

# BANK LEUMI LE-ISRAEL B.M. AND SUBSIDIARIES

## Condensed Financial Statements as at 31 March 2003 (unaudited)

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This is a translation from the Hebrew and has been prepared for convenience only. In the case of any discrepancy, the Hebrew will prevail.

29 May 2003

## **Bank Leumi le-Israel B.M.**

### **Directors' Report**

#### **Developments in the Economy <sup>(\*)</sup>**

Economic activity stabilized in the first quarter of 2003 following a conspicuous downtrend over the past two years. Nevertheless, the unemployment rate rose by 10.8%. Gross Domestic Product grew by some 0.4% compared with the corresponding quarter in 2002, posting a 2.5% annualized rise compared with the last quarter of 2002. This improvement resulted from industrial sector growth (particularly in export-oriented sectors), along with a degree of recovery in commercial and service sectors. Despite this, the State's tax revenues were substantially eroded, giving rise to fears that the budget deficit target as established in the Budget Law (3% of GDP) would be exceeded by a considerable margin. This being so, the government decided on an "economic recovery plan for Israel" providing for a series of reforms designed to promote growth along with budgetary adjustments (as outlined below). As uncertainties were reduced, along with expectations for an improvement in the economic position, the shekel gained strength. April saw a reinforcement of this trend. