	**6,561**	5,615	5,767
Non-interest income			
Non-interest financing income	**1,314**	1,134	384
Commissions	**2,852**	2,852	2,808
Other income	**121**	214	139
Total non-interest income	**4,287**	4,200	3,331
Operating and other expenses			
Salaries and related expenses	**4,566**	4,397 (a)	4,187 (a)
Maintenance and depreciation of buildings and equipment	**1,367**	1,281 (a)	1,257 (a)
Other expenses	**877**	947 (a)	1,023 (a)
Total operating and other expenses	**6,810**	6,625	6,467
Profit before taxes	**4,038**	3,190	2,631
Provision for taxes on profit	**1,430**	1,175	1,087
Profit after taxes	**2,608**	2,015	1,544
Bank's share in the profits (losses), net of operating profit of investee companies after tax	**183**	820	(131)
Net profit	**2,791**	2,835	1,413

(a) Reclassified.

Note 35 - Condensed Financial Statements of the Bank (cont'd)

Condensed Balance Sheet

	31 December 2016	31 December 2015
	NIS millions	
Assets		
Cash and deposits with banks	**73,376**	58,928
Securities	**70,226**	63,620
Securities borrowed or purchased under agreements to repurchase	**1,284**	1,764
Credit to the public	**238,771**	233,526
Allowance for credit losses	**(3,041)**	(3,060)
Credit to the public, net	**235,730**	230,466
Credit to governments	**642**	453
Investments in investee companies	**11,387**	12,543
Buildings and equipment	**2,576**	2,487
Assets in respect of derivative instruments	**10,577**	11,173
Other assets	**7,206**	6,349
Total assets	**413,004**	387,783
Liabilities and equity capital		
Deposits of the public	**323,614**	300,177
Deposits from banks	**3,662**	6,703
Deposits from governments	**178**	146
Securities loaned or sold under agreements to resell	**539**	938
Subordinated notes	**22,640**	21,308
Liabilities in respect of derivative instruments	**10,600**	11,032
Other liabilities	**20,424**	18,712
Total liabilities	**381,657**	359,016
Equity attributable to shareholders of the banking corporation	**31,347**	28,767
Total liabilities and equity	**413,004**	387,783

Note 35 - Condensed Financial Statements of the Bank (cont'd)

Condensed Statement of Cash Flows for the year ended 31 December

	2016	2015	2014
	NIS millions		
Cash flows from operating activities			
Net profit for the year	**2,791**	2,835	1,413
Adjustments:			
Bank's share in undistributed profits of investee companies less dividend received	**(176)**	(13)	147
Other, net (including provisions for doubtful debts and impairment of securities)	**19,485**	22,419	(1,434)
Net cash from operating activities	**22,100**	25,241	126
Cash flows from investment activities			
Acquisition of shares in investee companies	**(4)**	(75)	3
Central Severance Pay Fund	**173**	24	(304)
Other	**(7,958)**	(19,464)	16,462
Net cash from investment activities	**(7,789)**	(19,515)	16,161
Cash flows from financing activities			
Issue of bonds and subordinated notes	**4,443**	2,606	-
Redemption of bonds, notes and subordinated notes	**(3,892)**	(5,667)	(855)
Other	**-**	42	1
Net cash from financing activities	**551**	(3,019)	(854)
Increase (decrease) in cash and cash equivalents	**14,862**	2,707	15,433
Balance of cash at beginning of year	**55,943**	53,145	37,014
Effect of exchange rate changes on blances of cash and cash equivalents	**(351)**	91	698
Balance of cash and cash equivalents at end of year	**70,454**	55,943	53,145

Interest and taxes paid and/or received and dividends received for the year ended 31 December

	2016	2015	2014
	NIS millions		
Interest received	**8,624**	8,350	9,128
Interest paid	**(2,875)**	(3,060)	(3,602)
Dividends received	**13**	973	22
Taxes paid on income	**(1,473)**	(1,133)	(1,420)

(a) Not including profits (losses) of companies included on equity basis, as required under generally accepted accounting principles in Israel.

(b) Reclassified.

Note 36 – Events after the Balance Sheet Date

A. Redemption of Subordinated Notes

On 26 January 2017, the Board of Directors of the Bank resolved to redeem, during June-July 2017, by way of early redemption in full, NIS 400,000,000 par value deferred index-linked deposits/capital notes (unquoted), issued in June and July 2002. The estimated amount of redemption of the capital notes (including linkage differentials) is about NIS 500 million. The early redemption in full will be carried out in accordance with the Bank's existing rights to make an early redemption in full, in accordance with the terms of the capital notes.

B. Sale of Kenon

During the first quarter of 2017, the Bank sold the balance of the shares it held in Kenon Holdings. The profit before tax to be recorded by the Bank in respect of the sale of the shares is about NIS 13.5 million.

For information regarding the pledge of securities, see Note 27.

Other matters

A. Menora Mivtachim Sales Agreement

On 27 September 2016, the Bank signed an agreement with institutional investors from Menora Mivtachim Group ("The sale agreement" and "Menora Mivtachim," respectively), whereby, subject to fulfillment of conditions precedent, the Bank will sell to Menora Mivtachim, effective 31 October 2016 (or another date as agreed between the parties), 80% of the Bank's rights and related obligations in the housing loans portfolio (as set forth in Proper Conduct of Banking Business Directive No. 451) which are secured, *inter alia*, by mortgages on rights in real estate and/or pledges of contractual rights in real estate, as applicable, and which comply with the criteria as set forth in the sale agreement ("the loan portfolio").

The Bank will continue to hold the remaining 20% of the aforementioned loan portfolio, so that the rights and the related obligations to be sold to Menora Mivtachim will be pari passu to those remaining in the Bank. The amount of loans in the loan portfolio is estimated at a total amount of NIS 2 billion, so that the part sold to Menora Mivtachim is estimated at an amount of NIS 1.6 billion. Simultaneously to signing the sale agreement, the Bank signed a management agreement with Menora Mivtachim whereby, after the completion of the transaction, the Bank will manage on behalf of Menora Mivtachim its share of the purchased loan portfolio, against payment to be made to the Bank (the "Management Agreement").

On 27 October 2016, after all the conditions precedent stipulated in agreement were met in full, the transaction came into effect as of 31 October 2016, according to the provisions set forth in the agreement.

The transaction did not have any material impact on the financial results of the Bank.

B. Bank Leumi Jersey

On 8 April 2016, the transaction was completed regarding an undertaking of the sub-subsidiary, Bank Leumi Jersey, to sell its holdings of its subsidiary, Leumi Overseas Trust Corporation, after receiving the regulatory authorizations required in order to complete the agreement.

On 3 October 2016, the transaction was completed for selling the activity of Bank Leumi Jersey, the Bank's sub-subsidiary, to EFG Private Bank (Channel Islands) Limited, inter alia, after receiving the regulatory authorizations required to do so.

In light of the relatively small scope of activity of Leumi Jersey, which is not material when compared with the Bank Group's activity, this transaction had no material effect on the Bank's activity.

Bank Leumi Le-Israel B.M. and its Investee Companies
Corporate Governance, Additional Details and Appendices

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Members of the Bank's Board of Directors [*][**]

Mr. David Brodet, Chairman[c]

Mr. David Avner

Mr. Yitzhak Idelman[a][f]

Dr. Shmuel (Muli) Ben-Zvi[b]

Ms. Tamar Gottlieb [a]

Ms. Esther Dominissini[g]

Dr. Samer Haj Yehia

Ms. Esther Levanon[e]

Professor Haim Levy[b]

Mr. Ohad Marani[b]

Mr. Yoav Nardi[d]

Adv. Haim Samet[a]

Ms. Zipporah Samet[a]

Professor Yedidya Zvi Stern[b]

Mr. Itzhak Sharir[g]

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a. External director pursuant to the Companies Law, 1999 (hereinafter "E.D.").
b. External director pursuant to Proper Conduct of Banking Management Regulation No. 301 (hereinafter "External Director").
c. Mr. David Brodet was reelected to serve as a director with the status of "other director" and a director who is not an external director as stated in section 11d(a)(3 to the Banking Ordinance, 1941 (hereinafter, "other director") at the Annual General Meeting of the Bank which was held on 11 July 2016 and was re-appointed for term of office as Chairman for an additional period with effect from the end of his last term on 22 July 2016.
d. Mr. Y. Nardi was reelected with the status of "other director" for a period of three years at the Annual General Meeting of the Bank which was held on 11 July 2016.
e. Ms. E. Levanon was elected with the status of "other director" at the Annual General Meeting of the Bank which was held on 11 July 2016. Ms. Levanon began serving as a director at the Bank on 7 September 2016, after receiving the approval of the Banking Supervision Department.
f. Mr. Yitzhak Idelman was elected as external director at a Special General Meeting of the Bank held on 3 November 2016.
g. Ms. Esther Dominissini and Mr. Itzhak Sharir were elected to serve as directors with the status of "other director" at a Special General Meeting of the Bank held on 3 November 2016.
h. Ms. Nurit Segal and Mr. Shai Hermesh ceased to serve as directors in the Bank on 4 January 2017. Professor Gabriella Shalev ceased to serve as director on 31 January 2017.

** Further details regarding members of the Board of Directors of the Bank are presented in the Periodic Report of the Bank for 2016 and on the Magna website of the Israel Securities Authority - http://www.magna.isa.gov.il

The Board of Directors numbers 15 directors. The legal quorum for its discussions and approval of resolutions is the majority of the directors.

Pursuant to Proper Conduct of Banking Business Directive No. 301 of the Supervisor of Banks, at least one-third of the members of the Board of Directors shall be external directors who meet the eligibility requirements of an external director as defined in Proper Conduct of Banking Business Directive 301.

Accordingly, eight directors who are classified as external directors serve on the Board of Directors, four of whom are external directors, pursuant to the provisions of the Companies Law, 1999.

In addition, in light of the definition of an "independent director" in the Companies Law, the Audit Committee of the Board of Directors confirmed that the external directors, pursuant to Proper Conduct of Banking Business Directive No. 301 of the Banking Supervision Department and the external directors pursuant to the provisions of the Companies Law, are independent directors.

Pursuant to the provisions of the Companies Law and the related regulations, the Board of Directors of the Bank resolved that the minimum number of directors with "accounting and financial expertise", to serve on the Board of Directors of the Bank at any time, and who will participate in the discussions in the plenum of the Board of Directors on the draft financial statements and their approval, will be three, so as to allow the Board of Directors to comply with the requirements imposed upon it by law and the documents of incorporation and, in particular, with regard to its responsibility to examine the financial position of the Bank and to prepare the financial statements.

In determining the said minimum number, the Board of Directors took into account the size of the Bank, the complexity of its activities and the range of risks involved therein, and the systems and procedures in place at the Bank, such as control, risk management, compliance, internal audit, and the audit of the external auditors. It was also taken into account that all of the members of the Board of Directors comply with the qualification requirements to serve as a director of the Bank pursuant to the law.

All of the directors serving on the Board of Directors comply with the definition of a director with accounting and financial expertise and professional competence pursuant to the provisions of the Companies Regulations (Conditions and Tests for a Director with Financial and Accounting Expertise and Professional Competence), 2005.

With effect from 1 January 2013 and pursuant to Proper Conduct of Banking Business Directive No. 301 of the Supervisor of Banks, the discussions relating to the financial statements are held in the Audit Committee of the Board of Directors. Pursuant to the directives of the Bank of Israel, the Board of Directors has determined that at least three "directors with accounting and financial expertise" will serve on the Audit Committee of the Board of Directors at all times. In fact, most of the directors serving on the Audit Committee have accounting and financial expertise. The legal quorum for discussion and the approval of resolutions in the Audit Committee is a majority of the members of the committee, providing that a majority of those present are external directors who are independent and that at least one of them is an external director, pursuant to the provisions of the Companies Law. Seven directors currently serve on the Audit Committee, six of whom are external directors, including four directors who are external directors, pursuant to the provisions of the Companies Law.

Changes in the Board of Directors

At the Annual General Meeting of the Bank held on 11 July 2016, the incumbent directors, Mr. D. Brodet and Mr. Y. Nardi were elected to a third term of office as directors with the status of "other director" for a period of three years, which began on 22 July 2016 (date of termination of the second term of office as directors in the Bank), after receiving approval from the Bank of Israel on the absence of any objection to the appointment. In addition, Ms. E. Levanon was also elected to a term of office as director with the status of "other director" for a period of three years. Ms. Levanon commenced her term of office as director in the Bank on 7 September 2016, after receiving approval from the Bank of Israel on the absence of any objection to the appointment.

For further details regarding the Annual General Meeting of the Bank, see Immediate Report dated 2 June 2016 (|Ref. no 2016-01-043809) and Immediate Report on the results of the meeting dated 11 July 2016 (Ref. no. 2016-01-079798). For further details regarding the appointment of Ms. E. Levanon, see Immediate Report dated 8 September 2016 (Ref. no. 2016-01-119539) .

On 12 September 2016, the Board of Directors of the Bank resolved to appoint Mr. D. Brodet to serve as Chair of the Board of Directors for a further term of three years, commencing the end of his second term of office, on 22 July 2016. On 14 November 2016, approval was received from the Bank of Israel on the absence of any objection to the appointment.

For further details, see Immediate Reports dated 7 July 2016 (Ref. no. 2016-01-078028) and 12 September 2016 (Ref. no. 2016-01-121924).

On 3 November 2016, a Special General Meeting of the Bank was held, at which Mr. I. Sharir and Ms. E. Dominissini were elected to serve as directors with the status of "other director" for a period of three years, and Mr. I. Idelman was elected to serve as E.D. for a period of three years.

After receiving approval from the Supervisor of Banks on the absence of any objection to the said appointments, Ms. Dominissini commenced to serve as director in the Bank on 17 January 1017 Mr. Idelman commenced to serve as E.D. in the Bank on 2 February 2017, and Mr. Sharir commenced to serve as director in the Bank on 2 February 2017.

For further details regarding the Special General Meeting and regarding the proposed candidates, see Immediate Report dated 26 September 2016 (|Ref. no 2016-01-128920) and 13 October 2016 (Ref no. 2016-01-064572) and 21 October 2016 (2016-01-066408). For further details regarding the results of the General Meeting, see Immediate Report dated 3 November 2016 (Ref. no. 0723231). Also, see a supplementary Immediate Report regarding the appointment of Ms. Dominissini dated 17 January 2017 (Ref. no. 2017-01-007035) and 8 February 2017 (Ref. no. 2017-01-014253), respectively, Immediate Report regarding the appointment of Mr. Sharir dated 2 February 2017 (Ref. no. 2017-01-012126) and 5 February 2017 (Ref. no. 2017-01-012756), respectively.

Ms. Nurit Segal and Mr. Shai Hermesh ceased to serve in the Bank on 5 January 2017. Professor Gabriella Shalev ceased to serve as E.D.s in the Bank on 31 January 2017..

Further to a resolution of the Board of Directors of the Bank of 14 March 2017, on 15 March 2017, an Immediate Report was published regarding the intention to convene an Annual General Meeting of Shareholders of the Bank, with the agenda expected to include, among other things, the following topics: (1) the appointment of one external director pursuant to the provisions of Proper Conduct of Banking Management Directive 301 or one E.D. pursuant to the provisions of the Companies Law, 1999, which meets the competence conditions of an external director pursuant to Proper Conduct of Banking Management Directive 301, as will be determined by the Committee for the Appointment of Directors in Banking Corporations which was appointed pursuant to section 36A of the Banking Law (Licensing), 1981 and (2) the appointment of one ordinary director (i.e., with the status of "other director" – a director which is not and external director as stated in section 11D(2) to the Banking Ordinance) to the Board of Directors of the Bank.

For further details, see advance notice regarding an intention to convene an Annual General Meeting with a number of items on the agenda, including the appointment of directors, which was published on 15 March 2017 (Ref no. 2017-01-024366).

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

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

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

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

Mr. Omer Ziv, C.P.A. (Isr.)
First Executive Vice President, Head of Finance Division

Ms. Michal Dana*
First Executive Vice President, Head of Human Resources Division

Ms. Tamar Yassur
First Executive Vice President, Head of Digital Banking Division

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

Mr. Dan Cohen
First Executive Vice President, Head of Banking Division

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

Ms. Hila Eran-Zick*
First Executive Vice President, Chief Risk Officer, Head of Risk Management Division

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

Mr. Guy Fisher
First Executive Vice President, Head of Capital Markets Division

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Mr. Sasson Mordecai*
First Executive Vice President, Chief Internal Auditor, Head of Internal Audit Division

Ms. Livnat Ayin-Shai Vilder, Adv.
Bank and Group Secretary

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

For information on changes that have occurred relating to the management and office holders of the Bank during 2016, see Chapter "Appointments and Retirements".

* Further details on the Bank management are presented in the Periodic Report of the Bank for 2016 and on the Magna website of the Israel Securities Authority - http://www.magna.isa.gov.il

Internal Auditor

The Chief Internal Auditor, Mr. Sasson Mordecai, has served as the Chief Internal Auditor of the Bank since 1 March 2011 and is highly experienced in internal audit. His appointment was approved by the Bank’s Audit Committee on 13 December 2010 and by the Board of Directors on 14 December 2010.

On 30 April 2017, Mr. Sasson Mordecai will cease to serve as Chief Internal Auditor of the Group. On 1 May 2017, Ms. Sharon Gur will be appointed Chief Internal Auditor of the Group in accordance with the recommendation of the Audit Committee of the Bank and the decision of the Board of Directors, dated 27 December 2016. Ms. Gur's appointment was approved by the Bank of Israel on 22 February 2017.

The Chief Internal Auditor meets the criteria of section 146(b) of the Companies Law, 1999 and the provisions of section 8 of the Internal Audit Law, 1992 (hereinafter "the Internal Audit Law") and the internal audit employees meet the criteria of the provisions of paragraphs 11 and 12 of the Proper Conduct of Banking Business Directive No. 307 regarding the internal audit function.

The Chief Internal Auditor is a full-time employee of the Bank, with the status of a member of management and this is his sole occupation. His superior within the organization is the Chairman of the Board of Directors.

The Internal Audit Division has an annual work plan and a multi-year work plan for a period of up to four years. The annual work plan and the multi-year work plan are derived from a mapping of audit subjects which are based, *inter alia*, on the documents detailed in Directive No. 307. The work plans are derived from a systematic methodology of estimating risks and controls, according to which the frequency and scope of the audit for each subject is established. Thus, regarding subjects with a higher level of risk, audits will be carried out once a year, while for subjects that involve a lower level of risk, audits will be carried out at a frequency of between two and four years. The proposed annual work plan and multi-year work plan are submitted by the Internal Audit Division and are approved by the Chairman of the Board of Directors, the Audit Committee and the plenum of the Board of Directors.

The Internal Audit Division’s annual work plan and the multi-year work plan allow the Chief Internal Auditor to exercise discretion in deciding to deviate from the plan, when necessary.

In addition, the audit days are allocated each year to unplanned audit and the examination of special incidents enabling the Internal Auditor to review topics which arise on an ad hoc basis, either at the request of the Bank's management or the Audit Committee, or as a result of new activities or subjects within the Group.

As part of the audit work, a sample of material transactions carried out by the Bank – including the procedures through which they were approved – was examined. In this regard, material transactions include a material purchase or sale of activity, "transactions" - as stated in section 270 of the Companies Law and an "extraordinary transaction" – as defined in the Companies Law.

The Internal Audit Division’s annual work plan and the multi-year work plan each include a chapter dealing with the annual and multi-year work plans of the material consolidated subsidiaries in Israel (as set forth in Note 15C). Employees of the Internal Audit Division serve as internal auditors of the Bank’s consolidated subsidiaries in Israel. The process of structuring the consolidated companies’ work plans is similar to the process of structuring the work plan of the Bank’s Internal Audit Division. Generally, the financial statements of the companies included on equity basis include reference to the work plans of their internal auditors.

In the significant foreign subsidiaries, a local internal auditor (sometimes, an agent of the parent company) is appointed. The Internal Audit Division supervises the work of the local auditor, as provided in paragraph 21(L) of Directive 307. This is carried out, *inter alia*, through an examination of the local internal audit working program abroad before it is presented for approval to the audit committee and the board of directors abroad. The Bank's internal work plan includes targeted audits of the overseas subsidiaries by the Internal Audit Division in Israel. The work among the Israeli and overseas auditors is allocated by coordinating the topics which have been audited by each one. The internal auditors of the significant overseas subsidiaries report to the board of directors of their local audit committee.

The Chief Internal Auditor and his team of employees in the Leumi Group in Israel comprise, on average, 97.2 positions for 2016, as described below:

	Average positions of auditors in the Leumi Group in Israel
The Bank	90.0
Subsidiaries in Israel	4.5
Overseas subsidiaries	2.7
Total	97.2*

* Of which 4.0 positions on average are maternity leave / unpaid vacation.

In addition, 3.4 positions were invested on an outsourcing basis.

Furthermore, local auditors are employed in overseas subsidiaries in 15.6 positions (including outsourcing).

The number of positions was approved by the Audit Committee in Israel, based on the annual and the multi-year work plan.

The Chief Internal Auditor may, within the framework of the budget, use outsourcing for the execution of work that requires special knowledge or in the event of insufficient staff.

The table below shows details of the benefits and amounts which were paid or for which provisions were made for 2016 to the Chief Internal Auditor:

2016

Holding in the capital of the Bank	Remuneration for services				Other remuneration	
	Salary	Bonuses(2)	Social benefit provisions (3)	Share-based payments	Value of the benefit	Total (1)
	NIS thousands					
0.017	**1,171**	**561**	**432**	**363**	**120**	**2,647**

(1) Excluding salary tax.
(2) See Note 23G to the financial statements.
(3) As set forth in the Chapter "Salary of Senior Office-Holders" regarding the effect of the Remuneration of Senior-Office-Holders Law, pursuant to the terms of employment of the Internal Auditor, the Internal Auditor is entitled to a "defined benefit pension" (old-age pension and interim pension in the event of retirement under certain conditions before reaching retirement age) or other rights from the Bank. During the period, a one-time expense amounting to NIS 5,643 was recorded in respect of the pension or other liabilities of the Bank to the Internal Auditor, as set forth in Note 23C.2
(4) On 12 October 2016, the transitional period provided in the Remuneration Limitations Law finished. The proportional part of the remuneration paid to the Internal Auditor which is subject to the Remuneration Limitation Law amounted to NIS 400 thousand. The information related to the definition of "remuneration" in the Remuneration Limitation Law, and accordingly does not include a provision for severance pay and remuneration according to the law.

The total payments to the Chief Internal Auditor and the components thereof are submitted to and approved by the Audit Committee.

The Board of Directors believes that the holding of securities by the Chief Internal Auditor and the remuneration paid to him do not affect the exercise of his professional discretion.

The Chief Internal Auditor operates in accordance with the professional standards of the Institute of Internal Auditors in Israel and the Institute of Internal Auditors (IIA).

In addition, the Chief Internal Auditor operates in accordance with the directives and instructions of the Supervisor of Banks, including Proper Conduct of Banking Business Directive No. 307 regarding the Internal Audit function.

The Audit Committee and the Board of Directors have noted the Chief Internal Auditor's written statement, according to which he complies with the requirements set forth in the abovementioned generally accepted professional standards, and he operates in accordance with the directives and instructions of the Supervisor of Banks. On the basis of this statement and on the basis of his role, as expressed at the meeting of the Audit Committee of the Board of Directors, the Audit Committee and the Board of Directors are satisfied that the Chief Internal Auditor meets all said requirements.

Generally, upon the issue of written audit reports and records of the findings of the examination by the Internal Audit Division, and as part of the ongoing work process, discussions are held with the audited entities (branch managers, district managers or managers of other organizational units) on the audit reports and records and discussions are also held regarding material findings with the heads of the divisions, as well as the President & CEO and Chief Executive Officer.

Before the meetings of the Audit Committee, the Chairman of the Audit Committee, in consultation with the Chief Internal Auditor, determines which audit reports and records of the examination's findings will be presented in their entirety for discussion at the Audit Committee. Furthermore, lists of all the audit reports and records issued by the Internal Audit Division throughout the relevant period, along with a summary of the material findings, are submitted on an ongoing basis for the perusal of all the members of the Audit Committee. They may peruse any audit report they wish and make a request to the Chairman for them to be presented in their entirety for discussion by the Audit Committee.

Material audit reports and records of the examination's findings are discussed at the Audit Committee each month, and occasionally, several times a month.

At the end of the first and second halves of the year, the Internal Auditor submits reports summarizing the audit operations to the Chairman of the Board of Directors, the President and Chief Executive Officer and the Chairman of the Audit Committee, the Audit Committee and the Board of Directors, including a summary of the material findings, the auditor’s recommendations and the audited entity’s responses for the relevant periods.

In addition, the Chief Internal Auditor submits to the Chairman of the Board of Directors, the President and Chief Executive Officer and the Chairman of the Audit Committee, the Audit Committee and the Board of Directors an annual report summarizing the audit operations during the course of the entire year, including monitoring the performance of the annual work plan and an assessment of the effectiveness of the Bank's internal control framework.

The work plan of the Internal Audit Division for 2016 was submitted to the Audit Committee on 28 December 2015 and approved in the Committee on 31 December 2015, and submitted to the Board of Directors on 5 January 2016 and approved in the Board of Directors on 10 January 2016.

The Internal Auditor’s report for the first half of 2016 was submitted to the Audit Committee on 25 August 2016 and was discussed by the Committee on 30 August 2016 and reported to the Board of Directors on 30 October 2016.

The Internal Auditor’s report for the second half of 2016 was submitted to the Audit Committee on 15 February 2017 and was discussed by the Committee on 19 February 2017 and reported to the Board of Directors on 14 March 2017.

The work plan of the Internal Audit Division for 2017 was submitted to the Audit Committee on 19 December 2016 and approved in the Committee on 22 December 2016, submitted to the Board of Directors on 2 February 2017 and approved in the Board of Directors on 6 February 2017.

The Internal Auditor’s annual report for 2016 was submitted to the Audit Committee on15 February 2017 and was discussed by the Committee on 19 February 2017, and submitted to the Board of Directors on 14 March 2017 and approved in the Board of Directors on 6 February 2016.

The Chief Internal Auditor has been provided with documents and information as specified in section 9 of the Internal Audit Law and was given access to information, as specified in that section. He has continuous and direct access to the Bank’s information systems, including access to financial data.

The internal auditors in Israel who carry out audits of the subsidiaries in Israel and abroad have been provided with documents and information as specified in section 9 of the Internal Audit Law and were given access to information, as specified in that section. They have continuous and direct access to the information systems of the subsidiaries in Israel and abroad, including financial data.

The Board of Directors and the Audit Committee believe that the scope, nature and continuity of operations and the work plan of the Chief Internal Auditor are reasonable under the circumstances, and that they enable the Internal Audit to achieve its goals in the Group.

Auditors' Fees [a][b][c]

	Consolidated		Bank	
	2016	2015	**2016**	2015
	NIS thousands			
For auditing activity: (d)				
Joint auditors	**22,382**	27,358	**11,736**	13,226
Other auditors	**3,372**	4,849	**-**	-
Total	**25,754**	32,207	**11,736**	13,226
For audit related services: (f)				
Joint auditors	**4,021**	2,855	**3,548**	2,323
Other auditors	**-**	-	**-**	-
For tax services: (e)				
Joint auditors	**2,011**	2,004	**793**	856
Other auditors	**408**	890	**-**	-
For other services:				
Joint auditors	**5,590**	2,823	**4,054**	1,523
Other auditors	**292**	1,099	**-**	646
Total	**12,322**	9,671	**8,395**	5,348
Total auditors' fees	**38,076**	41,878	**20,131**	18,574

a. Report of the Board of Directors to the Annual General Meeting on the auditors' fees in respect of audit and additional services, under sections 165 and 167 of the Companies Law, 1999.

b. Auditors' fees include payments to partnerships and corporations under their control and also payments required by the VAT Law.

c. Including fees paid and accumulated fees.

d. Audit of annual financial statements and review of interim reports.

e. Includes the audit of tax reconciliation reports, assessment discussions and tax consultancy.

f. Audit related fees, mainly include: prospectuses, special certificates, comfort letters, and forms or reports to authorities which require the auditor's signature.

A. Remuneration policy to office-holders (2013-2015 and part of 2016)

On 11 February 2014, the General Meeting of the Bank, after obtaining the approval and recommendation of the Remuneration Committee and the approval of the Board of Directors, approved a remuneration policy regarding conditions of service and employment of Bank office-holders (including senior office holders), pursuant to Amendment 20 of the Companies Law, 1999, and pursuant to the directives of the Supervisor of Banks regarding remuneration policy of a banking corporation ("the previous remuneration policy. The previous remuneration policy and the previous bonus program are valid for each of the years 2013, 2014, 2015, and part of 2016.

For details of the previous remuneration policy including the previous bonus program, see the financial report for 2015, Chapter "Remuneration policy for office-holders and key employees (pages 436-437) and Note 23F to the 2015 financial statements.".

B. Remuneration policy to office-holders in the Bank in respect of part of 2016 and in respect of 2017, 2018 and 2019

On 3 November 2015, the Annual General Meeting of the Bank approved the new remuneration policy for office-holders in the Bank, which would apply from 12 October 2016 to 2019 (hereinafter "the new remuneration policy"), following the approval of the Board of Directors, in accordance with the approval and recommendations of the Remuneration Committee. The new remuneration policy is based on the provisions of Amendment 20 to the Companies Law regarding the conditions of service and employment of office-holders in the Bank, on the provisions of the amended Proper Conduct of Banking Business Directive 301A regarding the remuneration policy in a banking corporation and on the provisions of the Remuneration of Office-holders in Financial Corporations Law (Special Approval and Disallowance of Expense for Tax Purposes due to Exceptional Remuneration), 2016 (hereinafter "the Remuneration Limitation Law").

The new remuneration policy provides the framework for the remuneration of office-holders in the Bank and includes, inter alia, reference to the components of fixed remuneration, which is the main remuneration for office-holders, including fixed salary, social benefits and conditions related to salary and retirement terms and termination of employment, as well as components of variable remuneration, which include any remuneration which is not fixed, including an annual performance-based bonus, qualitative personal bonus and special bonus in respect of special events. With regard to the Chairman of the Board of Directors and with regard to the President and CEO of the Bank, it is provided that they will not be entitled to a variable annual bonus. However, they may be entitled to additional payment – a fixed component which is not eligible for social provisions in an amount equal to the difference between the maximum remuneration that will be payable by law and the cost of their current employment.

The total variable bonuses for an office-holder were limited to a ceiling of 6 monthly salaries in a year (and, in addition, one salary, as a special bonus) and for the Board of Directors of the Bank, the power to reduce the performance-based bonus accordingly, at its discretion. Furthermore, the new remuneration policy provides, pursuant to Directive 301A, a mechanism for the recovery of the variable bonuses, including criteria for recovery, circumstances for activating the recovery mechanism and the period of recovery.

The new remuneration policy further provided arrangements for deferring payments of the various bonuses to office-holders and the terms for releasing bonuses which had been deferred, which would apply prior to the inception of the new remuneration policy.

In addition, the remuneration policy includes instructions regarding the retention of rights accumulated for the period of employment preceding 12 October 2016, including rights which will be paid on retirement (e.g., enhanced compensation, early pension and non-contributory old-age benefit) and instructions regarding the option of freezing rights as stated above, and depositing them in an external fund, which will pay the rights accumulated on the date to be duly determined. The remuneration policy includes instructions regarding the power of the Board of Directors to approve the re-employment of an office-holder, including the President and CEO, if and when all of the office-holders decide to terminate their term of office in the Bank for the sake of retaining the rights accumulated to them in respect of the period of employment up to 12 October 2016.

For further information regarding the new remuneration policy, see "Convening of the Special General Meeting of the Bank" published on 21 October 2016 (Ref. no. 2016-01-066408) and Note 23G.

For information regarding the update of the terms of employment of the Chairman of the Board of Directors and of the President & CEO, see the financial statements, Note 25.

Remuneration of Senior Office-Holders

For the year ended 31 December 2016

Below are details of the benefits and amounts which were paid or provided in the years 2015 and 2014 to the Chairman of the Board of Directors and to the recipients of the highest salaries among the senior office holders of the Group. During the period, the Remuneration Law for Office-holders in Financial Corporations (Special Approval and Disallowance of Expense for Tax Purposes due to Unusual Remuneration), 2016 ("Remuneration Limitations Law") was enacted. As a result of the enactment of the law, appeals were submitted to the High Court, inter alia, due to a possible interpretation, according to which the law is liable to impair the pension and other rights accumulated in respect of the period of employment prior to the enactment of the law. Pursuant to the judgment of the High Court, rights accumulated in accordance with the employment agreements, in respect of periods of employment preceding the determining date stipulated in the law, will not be impaired due to the law and it will be permissible to pay them. In light of the Remuneration Limitation Law, management estimates regarding the probability of the realization of the Bank's obligation to make various payments in respect of severance pay were revised, mainly in respect of the payment of enhanced compensation and in respect of the payment of an interim pension, in accordance with the employment agreements in the Bank. Due to the revision of the estimates as aforesaid, actuarial computations and the one-time provisions made were updated for each of the recipients of salary, set forth in the table below, in the footnotes to the table.

The benefits described below do not include benefits in respect of banking services that are granted to employees in the Bank, such as benefits regarding interest on deposits of monies with the Bank, interest benefits in respect of mortgages, discounts or exemptions from commissions for banking services provided by the Bank, etc. The amounts of the benefits in respect of the banking services mentioned, regarding each recipient, are not material. Certain private banking customers, including customers who are included in arrangements between the Bank and employee groups, are occasionally awarded benefits that are similar to those granted to Bank employees and in some cases, even exceed them.

2016									
Details of recipient of remuneration (1)			Remuneration for services			Other remuneration			
Name	Position	Holding in the capital of the Bank	Salary	Bonuses	Social benefit provisions	Share-based payment	Value of the benefit (4)	Total (2)
		%	NIS thousands						
Mr. David Brodet (7)	Chairman of the Board of Directors	**0.007**	**2,153**	**691**	**781**	**691**	**126**	**4,442**
Ms. Rakefet Russak-Aminoach (6)	President and CEO	**0.029**	**2,708**	**1,215**	**1,629**	**1,215**	**127**	**6,894**
Mr. Avner Mendelson (10)	CEO, Bank Leumi USA	**-**	**1,654**	**2,115**	**316**	**-**	**2,079**	**6,164**
Mr. Yaron Bloch (15)	General Manager, Leumi Partners	**-**	**1,548**	**2,373**	**370**	**-**	**116**	**4,407**
Mr. Paul Hurd (13)	Managing Director, Leumi ABL	**-**	**705**	**2,931**	**106**	**-**	**67**	**3,809**
Mr. Phil Woodward (14)	Deputy Managing Director, Leumi ABL	**-**	**634**	**2,931**	**95**	**-**	**69**	**3,729**
Mr. Dan Yerushalmi (12)	Executive Vice-President, Head of Leumi Technologies Division	**0.008**	**1,554**	**700**	**581**	**710**	**20**	**3,565**
Professor Daniel Tsiddon (11)	Deputy Chief Executive Officer	**-**	**1,174**	**594**	**1,100**	**594**	**85**	**3,547**
Mr. Dan Cohen (8)	Executive Vice-President, Head of Banking Division	**0.015**	**1,250**	**607**	**657**	**607**	**116**	**3,237**
Ms. Hila Eran-Zick (9)	First Executive Vice President, Head of Risk Management Division	**0.006**	**1,127**	**560**	**679**	**250**	**112**	**2,828**

1. Those receiving remuneration hold 100%, full-time positions.

2. Excluding salary tax.

3. Social benefit provisions include provisions for severance pay, provident funds, pension (including current provisions for a "defined benefit pension" arrangement which applies to long-serving employees and long-serving office holders in the Bank – for details, see Notes 23B.1 to the financial statements) supplementary training fund, non-competition period, and national insurance, as well as supplemental reserves in respect of the above, due to salary changes during the accounting year. Senior employees of the Bank have special personal employment agreements with the Bank. For further details regarding the retirement conditions of senior officers and entitlement to advance notice on terminating employment, see Note 23C.2 to the financial statements.

4. The value of the benefit includes, *inter alia*, a car and telephone expenses.

5. As a result of the inception of the Remuneration Limitation Law and following adoption of the new remuneration policy by the general meeting, the terms of employment of the members of the Bank management were updated with effect from the determining date. In respect of 2016, the members of the Bank management are entitled to a variable bonus pursuant to the previous remuneration policy up to the date of commencement, and a variable bonus in accordance with the new remuneration policy with effect from the determining date. For further details, see Note 23H to the financial statements.

6. Ms. Rakefet Russak-Aminoach serves as President and CEO of the Bank since May 2012.

On 3 November, 2016, the General Meeting of the Bank approved the new terms of service and employment of the President and CEO of the Bank in accordance with the new remuneration policy with effect from 12 November, 2016 (hereinafter: "the date of commencement").

The President and CEO is not entitled to an annual variable bonus with effect from the commencement date (in respect of 2016, the President and CEO is entitled to a variable bonus according to her previous terms of employment in respect of the period up to the commencement date). For details of the terms of the new terms of employment of the President and CEO, see Note 23C.3 to the financial statements of the Bank for 2016 and Immediate Report of the Bank on the convening of the general meeting dated 21 October 2016 (Ref no. 2016-01-066408).

For details regarding the previous terms of service and employment of the President and CEO, see Chapter "Salary of Senior Office-Holders" and Note 23B.3a to the 2015 financial statements of the Bank, the contents of which are included below by way of reference (hereinafter: **"the previous terms of service"**). Pursuant to the previous terms of service, Ms. Russak-Aminoach was entitled to a "defined benefit pension" from the Bank, including entitlement to an interim pension until she reaches retirement age. During the period, a one-time expense in respect of past rights deriving from the abovementioned obligation, amounting to NIS 7,767 thousand. The new terms of employment of the President and CEO do not include entitlement to a defined benefit pension and all of the amounts accumulated to her credit through the date of commencement have been deposited in an external fund.

7. For details regarding the previous terms of service of the Chairman of the Board of Directors, see Chapter "Remuneration of senior office-holders" and Note 23A to the 2015 financial statements of the Bank as published as part of the Period Report for 2015 of the Bank the contents of which are included below by way of reference (hereinafter: **"the previous terms of service"**).

   On 3 November, 2016, the General Meeting of the Bank approved the new terms of service and employment of the Chairman of the Board of Directors of the Bank, in accordance with the new remuneration policy in effect as of 22 July 2016, the date of commencement of the term of office of Mr. Brodet as director and Chairman of the Board of Directors (hereinafter: "**the date of commencement**")

   The Chairman of the Board of Directors is entitled to fixed remuneration only (with regard to 2016 – in respect of the period up to the date of commencement, Mr. Brodet is entitled to various remuneration in accordance with the previous terms of employment) and social conditions and related expenses., as is generally accepted for office-holders in the Bank. In addition, and in view of the Remuneration Limitation Law, the terms of service and employment of the Chairman of the Board of Directors were adjusted and reduced such that would comply with the requirements of the Remuneration Limitation Law.

   For details of the new terms of employment of the Chairman of the Board of Directors, see Note 23C.4 to the financial statements of the Bank for 2016 and Immediate Report of the Bank for convening a general meeting dated 21 October 2016 (Ref no. 2016-01-066408).

8. With regard to 2016, Mr. Cohen is entitled to a variable bonus in respect of the period up to the determining date in accordance with the previous remuneration policy and a variable bonus in accordance with the new remuneration policy for the period commencing the determining date.

   Pursuant to his previous terms of employment in the Bank, Mr. Cohen is entitled to a "defined benefit pension" from the Bank, including entitlement to an interim pension until he reaches retirement age. During the period, a one-time expense was recorded in respect of past rights deriving from the abovementioned obligation, amounting to NIS 7,559 thousand. As a result of the inception of Remuneration Limitation Law and in light of Mr. Cohen's request to terminate his employment in the Bank as a result of the anticipated deterioration in his terms of employment due to the inception of the Remuneration Limitation Law, on 25 December 2016, the Board of Directors of the Bank decided, after receiving the recommendation of the Remuneration Committee of 21 December 2016, to activate the "open-close" alternative pursuant to the new remuneration policy with regard to Mr. Cohen, to employ Mr. Cohen anew with effect from 1 January 2017 (hereinafter: "**the commencement date**"), under conditions corresponding to the new remuneration policy conditions. In accordance with the aforesaid, with effect from 1 January 2017, Mr. Cohen is employed under a personal contract, in accordance with the new remuneration policy of the Bank.

9. Ms. Hila Eran-Zick serves as Head of the Risk Management Division and as Chief Risk Officer in the Bank. On 19 December 2016, the Board of Directors decided on the appointment of Ms. Eran-Zick to the position of the Head of Human Resources in the Bank and she will commence serving in this position on 1 April 2017. Pursuant to her previous terms of employment in the Bank, Ms. Eran-Zick is entitled to a "defined benefit pension" from the Bank, including entitlement to an interim pension until she reaches retirement age. During the period, a one-time expense was recorded in respect of past rights deriving from the abovementioned obligation, amounting to NIS 5,669 thousand.

10. Mr. Avner Mendelson serves as the CEO of Bank Leumi USA, a wholly-owned and controlled subsidiary of the Bank, with effect from 1 September 2013. During the period, Mr. Mendelson ceased to be an employee of the Bank (on unpaid leave) and a final account was prepared for him in respect of his work as a salaried employee in the Bank in Israel. Pursuant to Mr. Mendelson's terms of service in the Bank in Israel, he is entitled to increased severance pay. During the period, a one-time expense was recorded in respect of past rights deriving from the said obligation, amounting to NIS 252 thousand. The current salary and bonuses to Mr. Mendelson as set forth in the table above have been determined in accordance with the remuneration policy (of Bank Leumi U\SA) and in accordance with which what is customary with regard to the salary of CEOs of banks of similar size and activity in the United States. Mr. Mendelson's salary also includes additional related expenses, such as rent and the grossing-up of these expenses.

11. Professor Daniel Tziddon served as Deputy CEO of the Bank until 31 August 2016. Mr. Tziddon's salary, as set forth in the table above, is in accordance with the remuneration policy of the Bank with regard to the salary of senior officers in the Bank. For details regarding the retirement terms of the senior officers in the Bank and their entitlement to early notice on the termination of employment relations – see Note 23C.2. Pursuant to the terms of his employment in the Bank, Professor Tziddon is entitled to a "defined benefit pension" from the Bank, including entitlement to an interim pension until he reaches retirement age. During the period, a one-time expense was recorded in respect of the past rights deriving from the abovementioned obligation amounting to NIS 1,055 thousand.

12. Mr. Dan Yerushalmi serves as Head of the Leumi Technologies Division in the Bank. Mr. Yesrushalmi's salary as set forth in the table above is in accordance with the remuneration policy of the Bank with regard to the salary of senior officers in the Bank. For details regarding the retirement terms of the senior officers in the Bank and their entitlement to early notice on the termination of employment relations – see Note 23C.2. Pursuant to his previous terms of employment, Mr. Yerushalmi is entitled to increased severance pay on the termination of employment relations in the Bank. During the period, a one-time expense in respect of this past right was recorded to NIS 372 thousand.

13. Mr. Paul Hurd has served as Managing Director of Leumi ABL Ltd. (Leumi ABL), a wholly-owned subsidiary of Bank Leumi UK, since 2006. Mr. Hurd's salary in respect of his term of office as Managing Director of Leumi ABL is provided in an agreement with him which includes a variable remuneration mechanism derived from the profitability of ABL.

14. Mr. Paul Woodward has served as Deputy Managing Director wholly-owned subsidiary of Bank Leumi UK, since 2006. Mr. Woodward's salary in respect of his term of office is provided in his employment agreement, which a variable remuneration mechanism derived from the profitability of ABL.

15.. Mr. Yaron Bloch has served as General Manager of Leumi Partners Ltd ("Leumi Partners"), a wholly-owned and controlled subsidiary of the Bank since 1 January 2011 and as Chairman of the Board of Directors of Leumi Card since 23 March 2017. The annual bonus to Mr. Bloch, as set forth in the table above, was agreed by the Remuneration Committee and the Board of Directors of Leumi Partners, pursuant to the provisions of his employment agreement and according to the remuneration policy for office-holders in Leumi Partners which was approved in 2014. The annual bonus is comprised of a fixed annual bonus which is included in the table above in the data regarding the salary and a variable annual bonus.

16. Details regarding remuneration paid from the determining date stipulated in the Remuneration Limitation Law and through the end of the period.

On 12 October 2016, the transitional period provided in the Remuneration Limitation Law ended. The following are the data regarding the proportional part of the remuneration paid to those set forth in the table who are subject to the Remuneration Limitation Law, in respect of the period after the determining date. The data relate to the definition of "remuneration" in the Remuneration Limitation Law, and accordingly, do not include a provision for severance pay and remuneration according to law. Mr. David Brodet – NIS 522 thousand, Ms. Rakefet Russak-Aminoach – NIS 547 thousand, Mr. Dan Yerushalmi – NIS 536 thousand. Mr. Dan Cohen – NIS 430 thousand, Ms. Hila Eran-Zick – NIS 416 thousand.

17. Loans granted under favorable terms are granted under terms generally excepted for all employees in the Bank and their amounts have been determined according to consistent criteria. The said loans amount in aggregate to negligible sums (a few thousand shekels) and therefore, are not presented in the table.

18. Directors and other office-holders have been insured by the Bank under directors' and other officers' liability insurance policies covering the Bank and its investee companies. The proportional insurance premium paid is not included in the above tables, as it is insignificant. The total premium amounted to NIS 6,845 thousand and relates to all office-holders in the insured group.

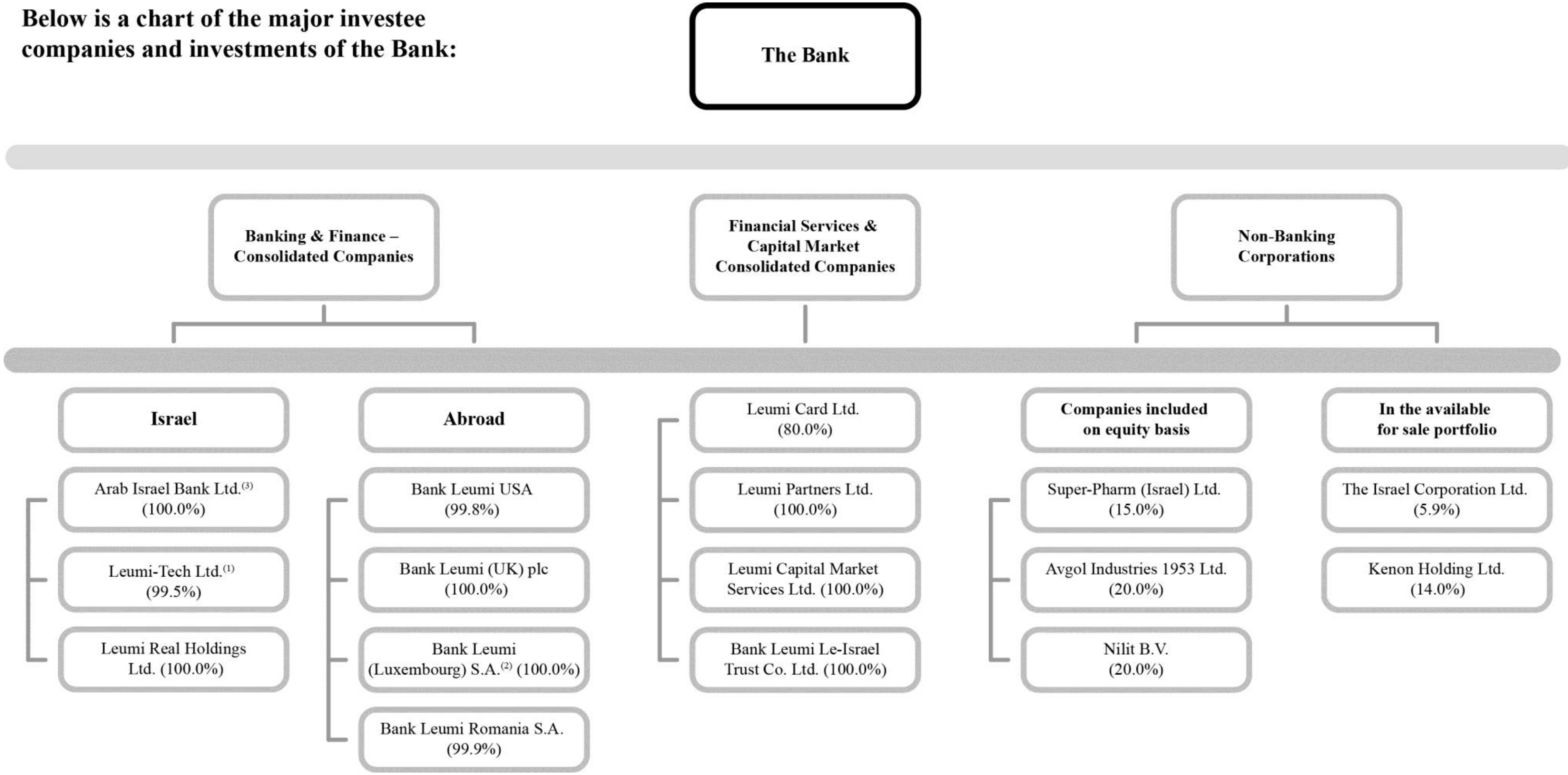
19. Having held discussions, received explanations and appropriate and relevant background material, and having examined the remuneration, taking into account the activities of the Bank and the Group and their results in 2015, and after noting the Bank's group remuneration policy and the remuneration policy in the Group companies, as well as the performance and activity of each senior officer in the Bank or in the Group, the Board of Directors believes that the remuneration to abovementioned senior officers, as set out in the table and the explanations above, represents remuneration that in no way exceeds fair and reasonable remuneration under the circumstances, taking into consideration the contribution of each of the office-holders, as stated in the Bank's operating results and the remuneration, as aforesaid, is in favor of the Bank.

For further details, see Note 23.

For details regarding office-holders who are included in the table for 2015, but are not included in the table for 2016, see Chapter "Salary of Senior Office-Holders" in the financial statements of the Bank for 2015 (from page 438).

2015								
Details of recipient of remuneration (1)			Remuneration for services			Other remuneration		
Name	Position	Holding in the capital of the Bank	Salary	Bonuses	Social benefit provisions	Share-based payment	Value of the benefit	Total
		%	NIS thousands					
Mr. David Brodet	Chairman of the Board of Directors	**0.002**	**2,185**	**1,359**	**750**	**1,359**	**171**	**5,824**
Ms. Rakefet Russak-Aminoach	President and CEO	**0.005**	**2,808**	**-**	**1,727**	**3,420**	**170**	**8,125**
Mr. Avner Mendelson	CEO, Bank Leumi USA	**-**	**1,707**	**1,366**	**345**	**-**	**2,314**	**5,732**
Mr. Paul Hurd	Managing Director, Leumi ABL	**-**	**823**	**4,425**	**123**	**-**	**85**	**5,456**
Mr. Phil Woodward	Deputy Managing Director, Leumi ABL	**-**	**753**	**4,425**	**113**	**-**	**89**	**5,380**
Professor Daniel Tsiddon	Deputy Chief Executive Officer	**0.001**	**1,566**	**-**	**1,131**	**1,954**	**121**	**4,772**
Mr. Yaron Bloch	General Manager, Leumi Partners	**-**	**1,549**	**-**	**369**	**2,373**	**118**	**4,409**
Mr. Dan Yerushalmi	Executive Vice-President, Head of Leumi Technologies Division	**0.002**	**1,490**	**-**	**780**	**1,931**	**21**	**4,222**
Ms. Hila Eran-Zick	First Executive Vice President, Head of Risk Management Division	**-**	**1,144**	**390**	**1,614**	**268**	**500**	**3,916**

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



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

Control of the Bank

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

For updated information regarding the holdings of interested parties in the Bank, see Immediate Report on the Holdings Position of Interested Parties and Senior Office Holders, dated 5 January 2017 (Ref no. 2017-01-002742) and Immediate Report dated 8 February 2017 (Ref. no. 2017-01-014253)/

Annual General Meeting and Election of Directors

On 11 July 2016, the Annual General Meeting was held, at which it was resolved, inter alia, to re-appoint the independent auditors and to appoint directors to the Board of Directors of the Company, as set forth in the chapter, "Changes in the Board of Directors", above.

For information regarding the resolutions approved at the Annual General Meeting, see Immediate Report regarding results of the General Meeting dated 11 July 2016 (Ref. no. 2016-01-079798).

On 3 November 2016, a Special General Meeting of the Bank was held, at which resolutions were passed on the following subjects: (1) the election of two directors with the status of "other director", as set forth above in the chapter "Changes in the Board of Directors"; the appointment of one external director pursuant to the provisions of the Companies Law, 1999, as set forth above in the chapter, "Changes in the Board of Directors"; (3) the approval of amendments to the Articles of Association of the Bank, including; in relation to the holders of indemnity for directors and office-holders in the Bank, the signing of the Bank's balance sheet and the jurisdiction clause; (4) the approval of a new remuneration policy for officeholders in the Bank; (5) the amendment of letters of indemnity of directors in the Bank; (6) the approval the terms of service and employment of the Chairman of the Board of Directors; and (7) the approval of the terms of service and employment of the President & CEO.

For further details, see the Immediate Report regarding the results of the Special General Meeting dated 8 November 2016 (Ref. 2016-01-074676) and the Immediate Report regarding the changes in the Articles dated 3 November 2016 (Ref. 2016-01-072234).

Further to the resolution of the Board of Directors darted 14 March 2017, an advance notice was published regarding the intention to convene an Annual General Meeting of Shareholders of the Bank, with the agenda expected to include the following topics: (1) discussion on the annual financial statements, (2) the appointment of the independent auditors and authorization to determine their fees, (3) the appointment of one external director pursuant to the provisions of Proper Conduct of Banking Management Directive 301 of the Supervisor of Banks or one E.D. pursuant to the provisions of the Companies Law, 1999, which meets the competence conditions of an external director pursuant to Proper Conduct of Banking Management Directive 301, as will be determined by the Committee for the Appointment of Directors in Banking Corporations, which was appointed pursuant to section 36A of the Banking Law (Licensing), 1981 and (4) the appointment of one ordinary director (i.e., with the status of "other director").

For further details, see results of the Special General Meeting dated 8 November 2016 (Ref. no. 2017-01-024366).

Lien in favor of the Bank of Israel

On 21 May 2008, the Bank signed a debenture pursuant to which it granted a first degree floating lien in favor of the Bank of Israel on its rights to receive amounts and monetary shekel payments that are and will be payable to the Bank from time to time from its customers who are corporations (established according to the laws of the State of Israel), and are not in arrears with their repayments to the Bank of loans received from the Bank, of which the average duration of the credit does not exceed three years, and were granted or will be granted to these customers by the Bank. The amount of the lien is equal to the total of the amounts to be secured by the debenture, from time to time, up to an aggregate of NIS 1.1 billion. This lien secures funds that are required for the Bank’s operations for the purpose of its activities with the CLS (Continuous Linked Settlement) Clearinghouse.

Fixed Assets and Plant

Buildings and equipment - the amortized cost of buildings and equipment as at 31 December 2016 amounted to NIS 3.1 billion, similar to last year.

Investments in buildings and equipment as at 31 December 2016 are as follows:

	Cost	Accumulated depreciation	Net book value	
	December 31			
	2016			2015
	NIS millions			
Buildings and land	**3,301**	**1,900**	**1,401**	1,476
Equipment, furniture and vehicles	**3,944**	**3,001**	**943**	545
Software	**4,616**	**3,813**	**803**	1,074
Total	**11,861**	**8,714**	**3,147**	3,095

The above buildings and equipment are used mainly for the activities of the Group. Buildings that are not used by the Group and are leased to non-Group parties, included in the consolidated balance sheet as at 31 December 2016, amounted to NIS 68 million.

Real estate

The majority of the premises in which the business of the Group is conducted in Israel are owned by the Bank or by subsidiaries. Most of the properties in which the business of the Group is conducted abroad are leased.

Data regarding the breakdown of the areas of the Bank, Binyanei Bank Ltd. and Lin City Center Ltd are as follows:

	31 December	
	2016	2015
	Sq. mtrs. in thousands	
Owned	**244**	250
Rented	**98**	97*
Total	**342**	3476

* Including the areas of the branches of the Arab Israel Bank to 11,000 sq. mtrs. which was merged within Leumi on 31 December 2015

Information systems

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

Leumi has an underground facility for the primary computer complex. The facility is protected against rocket attack, biological and chemical warfare and earthquakes. The facility was constructed with advanced technology enabling high-level day-to-day operation and independent functioning in times of emergency. The infrastructure in the computer center has a tier-3 survival and redundancy level and is in accordance with international standards.

After the end of December 2016, the primary and secondary computer at Keshev was consolidated within the primary computer. Today, Leumi has two mainframe computers: the primary computer in Keshev and a backup computer in Tel Aviv (MF) produced by IBM, part of the Z Series family, for use by the production, development and testing systems and the emergency recovery program. The total operating capacity of the computers is 14,106 mips (the values of the capacity are measured according to the number of instructions in millions per second). The Mortgage Department's main computer center is located in Keshev and receives services from IBM and a backup site for it has been constructed in Tel Aviv.

The Bank has an online and historical database stored on discs and cassettes in the main computer facility at Keshev and in the back-up facility in Tel-Aviv. A third copy of data is stored in a facility in the Jerusalem area. The data pass through a designated communication infrastructure between Leumi's computer centers.

Information security at Leumi is based on the principle of banking secrecy and various laws and directives, such as the provisions of the Protection of Privacy Law and related regulations, the provisions of the Computers Law, directives of the Bank of Israel, and generally accepted international standards of information and cyber security.

Based on these directives, extensive activity is undertaken in Leumi in defining and implementing a cyber-defense strategy and policy organizational information security policy, with an emphasis on devising work programs for the implementation of control and information security mechanisms, setting up systems and integrating information security management, and planning and execution of information security controls, including the drafting of procedures.

In an era in which threats from external and internal organizational factors are increasing, Leumi is prepared for computer attacks and is taking steps to hedge the risks arising from various types of cyber-attacks. In addition, the Bank is taking steps, in coordination with the Banking Supervision Department in the Bank of Israel, and in cooperation with the banking sector to set up a center for sharing cyber know-how and protection, and through the National Cyber Security Authority, to strengthen its ability to cope with cyber threats.

The operations and computer department of subsidiaries in Israel and abroad are based on independent systems, with the managements and boards of directors of those subsidiaries having professional and administrative responsibility, and in coordination with the Leumi's IT strategy of Leumi. Subsidiaries in Israel are connected in a communication network between them and Leumi. The communication is used for the mailing and preparation of data in a secured manner.

Bank Leumi USA has outsourcing agreements with a number of U.S. companies in the field of information systems used for the management of its banking business. In May 20165, the core systems and the secure site for customers in advanced systems were replaced.

For further information regarding the agreement to provide computer services of Union Bank, see chapter "Material agreements".

In 2016, the Group invested in equipment including software some NIS 707 million, compared with some NIS 711 million in 2015. The budget was adapted to support the strategic goals as defined by the Bank Management.

In 2016, Leumi developed a number of innovative products/services.

- Transition to an infrastructure of smart identification and the addition of advanced and innovative means of identification for entering applications. such as finger identification – in order to simplify the process of identification for the customer (e.g., no need to remember a password).
- Development of a new and responsive user interface on the secure website, in order to make the customer's surfing experience easier and more user-friendly, adapting the interface to the device from which the customer surfs (computer screen, cellular device, etc.)
- Integration of the ability to execute trade transactions in the capital market and deposit cheques in Leumi's central application – in order to enable customers to make essential transactions at any time and from any place they wish.
- Significant developments for corporate customers, such as the repayment of on-call loans via the Internet, occasional transfer – without the necessity of specifying payees – in order to simplify essential transactions for the customer and save time by executing them digitally.

In 2016, the Bank was certified for quality standards from Israel Standards Institute.:

Certification at the level of the Bank, as a whole, for environmental management ISO14001, for safety and health in employment ISO18001, energy management ISO50001management and a green mark for service.

Certification of the Real Estate Sub-Division for the Quality Standard ISO 9001 and certification of the Data Systems Development Sub-Division for the IT Services ISO 9001

For further details, see Note 16.

Intangible Assets

1. The Bank is the sole proprietor of the "Leumi" trademark, and its accompanying design logo, in the banking and finance services field in Israel.
2. In addition, the Group makes use of the names of its companies and their logos for the purposes of its activities, and the names of services and products, some of which are registered as trademarks and service marks.
3. The Group has registered databases in which information is stored regarding, *inter alia*, customers, suppliers and employees of Leumi, with advanced technological means that are designed to protect customer activity and the Bank's business activity, while reducing the risks arising from the use of information systems.
4. The Group holds various intellectual property rights and user rights in various computer programs and information systems for the purpose of managing its business, including the provision of services to its customers.
5. The Group has intangible assets and goodwill from the acquisition of companies. For further information, see Note 15.

Human Resources

Number of Personnel

In 2016, the number of positions in the Group decreased by 1,057, a fall of some 8.3% in relation to the number of positions in 2015. With regard to the average for the year, the number of positions in the Group fell by 802, a fall of 6.1% in relation to the average for 2015. The number of specific positions at the end of 2016 reflects a decrease of 2,260 (16.3%) positions in the space of four years.

The fall in the number of positions was achieved through a reduction in the workforce in the Bank as part of the streamlining procedures which included structural changes in the Bank's divisions e.g.: removing back-office activities from the centers of expertise, streamlining in the divisions' headquarters including, *inter alia*, the merger of the Corporate Division and the Commercial Division, the elimination of the Procurement Department, etc. and through early retirement, natural retirement and other streamlining measures carried out in the subsidiaries in Israel and abroad, in addition to the closure of overse5as offices.

	Positions at year end		Average positions during the year	
	2016	2015 (a)	**2016**	2015 (a)
The Bank in Israel (b)	**9,285**	9,757	**9,853**	9,993
Consolidated subsidiaries in Israel	**1,477**	1,975	**1,496**	2,010
Total of the Group in Israel	**10,762**	11,732	**11,349**	12,003
Overseas: Bank branches and representative offices	**1**	6	**2**	8
Consolidated subsidiaries	**873**	955	**906**	1,048
Group total in Israel and overseas	**11,636**	12,693	**12,257**	13,059

* Position – means a full time position including specific overtime, working hours of employees from temporary employment agencies and employment of external consultants.

(a) As a result of the retroactive application of the directives of the Supervisor of Banks regarding software costs, and as a result of the reclassification of expenses in respect of outside employees, the data on the number of employees have been restated. The effect of the retroactive application led to an increase in salary expenses and as a consequence, to an increase of 165 in the number of positions in 2015

(b) The Bank's position in 2016 includes the position of the Arab Israel Bank which was merged within the Bank on 31 December 2015.

Natural retirement

During 2016, around 90 employees left the Bank by natural retirement.

As of the date of the report, over the coming decade, around 1,700 employees are expected to leave by natural retirement, 80 of which will retire in 2017.

Remuneration system and salary structure

In general, the salary and remuneration systems for the Bank’s employees are based upon a correlation between the level of remuneration and the position of the employee, the contribution of the employee to the Bank and the evaluation of the employee’s manager. Consequently, the remuneration granted to the employee is differential.

Collective agreements with the employees

On 21 January 2015, a collective agreement was signed between the Bank, the Employees' Organization and the New General Histadrut Employees Organization regarding the extension of the term of the collective agreements for four years.

On 31 March 2015, a collective agreement was signed between the Bank, the Employees' Organization and the New General Histadrut Employees Organization, regarding first-generation pensions (HBS agreement).

On 26 October 2015, a collective agreement was signed between the Employees' Organization and the New General Histadrut Employees Organization regarding the release of severance pay to employees who retire from the Bank, regardless of the length of their period of employment in the Bank (through the amendment of am insurers' agreement from 2000).

On 10 December 2015, a special collective agreement was signed between the Bank, on the one part and the Arab Israel Bank Ltd., on the second part, and the representative body of the employees of the Arab Israel Bank, and the New General Histadrut Employees Organization, on the third part, regarding the merger of the Arab Israel Bank within Bank Leumi.

On February 17 2016, a special collective agreement was signed between representatives of the Bank's employees and the Bank, pursuant to which rights accumulated in favor of Bank employees would be converted to shares of the Bank. The rights converted to shares were an annual bonus in respect of 2015, voluntary conversion of up to 25% of pension rights ("defined benefit pension") and the conversion of the entitlement recorded in the Bank's books for jubilee bonuses and jubilee vacations. The Bank applied the conversion of the relevant rights also to managers and office-holders employed in the Bank under personal contracts.

For further information regarding the collective agreement, see Note 23.

For details in connection with the remuneration of senior officeholders, see chapter "Remuneration of Senior Officeholders"

Labor and Salary Costs (in the Bank)

	2016	2015	2014
	NIS thousands		
Cost per employee position (excluding bonus)*	**350.9**	345.3	338.0
Cost per employee position (including bonus)*	**388.3**	385.7	339.0
Salary per employee position (excluding bonus)*	**297.5**	234.9	230.6
Salary per employee position (including bonus)*	**267.7**	267.4	231.4

* Cost per employee position does not include pension expenses, costs of voluntary retirement, retro-severance pay, shares to employees, a collective salary agreement, a 2016 signing-on bonus, jubilee, sickness and the grossing-up of salary for overseas employees.

Training and Development

The Management of the Bank sets itself the goal of supporting the business units and the attainment of their business goals through study and training procedures, which focus on improving the professional and managerial ability of employees and managers. In this context, Leumi employees participated in 60,440 training days during 2016.

Training activities in 2016 focused on reinforcing professional knowhow of the employees and managers with emphasis on core banking areas – credit, investment counseling, service and sales, regulations and leadership development, all according to the business objectives of the Bank. In addition, designated training activities were held supporting processes of organizational changes, the acquisition of new skills and adaptation to changing needs in the various divisions.

In 2016, training activity focused on the sales and servicing skills in the Banking Division and on supporting the establishment of the Digital Bank's service unit. In addition, the Training Department supported the process of early retirement of employees from the aspects of knowledge retention and support for the retirees in the future.

Digital learning

The main aim of the digital learning is learning at any time or place, for any amount of trainees, in any medium, to maintain the high level of skill of employees at low cost. In 2016, the trend of intensifying digital learning in Leumi as a part of the learning culture in the organization continued. In 2016, employees of Leumi were drilled and certified in 10 regulation learning programs and participated in almost 26,630 hours of remote learning.

This year, the Training Sub-division continued to improve the learning experience, both in classes and out, using innovative digital means via the Internet, cellular devices and tablets. The ability to surf for information management and for a search engine by mobile phone was added. These devices improve the learning experience, encourage employee involvement in the learning, competition, brainstorming, discussion, recapping and processing of the study material, and thus, considerably improve the effectiveness of the learning.

Knowledge management

In 2016, Knowledge Management continued to provide performance-supporting solutions and establish new knowledge administrations in the corporate divisions: Capital Markets Division, Commercial Department, centers of expertise, and in the Digital Bank - Pepper.

In addition, an innovative search engine and an organizational "wiki" were launched and the rest of the divisions of the Bank supported the cross-organization processes, such as innovation and, internal organizational communication.

In the area of knowledge retention, as a result of the voluntary retirement campaign and in order to protect the risk of knowledge loss, a tool for independent knowledge retention was developed by a retiree/rotated employee, in-depth interviews were held for mining information retirees at the request of managers and activities such as expanding and assimilation of solutions in the central branch and in Leumi Technologies were continued.

Education

The percentage of employees with university education at the Bank is on a continuing upward trend.

The percentage of university graduates at the Bank was 73.5% of all employees at the end of 2016, compared with 70.1% in 2015 and 68.5% in 2014. The percentage of graduates among the managerial staff reached 96% in 2016, in comparison with 95.6% in 2015 and 95.3% in 2014.

This increase in the percentage of university graduates is the result of the recruitment of employees with university education, the departure of Bank employees who were not university graduates, and the acquisition of higher education by Bank employees.

Age and number of years of experience in the Bank

The average age of Bank's employees at the end of 2016 was 43.5 years, compared to 44.4 years in 2015 and 44.1 in 2014. The average number of years' experience of persons employed in the Bank at the end of 2018 was 17 years, compared with 18 in 2015 and 17.9 in 2014.

Employee rights

Labor relations between the Bank and its employees in Israel, save for those with personal employment contracts, are primarily based upon a basic collective labor agreement known as the "Labor Constitution" and supplementary and collective agreements. The terms of employment of members of the Bank’s Management and certain other senior employees are regulated by personal employment contracts. For additional details, see Note 23.

Employee involvement in the community

Leumi's management views the involvement of its employees and managers in the community as a key channel in the area of the Bank's involvement and social responsibility. Leumi encourages its employees to take an active part in volunteer projects and become involved in community life, providing them with frameworks for volunteering and a variety of opportunities to contribute and volunteer.

During the course of 2016, some 3,504 employees – from various units within the Bank - engaged in voluntary activity. The total hours of volunteer work by employees from which the community benefited in 2016 was 30,860.

The activities of the unit are based on a network of social leaders in the divisions of the Bank, numbering some 360 representatives from the various units of the Bank. Their purpose is to promote voluntary work among employees in their unit, while building an activity-supporting infrastructure and managing an employee involvement section in the Human Resources Division.

Leumi has a wide range of community partners, mainly in the area of children and youth. Many thousands of people benefit every year from the direct impact of volunteer work by Leumi's employees.

Employees from throughout the country are involved in a range of activities, such as assisting children and at-risk youth in residential homes, clubs and community centers; tutoring, assisting with homework and accompanying youth groups, collecting equipment for the needy, visiting hospitals, assisting Holocaust survivors, supporting populations with special needs, etc. Bank employees participate in the annual traditional Passover food collection, distributing food packages to needy families so that they can enjoy a festive Passover meal. In 2016, the Bank distributed 2,200 packages. In addition, packaging campaigns took place and 150 food packages were handed out to needy families who celebrate the Ramadan festival.

Alongside these many activities, the Bank chose to link with Leumi's vision of empowering the future generation through strategic programs, reinforcing the connection with associations supported by the "Leumi Tomorrow" organization with various projects, such as "Follow Me - Youth Leading Change". In addition, the Bank participates in activities in cooperation with associations such as "Pa'amonim", "Shi'ur Aharei", and more. As part of the involvement of Leumi employees in the community and the various interfaces with children and youth, we are meticulous about content, including enrichment, assimilation of values and, gradually, the financial education compatible with the Bank's core business.

Positions according to operating segments Management approach:

	Average positions in 2016		Average positions in 2015	
	Managerial staff	Clerical staff	Managerial staff	Clerical staff
Banking	**2,057**	**5,304**	2,044	5,302
Commercial	**434**	**705**	473	788
Corporate	**196**	**283**	205	296
Real estate	**123**	**126**	124	134
Capital market	**280**	**255**	281	274
Others and adjustments	**49**	**43**	45	35
Total Bank	**3,139**	**6,716**	3,172	6,829
Subsidiaries in Israel	**212**	**1,284**	335	1,675
Subsidiaries abroad	**467**	**439**	507	541
Total	**3,818**	**8,439**	4,014	9,045

The calculation of the number of positions according to operational segments is based on the management of personnel according to the Bank's main lines of business, with various adjustments, and on the basis of assessments. In calculating the number of positions according to operating segments, employees of head office units, who serve all or part of the operating segments of the Bank, have also been taken into account.

Appointments and Retirements

Appointments:

Mr. Danny Cohen, serves in the position of Head of the Banking Division, with effect from 1 January 2016.

Ms. Tamar Yassur, serves in the position of Head of the Digital Banking Division with effect from 1 January 2016.

Adv. Livnat Ayin-Shai Vilder serves in the position of the Bank's Secretary with effect from 1 March 2016., holding office which is of a non-management nature. Adv. Ayin-Shai Vilder will replace Adv. Yael (Ben Moshe) Rudnicki who will be appointed to a senior position in the Leumi Group.

Mr. Ron Fainaro, serves in the position of CEO of Leumi Card, with effect from 21 August 2016.

Mr. Omer Ziv serves in the position of Head of the Financial Division and member of Bank Management with the rank of First Executive Vice President with effect from 16 August 2016.

Mr. Hanan Friedman, member of Bank management and Head of the Legal Counsel Division, will be appointed to the position of Head of the Strategy and Regulation Division in the second quarter of 2017.

Ms. Hila Eran-Zick, member of Bank management and Head of the Risk Management Division, will be appointed to the position of Head of the Human Resources Division, with effect from 1 April 2017.

Mr. Shmulik Arbel, Head of the Commercial Department, will be appointed member of Bank management, Head of the Commercial Department and as Deputy Chairman of the Upper Credit Committee, and will report to the Head of the Corporate Commercial Division. The appointment will come into effect from 1 April 2017.

Ms. Sharon Gur will be appointed to the position of Internal Auditor and member of Bank management with the rank of First Deputy CEO with effect from 1 May 2017.

Ms. Bosmat Ben Zvi will be appointed to the position of Head of the Risk Management Division and member of Bank management with the rank of First Deputy CEO, with effect from 1 May 2017.

Mr. Ronen Agassi will be appointed to the position of Head of the Capital Markets Division and member of Bank management with the rank of First Deputy CEO, with effect from 1 May 2017.

Adv. Irit Rot will be appointed to the position of Chief Legal Counsel, Head of the Legal Division and member of Bank management with the rank of First Deputy CEO in the second quarter of 2017.

Retirements:

Professor Danny Tziddon, Deputy CEO, ceased to serve in his position on 31 August 2016 after 12 years of employment in Leumi, 3 years of which were as Deputy CEO.

Mr. Itai Ben-Zeev, member of Bank management and Head of the Capital Markets Division, ceased to serve in his position on 31 December 2016 after 13 years of employment in Leumi, 3½ years of which were as Head of the Capital Markets Division.

Mr. Yoel Mintz, member of Bank management and Head of International Credit and Real Estate Division, will cease to serve in his position on 31 March 2017, after 38 years of employment in Leumi, 4½ years of which were as member of management. After his retirement, he will continue to serve as Chairman of the Board of Directors of Bank Leumi UK and Chairman of the Board of Directors of Romania.

Mr. Sasson Mordecai, member of Bank management and Chief Internal Auditor, will cease to serve in his position on 30 April 2017, after 34 years of employment in Leumi, 5½ of which were as Chief Internal Auditor.

Ms. Michal Dana, member of Bank management and Head of Human Resources Division, ceased to serve in her position on 28 February 2017.

Mr. Dan Yerushalmi, member of Bank management and Head of Leumi Technologies Division, will cease to serve in position in 2017 after 4 years of employment in Leumi.

Mr. Yitzhak Naor, Head of the Corporate Department, will cease to serve in his position during 2017, after 42 years of employment in Leumi, 5 years of which were as Head of the Corporate Department.

Mr. Haggai Heller, CEO of Leumi Card, ceased to serve in his position in August 2016 after 16 years of employment in Leumi Card, 3½ years of which were as CEO.

Organizational Structure

The Leumi Group's organizational structure, according to lines of business and head-office services, as described below, combines the activity of companies in the fields of banking, finance, the capital market and financial services.

Lines of Business

Leumi is organized into lines of business that focus on different market sectors, each business line specializes in providing a service to a group of customers. This form of organization enables the customers to enjoy a high standard of professional service, varied distribution channels, products that are adapted to their requirements and fast and flexible decision-making processes.

Following is a description of the areas of responsibility for Leumi's four lines of business:

1. **Banking Division** – In 2016, a gradual transition from geographical structure (areas) to a structure of four business lines was implemented: Small Businesses, Private Banking, Premium and Retail. The lines of business operate in a format of independent profit and loss centers.

   The Banking Division manages the activity of private and small commercial customers, who receive the full range of services through 203 branches and by means of a variety of technological/direct distribution channels, including Leumi Call, which provides services to customers via telephone, mobile phones and the Internet. The services and products are adapted to all the customer sectors differentially according to the nature of their banking activity, their characteristics and their needs.

   Small Businesses Department – In January 2016, the Small Businesses Department was established, operating as an independent profit and loss management center, responsible for all small business customer activity.

   Premium Department – On 1 January 2017, the Premium Department was set up to operate in the format of the management of an independent profit and loss center. The Premium Department is responsible for the activity of customers with a large financial wealth.

   Retail Department – On 1 January 2017, the Retail Department was set up, to operate in the format of an independent profit and loss center. The department is responsible for household customers and growth, such as, youth, discharged soldiers, students, new immigrants, retirees and salaried employees.

   Private Banking Department - Responsible for private banking activity in Israel. The department has five private banking centers in Israel for Israeli residents and foreign residents and four branches.

   Mortgage Department – The main activity of the Mortgage Department is in the sector for loans to purchase housing and in the sector for any-purpose loans with a housing mortgage, with specific skill and expertise in the area. The department operates through 92 representative offices, most of which are located in the branches of the Banking Division, with a few in independent locations. The department operates a business center which coordinates activity in credit, underwriting and the transfer of loan funds to customers. The department also operates telephone call-centers which allow the submission of requests for approval in principle of a credit facility via telephone and the Internet, and the provision of a qualitative service to existing borrowers regarding managed loans. As part of the extension of housing loans, individual loans are made in the department to participants in a purchasing group.

   Investment Counseling Department is responsible for the construction and assimilation of the advisory doctrine and all its components and provides investment and pension advisors with an address for inquiries regarding professional automated topics and legal and ethical subjects. The department makes ongoing and continuous assessments of what is happening in the capital and money markets in Israel and around the world and distributes reviews and reports to investment advisors in order to keep them up to date regarding what is happening in the economic environment. In this context, the department constructs and operates decision-supporting systems and models for the use of the Bank's advisors. In addition, the department is responsible for the pension counseling centers. In January 2016, an organizational change was made, pursuant to which the department was transferred to the responsibility of the Head of the Banking Division.

   For information regarding the change in structure of the Banking Division, see further in the chapter.

2. **Corporate and Commercial Division -** Includes two departments: the Corporate Department and the Commercial Department (as detailed below). The Tel Aviv Central branch and the Head Office units provide services to the Corporate and Commercial Division and to the International Credit and Real Estate Division in Israel. In addition, the division is responsible for designing special transactions, which include project financing, financing the means of control, organizing syndicates, selling debts, examining investment and trade programs and international finance.

   Corporate Department - Manages the banking activity of the large business companies in the economy on the basis of sector expertise and synergy between industries. The department includes three business sectors: a technology and tourism sector, a sector for chemicals, energy, consumption and authorities and a sector for industry and trade.

   Commercial Department - Manages the activity of middle-market commercial companies, through 24 business branches, organized on a geographical basis into 5 commercial districts and the Leumi Tech Business Center. The organizational structure is unique in the banking system and enables the provision of an overall comprehensive service (one-stop shop).

   In 2016, the project, Commercial 2020, which includes the transfer of a part of the operational activity from the commercial branches to the performance centers, and other measures to improve the experience of the commercial customer, was launched. In 2016, the northern performance center commenced operations as aforesaid, and in 2017, we will take steps to further implement the project.

3. **International Credit and Real Estate Division** - Includes two departments - the Construction and Real Estate Department and the Special Loans Unit (as outlined below). In addition, the Division is engaged in the examination of aspects of corporate-commercial loans in the Bank's overseas offices in the United States, United Kingdom and Romania.

   Construction and Real Estate Department - Manages the large building companies, promoters and contractors in the economy (including national infrastructure projects) with specific skill and expertise in all areas of real estate in the economy. Financial services are provided both to finance the activity of the customers in Israel through the Bank's branches, and to fund their activity abroad, including cooperation in extending credit with the Bank's overseas units. Through the overseas offices, credit is also granted to local entrepreneurs who are active in the field of real estate, hotels and nursing retirement homes.

   Special Loans Unit - Deals with corporate customers who are in difficulty, while attempting to assist in the recovery of active customers through business help and support or by taking steps to collect the debts of corporate customers whose rehabilitation is not possible. In addition, the unit coordinates the professional assistance required for clarifying demands and claims against the Bank and consultation for the entire Bank on topics related to its area of expertise.

For information regarding the merger of the departments with the Corporate Commercial Division, see further in the chapter.

4. **Capital Markets Division** - Responsible for managing the Group's financial assets in Israeli currency and foreign exchange; management of the *nostro*; the activity of all the Bank's dealing rooms (Israeli currency, foreign exchange and Israeli and foreign securities); developing innovative financial products and investment products; supplying customers with sophisticated trading platforms, determining the collateral requirements from customers operating in derivatives and monitoring activity, managing the assets and liabilities of the Bank and managing market risks; management of the formulation of a price policy and financial margins in the Bank; relations with financial institutions abroad; co-ordination of the Bank's capital market (through the subsidiary, Leumi Capital Market Services Ltd.), and banking and operational services; and operational service for customers active in the capital and financial markets, including institutions.

In addition to the division according to lines of business, Leumi Group has the following head office units which provide services to the business units:

Finance Division -Responsible for coordinating and preparing the Bank's work plan; managing profit centers and financial and managerial measurement; planning and managing the Group's capital; preparing the Bank's expenditure budget and monitoring its application, sharing in setting priorities in the investment budget, contacts with investors and analysts; monitoring economic developments and preparing sectoral reviews and economic forecasts; formulating concepts, processes and organizational and administrative solutions; devising models for optimizing resources, directing overseas units and analyzing their activity, coordinating the policy regarding commissions and insurance of the Bank and the Group and the establishment of the CRS project. In addition, the division is responsible for providing services in the area of procurement (general, construction and technological), construction and maintenance.

Accounting Division - Responsible for managing, developing and determining the Bank's accounting guidelines, managing the Bank's books of account, preparing the financial statements of the Bank and the Group, the relationship with the Bank of Israel in all accounting matters and related reports and monitoring regulatory changes related to accounting and their assimilation in the Bank and in the Group. In addition, the Accounting Division is responsible for managing the tax affairs of the Bank and the Group, assessing the effectiveness of the key controls of the SOX 404 working process, calculating capital adequacy and reporting to the public in accordance with the Basel directives.

Human Resources Division - Responsible for formulating and implementing the Bank's human resources policy and, within this overall context, for selecting and placing employees, remuneration, salary structure, labor relations, developing and promoting employees, banking training – managerial and general, assimilation of the "Leumi Way" code of ethics, intra-organizational communications, internal advocacy, individual care, organizational counseling and development, employee involvement in the community and employee welfare. The division is responsible for managing the assets and providing the various logistical services in the area of launching and managing the logistical center in the Bank and in the subsidiaries in Israel.

Leumi Technologies Division - Responsible for computing and the operational deployment of the Bank and the Group, including the computerization of Union Bank, in accordance with an agreement with Bank Leumi. As part of its function, the division coordinates the formulation and determination of the strategy, policy and activity regarding technological development, computerization, operations, data technology, communications, cyber, data protection, security, operations of subsidiaries in Israel, and also supporting the overseas units in all matters related to technological services, operations and receiving the assistance required from Bank Leumi in Israel and extending automated solutions required for achieving Leumi's business goals.

Legal Counsel Division - Responsible for overall legal counsel to the Bank and its subsidiaries in Israel and for managing legal risks in the Bank and the Group. It is also responsible for expressing opinions regarding various legal matters and for the infrastructure of legal forms and opinions, following legislative and regulatory proceedings and representing the Group before the various legislative and regulatory bodies, legal advice for new products developed or integrated into the activity of the Bank and Group, and is responsible for dealing with claims against the Bank, the employment of outside attorneys and their supervision. In addition, the Division is responsible for the Ombudsman's Bureau, whose function is to examine customer complaints, for the Compliance and Enforcement Department, which is responsible for implementing compliance programs in the Bank and in the Group, including the prohibition of money laundering, the prohibition on the financing of terrorism, administrative enforcement.

Internal Audit Division - Responsible for the internal audit of the Leumi Group. The Division operates by virtue of the Internal Audit Law – 1992, Proper Conduct of Banking Business Directives of the Bank of Israel and directives of the Board of Directors. In addition, the Division acts in accordance with the professional standards of the Institute of Internal Auditors.

The Division deals, in an independent, impartial manner, with the examination and assessment of the Group's internal control system, including: examining the work and control processes, examining the method by which various risks are managed in the Group, maintaining the Bank's assets, minimizing exposures, complying with the rules of ethics and proper governance, implementing the directives of the Board of Directors, the management and the Bank's procedures and examining operational efficiency. In addition, the Audit Division conducts an independent review of the internal process for assessing the Group's capital adequacy (ICAAP). The Chief Internal Auditor reports directly to the Chairman of the Board of Directors.

Risk Management Division - Responsible for risk management in the Group and in the Bank, and coordinates risk management at the Group level in the main risk areas: credit, market and operations and compliance. The Division operates with an emphasis on independence in risk-taking. The object of the Division is the creation of a strong infrastructure for managing and controlling risks that will support the achievement of business targets, in accordance with the defined risk appetite. In addition, the Division is responsible for assisting the Board of Directors in defining the risk appetite, leading risk policy, developing and defining tools for measuring and pricing risks in the various activities; identifying, measuring and controlling the major risk focal points in the Group and the changes occurring in them and examining the risks inherent in new activities. The Division also includes the Credit Risk Management Department.

Credit Risk Management Department (CRM) - Responsible for the analysis of specific credit risk in excess of NIS 25 million and for examining the appropriateness of the classifications and allowances for credit losses. The Department is divided into three sections: analysis of corporate credit risk, analysis of credit risk in the real estate sector and commercial credit risk. The analysis of the risks is achieved as part of the process of approving the credit and is presented to the relevant credit committee before making the decisions.

The **Digital Banking Division** is responsible for leading, accelerating and implementing advanced digital innovation, with an emphasis on leading digital strategy and assimilating innovative digital products in all digital channels, along with the credit lines and business targets. The Division also manages and leads the Bank's "Big Data" activity and manages marketing while outlining the marketing strategy and implementing it in all of the Bank's credit lines.

The **Strategy Section** is responsible for assisting Group Management and the Board of Directors in defining and planning Bank and Group strategy and its validation, examining and analyzing subjects with strategic implications, and providing support and leadership of key projects in cooperation with the lines of business.

For further information regarding the Strategy and Regulation Division which was set up in 2017, see further in the chapter.

During the year, a number of significant organizational changes were made in Leumi:

Digital Banking Division

On 1 January 2016, a new division was set up in Leumi for Digital Banking, subject to the President and CEO. The establishment of the division will constitute an additional and significant step in the digital revolution. The division leads and implements advanced digital innovation in Leumi Group.

Banking Division

In light of changes and trends in the global business environment and in banking in Israel, it was decided to change from a geographical structure (regions) to four lines of business, which will operate as independent profit centers: Private Banking (an existing department), Small Businesses (set up on 1 January 2016), Premium Banking and Retail Banking. (established on 1 January 2016)

Investment Counseling Department

Until the end of 2015, the Investment Counseling Department reported to Mr. Danny Cohen, in his position as Head of the Human Resources Division. On 1 January 2016, on the appointment of Mr. Cohen to the position of Head of the Banking Division, the Investment Counseling Department was transferred to his responsibility.

Arab Israel Bank

On 31 December 2015, the Arab Israel Bank was merged with Bank Leumi (into the Banking Division). The merger enables Leumi Group to increase the level of Group synergy between the retail, commercial and consumer credit activities, and, among other things, to lead to a decrease in expenses and a streamlining of the allocation of resources within the Group.

Human Resources Division

On 1 July 2016, an organizational change was made in the Human Resources Division, wherein the administrative and professional responsibility for the Human Resources units in the Business Divisions was transferred to the Head of Human Resources Division. The change was made in order to strengthen the Division's professionalism, efficiency and flexibility and to provide the optimal solution for the needs of the business.

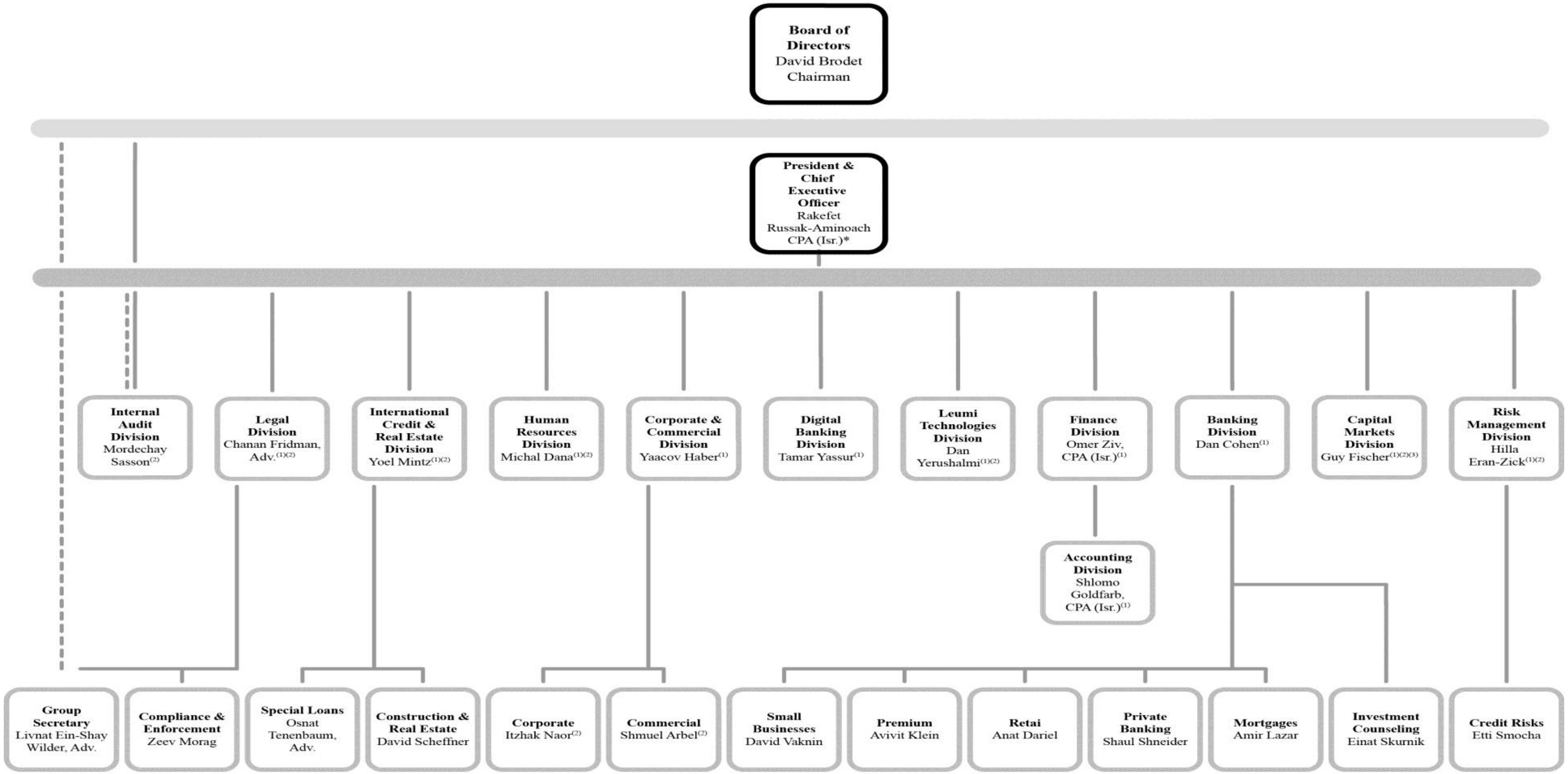
International Credit and Real Estate Division

On 1 April 2017, the Construction and Real Estate Department and the Special Loans Department, which belong to the International and Credit and Real Este Division, will be merged within the Corporate Commercial Division. This merger is intended to deepen the synergy in the Bank's corporate and commercial credit activity for all sectors of the economy.

Strategy and Regulation Division

In 2017, a new division, which will report to the President and CEO, will set up in Leumi. The division will be responsible for the delivery of a variety of key projects of the Bank. In addition, the division will be responsible for the Bank's strategy, regulation and O&M.

Bank Leumi le-Israel B.M.
Organizational Structure



(1) Member of Management
(2) Serves also as Legal Counsel to the Board of Directors

(1) Member of management

(2) For further information in respect of changes in organizational structure, see Chapter "Human Resources, Appointments and Retirements".

Legal Proceedings

A. Civil proceedings

1. The Bank is party to legal proceedings, including petitions to approve derivative claims and petitions to approve class actions, brought against it by customers and former customers of the Bank, as well as various third parties, who consider themselves damaged or harmed by the Bank's activity in the ordinary course of its business.

In the opinion of the Bank's Management, based on legal opinions, appropriate provisions have been included in the Financial Statements to cover possible damages in respect of all the claims.

The grounds for claims against the Bank are different and varied, including assertions as to the non-execution of instructions or their late execution, petitions for approval of attachments imposed by third parties on assets of debtors which, according to them, are held by the Bank, assertions that interest charged is not in accordance with the interest rates agreed upon between the Bank and the customer, interest rates deviating from those permitted by law, assertions regarding commissions charged, assertions relating to securities, labor relations, drawing cheques without cover, and failure to honor cheques.

For information regarding claims against the Bank in material amounts, see Note 25.

2. As part of measures taken to recover debts during the ordinary course of its business, the Bank initiated, *inter alia,* various legal proceedings against debtors and guarantors, as well as proceedings to realize collateral. The financial statements contain allowances for credit losses that were made by the Bank based on an assessment of all the risks involved in the credit to the various sectors of the economy and taking into account the extent of the information concerning the relevant debtor/guarantor with regard to their financial stability and the collateral provided to the Bank to secure ensure the repayment of the debt.

3. **U.S. Customers Affair**

The terms of the arrangements with the U.S. authorities, their background and the developments on this topic, including the legal proceedings, are set forth in Note 26.

Material Agreements

1. Following the publication of the circular by the Supervisor of Banks regarding measurement and disclosure of impaired debts, credit, and the allowance for credit losses (the banks, including the Bank, reached an agreement with the Tax Authority regarding recognition of allowances for credit losses for tax purposes. The agreement was signed on 19 March 2012 and is effective for impaired debts that were recorded as of 1 January 2011. (The previous arrangement applies to doubtful debts registered before 31 December, 2010).

For further information, see Note 8.

2. A compromise agreement for the regulation of tax payments in Israel in respect of profits of the Bank's overseas subsidiaries of the Bank, between the Bank and the Assessing Officer for Large Enterprises. from August 1987. This agreement is in force until such time as one of the parties gives a year's notice of its intention to propose changes to the agreement.

3. An agreement from April 2005 between the Bank and the Tax Authority, in connection with an offset of taxes in respect of the profits of an overseas subsidiary and a follow-up letter from the Tax Authority dated 29 June 2014, in connection with an offset of taxes in respect of the profits of overseas subsidiaries.

For further details, see Note 8.

4. An agreement between the Bank and Union Bank Ltd. (“Union Bank”) for providing comprehensive computing and operational services, including development work and new and special projects as well as relevant training, by the Bank to Union Bank and its related entities, signed in September 2001 and effective retroactively from September 1998 for a period of 11 years with an option to extension. In December 2007, an addition to the agreement was signed by Leumi and Union Bank, concerning an extension of the relationship, with changes in business terms. The term of the new relationship is ten years, starting 1 January 2007, during which a gradually increasing amount of annual consideration will be paid to the Bank. The addition has been approved by the Supervisor of Banks and the Antitrust Commissioner. According to provisions of the agreement, it terminates on 31 December 2016, with Union Bank having the right to announce that the separation mechanism provided in the agreement will apply only on 31 December 2016.

On 28 December 2016, the Antitrust Authority extended the exemption from the approval of a restrictive arrangement between the Bank and Union Bank, on the matter of computer and operating services, until 31 December 2019, in accordance with the conditions stipulated therein.

5. On 28 February 2016, the Bank signed an agreement with institutional entities from Harel Insurance and Finances Ltd. (hereinafter: "Harel") for the joint extension of secured housing loans, secured, *inter alia*, in mortgages and pledges on contractual rights in connection with land. Pursuant to the agreement, Harel will participate with the Bank in the extension of housing loans, in which the ratio of the amount of the loan to the value of its asset (LTV) is up to 60% only (as long as Harel is not given regulatory approval to participate in loans at a higher financing rate). On 13 June 2016, after meeting the prerequisites in the agreement, the parties commenced a joint extension of housing loans pursuant to the agreement.

The amount of participation of Harel in the extension of housing loans in collaboration with the Bank in 2016 stood at NIS 1.4 billion.

6. On 27 September 2016, an agreement was signed between institutional entities from the Menora Mivtahim Group ("the sale agreement" and "Menora Mivtahim", respectively), according to which, the Bank sold to Menora Mivtahim, with effect from 31 October 2016, 80% of the Bank's rights and the related obligations in the housing loan portfolio (as defined in Proper Conduct of Banking Business Directive no. 451), which is secured, inter alia, by mortgages on rights to land and/or pledges on the contractual rights to land, as applicable, and which meet the criteria set forth in the sale agreement, while the Bank shall continue to hold the remaining 20%, which will be of a level equal to the loans sold to Menora Mivtahim (together: "the loan portfolio").

At the same time as signing the sale agreement, a management agreement was signed between the Bank and Menora Mivtahim, pursuant to which the Bank will manage for Menora Mivtahim its share in the loan portfolio acquired, against a payment to be made to the Bank.

On 17 November 2016, all of the necessary steps for closing the transaction had been completed and the amount of the loans in the loan portfolio stood at NIS 2 billion, such that the part sold to Menora Mivtahim stood at NIS 1.6 billion.

The completion of the transaction has no material effect on the Bank's financial results.

7. The Bank granted office-holders and others letters of indemnity. For further information, see Note 26F.

8. For information regarding an agreement for guarantees insurance by virtue of the Sales Law and obligations for taking out guarantees, see Chapter "Capital and Capital Adequacy".

Legislation and Regulations relating to the Banking System

Some of the information in this chapter is "forward-looking information". For the meaning of this term and the consequences arising from this meaning, see the chapter, "Forward-Looking Information".

A large number of proposals for changes in regulations and changes in various provisions of the law were made during the reporting period, which could have an impact on the characteristics of the Group's activity, the scope of activity in some of the Group's areas of activity, the rate of profitability in some of the Group's activity and the credit risks and the operating and legal risks to which the Group is exposed. Most of the regulations are at various stages of discussion, and consequently, it is not possible to assess whether they will be issued as binding directives and, if issued, what the ultimate directives that are established will be. Accordingly, at this stage, it is not possible to estimate the impact that these regulations will have on the overall activity of the Group, if any. This chapter outlines regulations which have come into effect during the period of the report and directives which are expected to come into effect, whose impact on the Bank is expected to be significant.

Legislation

Proposed Insolvency and Economic Rehabilitation Law, 2016

On 7 March 2016, the proposed Insolvency and Economic Rehabilitation Law was approved in a first reading. The proposal includes a reform of insolvency proceedings of individuals and corporations. The proposal includes instructions related to all kinds of debtors, alongside instructions dealing with the unique aspects of various kinds of debtors – units and corporations. Among other things, the proposal includes a directive providing that a secured creditor in a floating lien will be entitled to repay his/her secured debt from the floating lien only up to an amount equivalent to 75% of the value of the assets to which the lien applies. The balance of the assets under the lien will be used as payment to the general creditors. This directive, if passed, is likely to impair the value of the current liens held by the Bank.

Supervisory Regulations of Financial Services (Provident Funds) (Purchase, Sale and Holding of Securities)(Amendment), 2016

On 19 December 2016, the Minister of Finance requested the Chairman of the Knesset Finance Committee to approve a proposed amendment on behalf of the Capital Markets, Insurance and Savings Authority to the Supervisory Regulations of Financial Services (Provident Funds) (Purchase, Sale and Holding of Securities)(Amendment), 2016. The revised wording of the Regulations includes provisions regarding the competitive proceeding which an institutional investor will be obliged to conduct when selecting the entity that provides services to purchase and sell of securities and services to hold securities. In addition, the regulations provide that an institutional investor who is part of a group of investors, one of whose members has an engagement agreement with a corporation to provide management or operating services (hereinafter: "the operator"), is entitled to purchase or sell securities through the operator, or through a party related to the operator, providing that the rate of purchase or sales commission does not exceed 20 percent of the total purchase or sales commissions paid by the institutional investor during that year.

Law for Increasing Competition and Reducing Concentration in the Banking Market in Israel (Legislative Amendments), 2017

On 31 January 2017, the Law was published in Reshumot.

The main points of the Law are as follows:

- Within 3 years of publishing the law – banks with a broad scope of activity (Leumi and Hapoalim) are required to separate from the credit card companies under their ownership. This date will be postponed for another year if the bank's shareholding in the means of control of the credit card company has been diminished throughout the aforementioned three years to 40% or less, providing at least 25% of the means of control were issued to the public; in this regard, "banks with a broad scope of activity" – a bank whose asset value exceeds 20% of the asset value of all banks in Israel.
- A bank with a broad scope of activity must not engage in issue of debit cards, must not deal with clearing of debit card transactions, must not control and must not own the means of control in a corporation which is engaged in issuing or clearing as aforesaid. Nevertheless, such a bank will be permitted to engage in debit card issuances through another or to enter into an engagement with a clearinghouse.

- The Law includes transitional provision, which will be in force for specified periods as set forth in the Law, including:
  - A bank which, prior to the publication date of the Law, controlled a credit card company, will engage in debit card issuance operations through an operating company and will enable the operating company to be party to the debit card contract.
  - A bank will not engage in issuance through one operating company, of more than 52% of the sum of new debit cards that it issues to its customers.
  - The engagement of a bank with a wide scope of activity - the division of income deriving between the bank and the debit card companies will be according to the engagement agreement between them, which came into effect on 3 June 2015, unless otherwise instructed by the Supervisor of Banks.
  - A bank with a wide scope of activity is entitled to contact the customer regarding credit card renewal only within 45 days before the end of the credit card contract, except in the cases set forth in the Law.
  - After four years from the date of publication of the law until after seven years from the date of publication thereof, the total credit facility in the credit cards of the Bank's customers, in any given year, shall not exceed 50% the total credit facility in the credit cards of the Bank's customers, as it was in 2015. In the calculation, the total credit facilities as stated, the credit facilities of the Bank's customers which are higher than NIS 5,000 will be brought into account. In addition, it is provided that a credit facility of a customer for an amount of less than NIS 5,000 will not be reduced only due to the aforesaid in this regulation.
  - A debit card company is entitled to make use of the details of the engagement of the customer, which have duly reached it before the publication date of the Law or during the transitional period, by way of the performance of the issuance operation of debit cards for a bank, for the purpose of contacting the customer in order to offer the provision of services as an issuer or to offer the provision of credit.
- The shareholding percentage of the banks in Automatic Bank Services must not exceed 10%, except where the Minister of Finance and the Bank of Israel have agreed with the approval of the Knesset Economics Committee that this is essential for the proper management of the interface system. The decrease in the shareholding percentage of the banks must be within four years of the inception of the Law.
- Regulations were provided regarding service for comparing financial costs.
- A banking corporation must not unreasonably refuse a borrower's request to give its consent to an additional lien of an asset, junior in ranking, in favor of another creditor. Realization of the additional lien is subject to the consent of the banking corporation. The banking corporation must not refuse to give its consent, except on reasonable grounds.
- If, within nine months of the inception of the Law, technological infrastructure for the supply and operation of computer services for financial entities has not been established, the Ministry of Finance will publish a tender to establish an infrastructure, as aforesaid. However, if, within 18 months of the inception date of the Law, the Minister of Finance believes that competition has not yet developed in the area of technological infrastructure, he has the authority to compel the major banks to sell or lease the computing or real estate services, used by the bank for computer and operating services.

Some of the provisions of the law come into effect upon its publication and some will gradually come into effect.

The Law requires the Bank to sell its holding in Leumi Card.

The Law significantly restricts the Bank's activity in the area of debit cards and in the area of credit and is likely to have an adverse effect on the Bank's income in these areas.

For disclosure relating to the Remuneration of Office-holders in Financial Corporations Law (Special Approval and Disallowance of Expense for Tax Purposes due to Unusual Remuneration), 2016, see Note 23A.

Taxation

Companies tax - On 5 January 2016, the Law for the Amendment of the Income Tax Ordinance (No. 216), 2016 was published, reducing the rate of companies tax from 26.5% to 25%, with effect from 2016 onwards. On 29 December 2016, the Economic Efficiency Law (Legislative Amendments for Achieving the Budget Targets for the 2017 and 2018 Budgets), 2016 (hereinafter: "the Efficiency Law") was published, providing, inter alia, reduction in the rate of Companies Tax from a rate of 25% to 23% in two tranches: in the first tranche – the tax rate fell to 24% from 1 January 2017 and in the second tranche, the tax rate will fall to 23% from 1 January 2018 and thereafter.

The balances of deferred taxes as of 31 December 2016 are calculated at the tax rates expected to be in force at the date of reversal.

Accordingly, the impact of the changes outlined above in the rates of companies tax on the financial statements as at 31 December 2016 is reflected in a decrease in net deferred tax balances receivable amounting to NIS 380 million. The decrease in the deferred tax balances was recognized against deferred tax expenses amounting to NIS 303 million and against capital amounting to NIS 77 million.

The current taxes for the reported periods are computed in accordance with the tax rates presented in the table below.

The taxes applicable to the profit of the banking corporations include companies tax levied pursuant to the Income Tax Ordinance and profit tax levied pursuant to the Value Added Tax Law.

The table of historical tax rates applicable to banking corporations is follows:

Year	Rate of profit tax	Rate of income tax	Overall rate of tax	Comments
2014	18.00%	26.50%	37.71%	Derives from an increase in the rate of companies tax from 1 January 2014
2015	17.75%	26.50%	37.58%	Derives from a decrease in value added tax effective 1 October 2015 to a rate of 17%
2016	17.00%	25.00%	35.90%	Derives from a decrease in companies tax effective 1 January 2016
2017	17.00%	24.00%	35.04%	Derives from a decrease in companies tax effective 1 January 2017
2018 and thereafter	17.00%	23.00%	34.19%	Derives from a decrease in companies tax effective 1 January 2018

International regulations

FATCA and the Standard for Automatic Exchange of Financial Account Information – OECD

The OECD has published a uniform standard for implementing the automatic exchange of financial account information with regard to financial accounts between companies (hereinafter: "the Standard"). The Standard was constructed in the spirit of the U.S. FATCA and is intended to increase transparency and supervision of the tax reports of residents of countries holding financial accounts outside their country of residence. The model was approved in principle by the G-20 Committee in September 2013. On 21 July 2014, the OECD published a guide for the implementation of the Standard.

The reporting standard is comprised of two parts:

1. The Common Reporting Standard (CRS) - A uniform standard including the due diligence required from financial institutions for identifying their customers and the information required for reporting accounts which have been classified as reportable.
2. The Competent Authority Agreement (CAA) - A model for the Inter-Governmental Agreement, which constitutes the basis for agreements to be signed between the qualified authorities of the various countries, for the purpose of the exchange of information to be received from the financial institutions. To date, more than 100 countries have undertaken to adopt the Standard, some of which have undertaken early adoption of the Standard (commencement of implementation for them on 1 January 2016 and first reporting in September 2017).

During October 2014, the Ministry of Finance announced that "Israel will adopt the procedure of the Automatic Exchange of Information regarding Financial Accounts for tax purposes by the end of 2018".

On 24 November 2015, Israel joined the Multilateral Treaty regarding Reciprocal Administrative Assistance on Tax Affairs. Israel is the 91st country to sign up to the treaty.

On 13 May 2016, the Tax Authority Manager signed to enlist Israel to the agreement of the qualified authorities for implementing the Multilateral Treaty for the Automatic Exchange of Information regarding Financial Information ("CRS") and the implementation of the Multilateral Treaty for Inter-Governmental Reporting ("CBC").

For the purpose of implementing the Standard and the FATCA agreement, on 14 July 2016, the Law for the Amendment of the Income Tax Ordinance (no. 227) was published, regarding the implementation of the FATCA agreement and agreements for the Automatic Exchange of Information between the State of Israel and other countries, pursuant to the Standard ("implementation agreements"), the main points of which are:

A. Amendments in the Income Tax Ordinance:

- Giving authority to the Minister of Finance to provide regulations and directives regarding the obligation of a reporting Israeli financial institution to identify its customers and transfer information to the tax authority regarding an account which has been identified as "reportable".
- For the purpose of applying the FATCA agreement – providing the Minister of Finance with the authority to stipulate, within the regulations, the terms which, when met, a reporting Israeli financial institution shall close a new account opened with it after 30 June 2014, for which it was unable to receive any statements or documents.
- Imposing monetary sanctions on financial institutions due to their failure to perform, as required, the procedure for identifying an account holder and, due to the failure to transfer information / transfer partial information in relation accounts managed with it.
- Granting authority to the Israeli Tax Authority to transfer information to a tax authority in another country in accordance with the FATCA agreement or an implementation agreement.

  For further information, see also the Law for the Amendment of the Income Tax Ordinance (Amendment 207), 2015

- Granting authority to the Minister of Finance, under certain circumstances, to provide regulations regarding the provision of notice by an Israeli financial institution to whoever is classified as a citizen or a resident of a foreign country of the fact that the information thereon and on the account under its ownership is expected to be included in reporting to the authority of a foreign country.

B. Amendments to the Prohibition of Money Laundering Law

- A financial institution will be entitled to use the identification details that have reached it by virtue of the Prohibition of Money Laundering Law, in order to fulfil its function or in the course of its work, for the purpose of identifying the customer for implementing FATCA or for fulfilling an implementation agreement.
- Adaptation of the term "control" in the Prohibition of Money Laundering Law for recommendations of the International Organization for the Struggle of Money Laundering and the Financing of Terrorism (Financial Action Task Force).
    1. A clarification that there is a requirement to trace the individual who is the controlling shareholder in a corporation.
    2. Determination of the opinion that it is sufficient for a holding of 25% of a certain class of the means of control in a corporation, in lieu of the 50% currently required, in order to consider the holder a "controlling shareholder", when there is no other person holding a higher rate.
    3. A determination that, in cases in which there is no individual controlling shareholder, the chairman of board of directors and the chief executive officer will be considered the controlling shareholder, and if there is no such office-holder, the office-holder who has effective control in the corporation.

The law provides that its inception will be on the date of publishing the regulations to be introduced by virtue thereof, except the issue of monetary sanctions and the amendment of the definition of "controlling shareholder" in the Prohibition of Money Laundering Law which will come into force six months after the publication date of the regulations. For the purpose of implementing the law, a definition of a controlling shareholder has been set forth in a temporary provision, which will apply in the six months from its inception.

The Income Tax Regulations (Implementation of the FATCA Agreement), 2016 were published on 4 August 2016, the first reporting date was established in the regulations up to 20 September 2016. The Bank complies with the requirements applicable to it by virtue of the regulations.

With regard to the implementation of the CRS standard, the Ministry of Finance issued a press release dated 1 January 2017, detailing that the first report by the State of Israel is expected to be in September 2018 and the information to be transferred will relate to 2017 and thereafter. Regulations for the implementation of the Standard have yet to be published.

The offices of Bank Leumi in the UK and in Romania commenced implementing the Standard on 1 January 2016 pursuant to the provisions of the local regulations to which they were subject.

Leumi continues to apply the FATCA requirements and to prepare itself for compliance with the requirements of the Standard for the Automatic Exchange of Information (CRS) of the OECD. The implementation of these regulations involves significant and complex preparatory procedures.

Credit Rating

The table below shows the credit ratings of Israel and of the Bank on 18 February 2017:

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

On 5 February 2016, S&P International Credit Rating Agency affirmed the rating of the State of Israel.

On 15 March 2016, Fitch Credit Rating Agency affirmed the rating of the State of Israel.

On 30 March 2016, Moody's Credit Rating Agency affirmed the rating of the State of Israel.

On 1 April 2016, S&P International Credit Rating Agency affirmed international rating of Bank Leumi USA, the Bank's subsidiary. The long-term rating of Bank Leumi USA was approved at a level of 'BBB+' and the outlook on the rating was affirmed as stable.

On 7 April 2016, Moody's Credit Rating Agency affirmed the Bank's rating and outlook.

On 21 April 2016, Fitch Credit Rating Agency affirmed the rating of the State of Israel and increased the outlook from stable to positive.

On 5 August 2016, S&P International Credit Rating Agency affirmed the State of Israel's rating and outlook.

On 1 September 2016, Fitch Credit Rating Agency affirmed the Bank's rating and outlook.

On 26 September 2016, Moody's Credit Rating Agency affirmed the Bank's ratings and outlook.

On 11 November 2016, Fitch Credit Rating Agency increased the State of Israel's rating. The long-term rating of the State of Israel was raised to A+ and the short-term rating was raised to F1+. The outlook was revised to stable.

On 25 November 2016, Fitch Credit Rating Agency raised the Bank's long-term rating to A. The outlook was left at stable.

On 12 December 2016, Midroog Credit Agency affirmed the Bank's rating and outlook.

On 20 December 2016, S&P Credit Agency affirmed the Bank's rating and outlook.

On 21 December 2016, S&P Ma'alot Agency affirmed the Bank's rating and outlook.

On 14 February 2017, Fitch Credit Rating Agency affirmed the Bank's rating and outlook.

On 19 March 2017, Moody's Credit Rating Agency affirmed the Bank's ratings and outlook.

A. Management approach – Retail segment

General

The retail segment is characterized by the provision of value offers and financial services to household customers and private persons, small and mid-sized businesses and to wealthy customers in Israel and around the world (Private Banking). These offers and services are provided to customers according to their changing needs and preferences, in accordance with other relevant characteristics.

Structure and features of the segment

Branches:

Household customers and private persons – A wide deployment of 203 branches spread throughout the country. The service to customers in the branch is provided by teams of bankers divided according to customer segments. These teams coordinate the handling of the customer in all aspects and specialize in dealing with the characteristics and needs of the customer.

The branches include the branches of the Arab Israel Bank were merged with Leumi in December 2015.

Private Banking customers – the sector in Israel is managed in five unique Private Banking centers deployed countrywide – Tel Aviv, Jerusalem, Haifa and Herzlia Pituah. The centers serve wealthy private customers, residents of Israel and foreign residents according to their language and are acquainted with their customers' requirements., preferences and areas of interest. In addition, the Department maintains four designated branches for a section of the customers with investment portfolios of between NIS 1.5 million and NIS 6 million, located in Haifa, Rehovot, Tel Aviv and Herzlia.

Online and digital channels

Banking services are also provided on the Leumi website, Leumi Digital application on mobile phone, a telephone call center in Leumi Call, Leumi information devices and other advanced Internet and cellular solutions.

The segment operates, inter alia, both to expand the scope of customers receiving Leumi Call tele service center (with the following currently connected: hundreds of thousands of customers who carry out most of the day-to-day activity through it in their account) and to expand activity in the digital channels (thousands of transactions are carried out through the Internet or mobile phone each day).

In addition, Leumi recently launched the payments app, "PEPPER PAY", and the banking app "PEPPER" (the latter, open, at this stage. only to invitees), which are initial central milestones in the area of digital banking which will be **managed entirely by mobile**. The new apps will allow users to enjoy a personal, quality and advanced customer experience based on a response to their needs, in a user-friendly, fair and personally-tailored way "any time, any place".

Developments in the markets of the segment and the customer characteristics

Competition is affected by changes in demographic and economic data in the country's population, changes in private consumption and the customers' savings characteristics.

Competition in the segment is increasing and is on a strengthening trend. In recent years, competition has developed in retail banking on the part of financial entities, mainly in credit cards (in the area of consumer credit), insurance companies, retail marketing networks and financial technological ventures. Some of the competition comes from entities which are not regulated by the Bank of Israel or are not regulated at all and which do not work under the restrictions applicable to banks.

In the **Private Banking segment**, the business reality is characterized by increased competition conditions, with a high degree of uncertainty and significant regulatory changes.

Products and services

The Bank has defined the small and mid-sized businesses in the population, and targeting and accordingly launched the Leumi business arena, which is an envelope of exclusive and innovative tools and services.

Private credit: The Bank offers customers various credit products which match their needs and the various stages in their lives. In recent years, there has been a significant increase in credit to household in Israel. The loans are attractive, *inter alia*, as a result of the low rates of interest in the market. Still, the level of leverage of households in Israel is low compared with developed countries around the world. However, the trend is one of an increase is credit volumes and with it, the risk.

The Bank's policy is to take steps to disperse the credit risk by determining the rate of exposure frameworks in the credit portfolio. The management of the credit portfolio is achieved according to risk and yield versus risk considerations.

The Bank offers housing loans to private customers, both from the funds of the Bank and as part of government assistance programs, through representative offices in the various branches dispersed throughout the country which belong to the Mortgage Department. The Mortgage Department has 86 representative offices operating in the branches of Leumi and 6 independent representative offices.

Center for Small Businesses

On 17 January 2016, the Ministry of Finance announced that the proposal of the Leumi-Menorah Partnership won first place from the bids submitted as part of the State tender to finance small and medium-sized businesses.

The fund commenced operations in April 2016. Pursuant to the joint activities of the partnership, loans will be made to small and medium-sized businesses with a government guarantee.

The loans are being extended by the joint finance of Leumi – 60% and Menorah – 40%. As part of the first tranche of the guarantee, loans of up to NIS 1 billion will be available to small and medium-sized businesses.

Pension consulting

The balances of the customers' pension assets who are being advised in the Leumi Group which are known as at the end of December 2016, including training funds, in respect of which advice is provided as part of pension consulting and/or advice in investments, amounted to NIS 29.4 billion.

Customers

The Bank is able to offer its services with adaptations to the following various population groups in the segment:

B. Management approach – Commercial Banking segment

General

Commercial banking - specializes in the provision of the entire spectrum of financial services to middle-market business entities in all sectors of the economy. The interested parties of the business companies in the segment, including shareholders and senior office holders, are sometimes also dealt with in this segment.

Service and marketing to these companies are carried out on an individual basis, including the financing of transactions with credit instruments tailored to the customers' unique requirements, the adaptation of investment products and financial instruments for hedging risks, the financing of international trade transactions and the financing of start-up companies.

The commercial banking segment also includes activities outside of Israel through the Bank's subsidiaries abroad. Companies that are served by the Commercial Department can also opt to work with these offices, in expanding their overseas activities.

Structure and characteristics of the segment

The segment is managed in Israel by the Commercial Department, which is a part of the Commercial Corporate Division. The principal contact with customers is through designated commercial branches located throughout the country and through technological services, like direct channels, cash management system, etc. The Commercial Department has 24 business branches located in industrial zones and in the major cities, which are attributed geographically to five commercial districts. The branches specialize in the management of business activities characteristic of the segment's customers, giving the Department a competitive advantage.

For information regarding the change in the organizational structure of the department, see Chapter "Organizational structure".

Development in the markets of the segment, and in its customers' characteristics

The main activities of the segment's customers are in the local market, in the industrial, infrastructure, hi-tech, trade and services and real estate sectors of the economy, and also, markets abroad,

Expectations for 2017 are for continuation of moderate economic growth around the world and in Israel which is expected to have implications for export customers and customers active in the middle-market segment. Accordingly, the Commercial Department takes particularly cautious steps in managing the credit risks, regularly reviewing the customer population, and, in particular, sensitive customers, in particular, and reviewing trends of development and their implications.

Products and services

The Commercial Department has a wide range of products designed for its different customers, including, inter alia, financing revolving capital requirements, financing long-term investments, foreign trade finance, rental property finance and C/L finance, invoice discounting and factoring, financing of mergers and acquisitions, etc.

Leumi is the first Israeli bank to launch a "cash management" system, an innovative and secured portal, which includes a package of advanced financial services and products. The portal enables, *inter alia,* the receipt of centralized data regarding accounts in the various banks, monetary balances and movements, etc.

Customers

Customers belong to the Commercial Department are medium-sized business companies from various sectors of industry: commerce, industry, real estate, hi-tech, etc. In addition, the Commercial Department also provides services for interested parties in those companies.

As a rule, customers with a volume of approved credit facilities between more than NIS 10 million and NIS 120 million (inclusive) or with a business turnover of between more than NIS 20 million and up to NIS 400 million will be associated with the commercial banking segment. In addition, the segment includes startup companies with any credit facility or business turnover.

C. Management approach – Corporate Segment

General

The corporate banking segment specializes in providing banking and financial services to large corporations, some of which are corporations with multi-national activities. The services provided are based on the provision of an overall solution for all of the customer's needs, with a view to the entire range of their business activity.

Structure and characteristics of the segment

The corporate banking segment is managed in Israel by the Corporate and Commercial Division Corporate Commercial Department, The Corporate Department operates through three corporate sectors: a technology and tourism sector, a sector for chemicals, energy and trade and industry sector. Service to customers is provided by customer relations managers, who coordinate the Group's services vis-à-vis the customer and specialize in the market sector in which the customer operates. The segment supplies a comprehensive range of banking services to all types of companies in the various sectors. The customers' accounts are mainly managed through departments located in central branches, which specialize in handling large customers and customers with diverse activities, and, as far as is relevant, through the Bank's overseas offices. Special/complex transactions, for example, the acquisition of means of control, examination of investment programs and the financing of projects, international trade activity, finance of foreign debtors/domestic debtors, financial transactions executed by way of a syndicate, etc. are handled by designated units specializing in handling transactions of this kind, due to the complexity and level of risk involved.

The Special Loans Unit, which operates within the framework of the segment, deals with corporate customers who have encountered difficulties, with experience in assisting in the recovery of active customers and the collection of debts of corporate customers who cannot be rehabilitated.

Developments in markets of the segment or changes in the characteristics of its customers

The Corporate segment manages the credit risk displaying caution with a regular examination of the population of customers and focusing on the sensitive customers and checking development trends and the implications for them.

Products and services

The services provided include, *inter alia*, ongoing financing according to the customers' needs, financing of investments to maintain and expand operations, provision of solutions in the spheres of financing and international trade (including financing credit insurance or private insurance companies of projects abroad), financing and guidance of national and international projects, financing of mergers and acquisitions, extension of finance in large transactions through organization of syndicates cooperating with the institutional entities and foreign and Israeli banks, financial instruments to hedge against currency risks, interest risks and fluctuations in commodities prices. The service also includes the initiation and promotion of banking services to the companies, managements and employees of companies.

Customers

Customers belonging to this segment are mostly characterized by their leading position in the market and dominance in their field of activity. Some of these are public companies from a variety of different sectors of the economy, with complex organizational structures comprised of numerous management echelons and a broad span of control.

As a rule, customers with a volume of approved credit facilities exceeding NIS 120 million (inclusive) or customers with a business turnover of more than NIS 400 million will be associated with the corporate banking segment. Customers with a facility of up to NIS 80 million will also be dealt with in the corporate banking segment, if their total obligo in the banking system exceeds NIS 250 million.

D. Management approach – Real estate segment

General

The Real Estate Department specializes in the provision of banking and financial services, mainly in the area of construction and real estate and in the area of infrastructure projects. The financing of the construction sector projects is effected through the use of instruments and special analysis tools, adopting considered policy. The financing of the projects is achieved through a closed financing format (construction loan) with frequent close supervision and monitoring and with an emphasis on meticulous examination of each project.

Structure and characteristics of the segment

The Real Estate Segment in Israel is mostly managed by the International Credit and Real Estate Division. The Real Estate Department operates through two sectors: corporate real estate, and real estate enterprise. The department provides a comprehensive range of banking services to construction companies and the large developers and contractors in the market, with expertise and specific skill in all areas of real estate in the economy. Customers' accounts are managed mainly in corporate offices specialized in dealing with large customers and those with varied activities and located in central branches, and, as far as is relevant, in the Bank's overseas offices. Service to the customer is provided by the customer relations managers, who coordinate the Group's services vis-à-vis the customer and specialize in the market sector in which the customer operates.

Developments in markets of the segment and in the characteristics of the customers

2016 was characterized by an increase in competition for financing real estate activity among the capital market institutions, on the one hand, and capital restrictions in the banking system, on the other.

The real estate market in Israel is a part of the total corporate activity in the Israeli economy. Expectations for 2017 are for a continuation in moderate economic growth in Israel, which, inter alia, will also have implications for the domestic market. Business activity will be affected by the macroeconomic situation in Israel and around the world, such as: the prices of goods and energy, the change between currencies and the geopolitical situation, which will affect the investment decisions of large corporations in the Israeli economy.

The real estate segment manages credit risks with extreme caution with regular review of customer populations and focusing on sensitive customers and examining trends of developments and their repercussions.

The housing real estate area in 2016 was characterized by moderation and stabilization in the rate of sales, although this was still higher than the corresponding period, and higher than the long-term average. Furthermore, the impact on the price of apartments of the "Affordable Housing" program, which accounts for most of the marketing of land since the beginning of the program in its new format in 2015, is still not clear, particularly in prime areas of demand.

The office rental property market correlates strongly with growth in the corporate product. In future years, it is likely that there will be an excess supply of office space in projects which are currently in the process of construction, but, until now, no material changes have been noted in the occupancy rate or in rents.

The commercial real estate market is strongly affected by developments in private household consumption. This market remained relatively stable, which is reflected in maintaining relatively high occupancy rates and stable rents. However, a certain trends of an increase in the ratio of rental costs to redemption may be distinguished, as a result of the erosion therein.

In the field of national infrastructure, including in the area of performance and infrastructure contractor, which, in recent years, has enjoyed an increase in the volume of housing and non-housing construction, a slowdown in the rate of new project starts in national infrastructure continued, together with fluctuations in the volumes of construction in the housing market and increasing competition in the area of performance, who results in an increasing trend in the level of risk in this area..

In 2017, as in previous years, activity in the area of real estate is expected to be affected by the macroeconomic situation, government/regulatory intervention (particularly in the housing market), building completions (particularly in the office market) and the volumes of investments by the State in the area of national infrastructure.

Products and services

Finance in the area of construction and real estate is effected by the use of specific analysis and monitoring tools which assist in the decision-making process and control of financial support given to the various projects and assets. Financing is carried out, directing the diversity of the credit portfolio and distinguishing between the various segments – housing, rental property with a designation for commerce and offices, construction for industry and commerce. The financing of projects during the period of construction, and particularly, for housing, will, in general, be effected using the construction loan method which facilitates frequent close supervision of the project being financed.

In addition, pursuant to the financing of the area of construction and real estate, the segment also deals with the extension of credit, support of the initiation and development of real estate and hotel projects, the purchase of rental properties, including nursing retirement homes and their operation through the Bank's overseas units.

In 2016, noting the various regulatory requirements, the segment continued implementing a considered credit policy distinguishing between the various degrees of risk, and the determination of credit margins and its conditions, respectively.

The financing of business activity in in the main service centers of the Bank abroad contributes to the dispersal of risks through exposure to various macroeconomic environments and various characteristics of customers. Accordingly, the Bank is taking steps to increase its participations in transactions of the its overseas offices

Customers

Customers of the department comprise the large and mid-sized companies in the market in the area of real estate development, performance and infrastructure contractors and selected business companies engaged in real estate development and contractors and in the area of rental property.

Customers of the Construction and Real Estate Department with total approved facilities of over NIS 50 million in real estate projects (CL), over NIS 80 million in the area of performance and infrastructure contactors and over NIS 120 million in financing of rental property (NIS 80 million per single property) are associated with the real estate segment.

E. Management approach – Capital Markets segment

General

1. The financial management of the Bank and of the Group deals with the management of the dealing rooms and provides various services to banks and institutional investors, and acts as a "customer manager" for them. The main areas of activity of the segment are as follows:

   - Management of the *nostro*, by way of the investment of the Bank’s independent financial means in tradable and non-tradable investment instruments and management of direct investments, in the companies' tradable and non-tradable shares, with the non-bank investments being managed by Leumi Partners.
   - Management of the dealing rooms, which provide trading services to customers of the Bank, including market-making, primarily in currencies, securities and derivative instruments;
   - Management of sources and applications and liquidity;
   - Management of market risk exposures – including the management of basis, interest and liquidity exposures;
   - Price management – by setting transfer prices and costing special financial transactions;
   - Management of banking activity of institutional customers and other corporations with extensive activity in the capital market;
   - Development of financial instruments.

Structure of the segment

Financial management is carried out by the Capital Markets Division, which centralizes and coordinates the topic at Group level. The financial management activity includes the banking portfolio and the trading portfolio, as well as providing service to customers active in the capital and money markets, including institutional customers. Activity in the banking portfolio is managed in the ALM Department and includes the management of sources and applications and exposure to market risks and liquidity. Activity for commerce is performed by the trading rooms and *nostro* units in Israeli and foreign currencies.

The main tools for management of the banking portfolio – transfer prices, activity in the available-for-sale *nostro* portfolios and the use of derivative instruments.

The main areas of responsibility of ALM – Management of the Bank's financial capital and exposures to market risks, management of corporate and statutory liquidity and liquidity risk, as well as the allocation of sources to the various applications by means of the implementation of transition price policy. This policy is determined according to: the Bank's requirements, planning and management of the mix of sources and applications, developments in the corporate environment and forecasts. Within this framework, the methodology for settling accounts between the profit centers is also determined, and the complex and special transactions are priced.

The day-to-day management of the liquidity is applied pursuant to the Bank's policy and according to the requisite directives. The management is carried out by a designated unit, whose main function is the optimal planning and management of the liquidity balances, subject to the risk appetite, ensuring a level of liquidity which enables corporate activity, compliance with all the Bank's financial obligations in a normal business environment and in stress scenarios. The measurement, analysis, planning and reporting is carried out through Summix (formerly Risk Pro) risk management system, which provides vast information on any financial activity of the Bank and on market and liquidity risks inherent therein. The system facilitates review and control of the effect of various scenarios (price and quantity) on the Bank's financial profitability and capital.

For a description of the main points of policy for investments in securities (*nostro*), see Chapter "Structure and Development of Assets and Liabilities, Capital and Capital Adequacy, Securities".

Profit of the segment

The segment's profit is mainly influenced by the *nostro* activities, the dealing rooms and ALM management, as well as the results of non-banking companies included on equity basis. The principal components of net profit are as follows:

- Results of market risk management, including the changes that have occurred in transfer prices. Income and expenses resulting from changes in transfer prices are attributed in full to the financial segment, to which all of the market risks from the other operating segments are also transferred;
- Profits/losses from the realization of securities and from provisions for declines in values of securities in respect of declines of a non-temporary nature, and from unrealized profits/losses from adjustments of securities for trading to market value;
- Adjustments of derivative instruments to market value;
- Effects of foreign currency/shekel exchange rate and consumer price index differentials, including adjustments from the translation of overseas investments, including the effects of related taxes;
- Income deriving from market-making activity;
- Income/expenses deriving from the investment for pension, jubilee and regular holiday reserves;
- Particular costs relating to pension liabilities, calculated on an actuarial basis;
- Profits of companies included on equity basis.

Operating expenses of the segment include mainly direct operating expenses, as well as indirect expenses involved in the management of market risks, management of the independent securities (the *nostro*) portfolios and management of the dealing rooms.

Developments in the markets

In 2016, against a backdrop of fluctuations and significant macro events, the economic trends in the market was changes several times during the year, necessitating adjustments in financial management and the management of exposures.

Products and services

Most of the activity in this segment includes custodian services, brokerage and negotiable and non-negotiable derivatives. In addition, the Bank provides operating services to provident fund, mutual fund and investment fund management companies.

Customers

The customers belonging to this segment are insurance companies, provident funds, training funds, pension funds, mutual funds, ETFs, commercial banks and investment banks, as well as other customers operating intensively in the capital markets.

C. APPENDICES

Rates of income and expenses(a) and analysis of changes in interest income and expenses

Part A – Average balances and interest rates - assets

	2016			2015			2014		
	Average balance (b)	**Interest income**	**Rate of income**	Average balance (b)	Interest income	Rate of income	Average balance (b)	Interest income	Rate of income
	NIS millions		%	NIS millions		%	NIS millions		%
Interest-bearing assets									
Credit to the public (c)									
In Israel	**238,767**	**7,757**	**3.25**	229,093	7,265	3.17	216,805	8,108	3.74
Outside Israel	**23,366**	**940**	**4.02**	23,069	905	3.92	23,025	945	4.10
Total (i)	**262,133**	**8,697**	**3.32**	252,162	8,170	3.24	239,830	9,053	3.77
Credit to the government									
In Israel	**502**	**18**	**3.59**	448	15	3.35	464	18	3.88
Outside Israel	**10**	**-**	**-**	13	-	-	42	-	-
Total	**512**	**18**	**3.52**	461	15	3.25	506	18	3.56
Deposits in banks									
In Israel	**7,529**	**69**	**0.92**	9,654	56	0.58	8,387	57	0.68
Outside Israel	**754**	**17**	**2.25**	987	14	1.42	1,518	25	1.65
Total	**8,283**	**86**	**1.04**	10,641	70	0.66	9,905	82	0.83
Deposits in central banks									
In Israel	**34,420**	**36**	**0.10**	27,544	35	0.13	24,651	136	0.55
Outside Israel	**5,451**	**6**	**0.11**	4,642	4	0.09	5,376	10	0.19
Total	**39,871**	**42**	**0.11**	32,186	39	0.12	30,027	146	0.49
Securities borrowed or purchased under resale agreements									
In Israel	**1,455**	**2**	**0.14**	1,732	3	0.17	1,668	11	0.66
Outside Israel	**-**	**-**	**-**	-	-	-	-	-	-
Total	**1,455**	**2**	**0.14**	1,732	3	0.17	1,668	11	0.66
Bonds available for sale (d)									
In Israel	**60,198**	**536**	**0.89**	42,997	326	0.76	35,451	517	1.46
Outside Israel	**5,016**	**102**	**2.03**	4,581	73	1.59	4,473	76	1.70
Total	**65,214**	**638**	**0.98**	47,578	399	0.84	39,924	593	1.49
Bonds for trading (d)									
In Israel	**11,088**	**59**	**0.53**	11,330	83	0.73	10,249	106	1.03
Outside Israel	**69**	**10**	**14.49**	304	5	1.64	166	3	1.81
Total	**11,157**	**69**	**0.62**	11,634	88	0.76	10,415	109	1.05
Total interest-bearing assets	**388,625**	**9,552**	**2.46**	356,394	8,784	2.46	332,275	10,012	3.01
Receivables for non-interest bearing credit cards	**6,508**			6,030 (j)			7,396		
Other non-interest bearing assets (e)	**37,672**			44,959 (j)			36,374 (j)		
Total assets	**432,805**	**9,552**		407,383	8,784		376,045 (j)	10,012	
Total income-bearing assets attributable to activity outside Israel	**34,666**	**1,075**	**3.10**	33,596	1,001	2.98	34,600	1,059	3.06

See notes on page 384 below.

Part B – Average balances and interest rates – liabilities and equity

	2016			2015			2014		
	Average balance (b)	**Interest expenses**	**Rate of expenses**	Average balance (b)	Interest expenses	Rate of expenses	Average balance (b)	Interest expenses	Rate of expenses
	(NIS millions)		%	(NIS millions)		%	(NIS millions)		%
Interest- bearing liabilities									
Deposits of the public									
In Israel	**238,902**	**(1,093)**	**(0.46)**	221,889	(821)	(0.37)	210,458	(1,447)	(0.69)
On demand	**90,324**	**(15)**	**(0.02)**	75,133 (j)	(13)	(0.02)	48,914	(63)	(0.13)
Fixed term	**148,578**	**(1,078)**	**(0.73)**	146,756 (j)	(808)	(0.55)	161,544	(1,384)	(0.86)
Outside Israel	**16,849**	**(131)**	**(0.78)**	16,570	(124)	(0.75)	16,479	(138)	(0.84)
On demand	**3,740**	**(10)**	**(0.27)**	2,943	(7)	(0.24)	2,779	(7)	(0.25)
Fixed term	**13,109**	**(121)**	**(0.92)**	13,627	(117)	(0.86)	13,700	(131)	(0.96)
Total	**255,751**	**(1,224)**	**(0.48)**	238,459	(945)	(0.40)	226,937	(1,585)	(0.70)
Deposits of the government									
In Israel	**154**	**(4)**	**(2.60)**	149	(4)	(2.68)	144	(6)	(4.17)
Outside Israel	**583**	**-**	**-**	421	-	-	245	-	-
Total	**737**	**(4)**	**(0.54)**	570	(4)	(0.70)	389	(6)	(1.54)
Deposits from central banks									
In Israel	**-**	**-**	**-**	-	-	-	61	-	-
Outside Israel	**-**	**-**	**-**	-	-	-	-	-	-
Total	**-**	**-**	**-**	-	-	-	61	-	-
Deposits from banks									
In Israel	**4,416**	**(7)**	**(0.16)**	5,100	(11)	(0.22)	4,147	(26)	(0.63)
Outside Israel	**13**	**(8)**	**(61.54)**	40	(3)	(7.50)	94	(20)	(21.28)
Total	**4,429**	**(15)**	**(0.34)**	5,140	(14)	(0.27)	4,241	(46)	(1.08)
Securities lent or sold under resale agreements									
In Israel	**812**	**(2)**	**(0.25)**	958	(3)	(0.31)	876	(9)	(1.03)
Outside Israel	**-**	**-**	**-**	-	-	-	-	-	-
Total	**812**	**(2)**	**(0.25)**	958	(3)	(0.31)	876	(9)	(1.03)
Bonds									
In Israel	**24,204**	**(781)**	**(3.23)**	21,237 (j)	(700)	(3.30)	24,503	(1,003)	(4.09)
Outside Israel	**-**	**-**	**-**	-	-	-	10	-	-
Total	**24,204**	**(781)**	**(3.23)**	21,237	(700)	(3.30)	24,513	(1,003)	(4.09)
Total interest-bearing liabilities	**285,933**	**(2,026)**	**(0.71)**	266,364	(1,666)	(0.63)	257,017	(2,649)	(1.03)
Non-interest bearing deposits of the public	**81,458**			76,278			59,070		
Payables for non-interest bearing credit cards	**6,112**			6,430 (j)			8,009		
Other non-interest bearing liabilities (f)	**29,333**			30,702 (j)			26,339		
Total liabilities	**402,836**	**(2,026)**		379,774	(1,666)		350,435	(2,649)	
Total capital means	**29,969**			27,609			25,610	-	
Total liabilities and capital means	**432,805**	**(2,026)**		407,383 (j)	(1,666)	-	376,045	(2,649)	-
Interest margin		**7,526**	**1.75**		7,118	1.84		7,363	1.98
Net yield (g) on interest-bearing assets									-
In Israel	**353,959**	**6,590**	**1.86**	322,798	6,244	1.93	297,675	6,462	2.17
Outside Israel	**34,666**	**936**	**2.70**	33,596	874	2.60	34,600	901	2.60
Total	**388,625**	**7,526**	**1.94**	356,394	7,118	2.00	332,275	7,363	2.22
Total interest-bearing liabilities attributable to activity outside Israel	**17,445**	**(139)**	**(0.80)**	17,031	(127)	(0.75)	16,828	(158)	(0.94)

See notes on page 384 below.

Part C – Average balances and interest rates – additional information on interest-bearing assets and liabilities attributable to activity in Israel

	2016			2015			2014		
	Average balance (b)	**Interest income (expenses)**	**Rate of income (expenses)**	Average balance (b)	Interest income (expenses)	Rate of income (expenses)	Average balance (b)	Interest income (expenses)	Rate of income (expenses)
	(NIS millions)		%	(NIS millions)		%	(NIS millions)		%
Unlinked Israeli									
Total interest-bearing	**252,026**	**6,030**	**2.39**	222,907	5,648	2.53	200,542	6,178	3.08
Total interest-bearing	**185,536**	**(624)**	**(0.34)**	169,944 (j)	(503)	(0.30)	152,607	(906)	(0.59)
Interest margin	**-**	**-**	**2.05**	-	-	2.23	-	-	2.49
Index-linked Israeli currency									
Total interest-bearing assets	**51,140**	**1,482**	**2.90**	52,685	1,294	2.46	56,436	1,890	3.35
Total interest-bearing liabilities	**41,381**	**(948)**	**(2.29)**	42,457	(858)	(2.02)	48,374	(1,418)	(2.93)
Interest margin			**0.61**			0.44			0.42
Foreign currency									
Total interest-bearing assets	**50,793**	**965**	**1.90**	47,206	841	1.78	40,697	885	2.17
Total interest-bearing liabilities	**41,571**	**(315)**	**(0.76)**	36,932	(178)	(0.48)	39,208	(167)	(0.43)
Interest margin			**1.14**			1.30			1.75
Total activity in Israel									
Total interest-bearing assets	**353,959**	**8,477**	**2.39**	322,798	7,783	2.41	297,675	8,953	3.01
Total interest-bearing liabilities	**268,488**	**(1,887)**	**(0.70)**	249,333 (j)	(1,539)	(0.62)	240,189	(2,491)	(1.04)
Interest margin			**1.69**			1.79			1.97

See notes on page 384 below.

Part D – Analysis of changes in interest income and interest expenses

	2016 compared with 2015			2015 compared with 2014		
	Increase (decrease) due to change (h)		Net change	Increase (decrease) due to change (h)		Net change
	Amount	Price		Amount	Price	
	(NIS millions)					
Interest-bearing assets						
Credit to the public						
In Israel	**314**	**178**	**492**	390	(1,233)	(843)
Outside Israel	**12**	**23**	**35**	2	(42)	(40)
Total	**326**	**201**	**527**	392	(1,275)	(883)
Other interest-bearing assets						
In Israel	**134**	**68**	**202**	71	(398)	(327)
Outside Israel	**9**	**30**	**39**	(10)	(8)	(18)
Total	**143**	**98**	**241**	61	(406)	(345)
Total interest income	**469**	**299**	**768**	453	(1,681)	(1,228)
Interest-bearing liabilities						
Deposits of the public						
In Israel	**78**	**194**	**272**	42	(668)	(626)
Outside Israel	**2**	**5**	**7**	1	(15)	(14)
Total	**80**	**199**	**279**	43	(683)	(640)
Other interest-bearing liabilities						
In Israel	**57**	**19**	**76**	(60) (j)	(266)	(326)
Outside Israel	**2**	**3**	**5**	1	(18)	(17)
Total	**59**	**22**	**81**	(59)	(284)	(343)
Total interest expenses	**139**	**221**	**360**	(16)	(967)	(983)

Notes:

(a) The data in these tables are after the effect of derivative instruments.

(b) Based on monthly opening balances, except for the unlinked Israeli currency sector in which the average balance is based on daily figures, and before deduction of the average book balance of allowances for credit losses, overseas subsidiaries on the basis of quarterly opening balances.

(c) Before deduction of the average balance of allowances for credit losses. Including impaired debts not accruing interest income.

(d) From the average balance of the assets there has been deducted (added) the average balance of unrealized profits (losses) from adjustments to fair value of debentures held for trading and available for sale, in the various sectors, the amount of NIS 548 million (31 December 2015 – NIS 490 million).

(e) Including book balances of derivative instruments, other non-interest bearing assets, non-monetary assets and after deducting the allowance for credit losses.

(f) Including book balances of derivative instruments, and non-monetary liabilities.

(g) Net return – net interest income divided by total interest-bearing assets.

(h) The calculation of the allocation between a change in amount and a change in price is made as follows: change in price - the change in price is multiplied by the book balance for the corresponding period; change in amount – the change in book balance is multiplied by the price for the current period.

(i) Commissions in the amount of NIS 310 million were included in interest income from credit to the public (31 December 2015 – NIS 363 million).

(j) Reclassified.

Quarterly Consolidated Statements of Profit and Loss – Multi-Quarter Data

	2016				2015			
	4	3	2	1	4	3	2	1
	(NIS millions)							
Interest income	2,316	2,607	2,704	1,925	2,001	2,463	2,818	1,502
Interest expenses	449	637	670	270	274	588	818	(14)
Interest income, net	1,867	1,970	2,034	1,655	1,727	1,875	2,000	1,516
Expenses (income) in respect of credit losses	46	106	(154)	(123)	33	73	12	81
expenses in respect of credit losses	1,821	1,864	2,188	1,778	1,694	1,802	1,988	1,435
Non-interest income								
Non-interest financing income	225	499	534	24	71	325	(105)	1,319
Commissions	994	996	989	988	993	1,013	1,035	1,051
Other income	105	19	15	20	481	6	53	55
Total non-interest income	1,324	1,514	1,538	1,032	1,545	1,344	983	2,425
Operating and other expenses								
Salaries and related expenses	1,280	1,354 (a)	1,546(a)	1,242(a)	1,349 (a)	1,384(a)	1,369(a)	1,442(a)
Building and equipment maintenance and depreciation	443	435 (a)	425(a)	394(a)	414 (a)	421(a)	428(a)	415(a)
Amortization of intangible assets and goodwill	-	-	-	-	5	-	-	-
Other expenses	557	166(a)	384(a)	354(a)	550(a)	316(a)	365(a)	378(a)
Total operating and other expenses	2,280	1,955	2,355	1,990	2,318	2,121	2,162	2,235
Profit before taxes	865	1,423	1,371	820	921	1,025	809	1,625
Provision for taxes on profit	425	514	407	371	502	327	297	565
Profit after taxes	440	909	964	449	419	698	512	1,060
Banking corporation's share in profits of companies included on equity basis, after tax	10	21	16	19	16	15	15	131
Net profit (loss):								
Before attributiing to non-controlling interests	450	930	980	468	435	713	527	1,191
Attributed to non-controlling interests	(7)	(11)	(10)	(9)	(4)	(9)	(9)	(9)
Attributable to shareholders of the banking corporation	443	919	970	459	431	704	518	1,182
Basic and diluted earnings per share:								
Net profit (loss) attributable to shareholders of the banking corporation (in NIS)	0.27	0.58 (b)	0.63(b)	0.31(b)	0.29	0.48	0.35	0.80

(a) Reclassified.

Quarterly Consolidated Balance Sheets – Multi-Quarter Data

	2016				2015			
	4	3	2	1	4	3	2	1
	(NIS millions)							
Assets								
Cash and deposits with banks	**74,757**	**59,067**	**57,881**	**55,648**	60,455	52,562	46,170	51,769
Securities	**77,201**	**82,493**	**84,872**	**78,727**	69,475	67,545	64,810	64,379
Securities borrowed or purchased under agreements to resell	**1,284**	**896**	**1,476**	**1,621**	1,764	1,420	2,177	2,197
Credit to the public	**265,450**	**267,895**	**269,602**	**267,705**	265,070	263,822	258,460	254,223
Allowance for credit losses	**(3,537)**	**(3,527)**	**(3,554)**	**(3,572)**	(3,671)	(3,813)	(3,912)	(3,948)
Credit to the public, net	**261,913**	**264,368**	**266,048**	**264,133**	261,399	260,009	254,548	250,275
Credit to governments	**642**	**623**	**480**	**412**	453	474	435	433
Investments in companies included on equity basis	**901**	**897**	**923**	**899**	924	948	889	896
Buildings and equipment	**3,147**	**3,044**	**3,042**	**3,060**	3,095	2,992	3,054	3,103
Intangible assets and goodwill	**17**	**17**	**17**	**17**	18	18	17	18
Assets in respect of derivative instruments	**10,654**	**11,630**	**12,999**	**13,150**	11,250	15,314	14,538	18,831
Other assets	**8,087**	**8,723**	**8,662**	**7,890**	7,666	7,242	7,113	7,418
Total assets	**438,603**	**431,758**	**436,400**	**425,557**	416,499	408,524	393,751	399,319
Liabilities and equity								
Deposits of the public	**346,854**	**336,851**	**339,998**	**330,354**	328,693	317,991	304,043	305,017
Deposits from banks	**3,394**	**3,589**	**4,165**	**4,441**	3,859	3,650	4,581	6,187
Deposits from governments	**900**	**661**	**686**	**808**	750	644	631	517
Securities loaned or sold under agreements to repurchase	**539**	**553**	**789**	**845**	938	503	1,371	1,384
Debentures, bonds and subordinated notes	**22,640**	**23,765**	**24,151**	**24,810**	21,308	22,187	19,720	19,596
Liabilities in respect of derivative instruments	**10,677**	**12,634**	**13,743**	**13,996**	11,098	14,766	14,430	18,086
Other liabilities	**21,885**	**22,117**	**22,455**	**20,650**	20,746	19,873	20,368	21,591
Total liabilities	**406,889**	**400,170**	**405,987**	**395,904**	387,392	379,614	365,144	372,378
Non-controlling interests	**367**	**360**	**349**	**340**	340	335	334	329
Equity attributable to shareholders of the banking corporation	**31,347**	**31,228**	**30,064**	**29,313**	28,767	28,575	28,273	26,612
Total equity	**31,714**	**31,588**	**30,413**	**29,653**	29,107	28,910	28,607	26,941
Total liabilities and equity	**438,603**	**431,758**	**436,400**	**425,557**	416,499	408,524	393,751	399,319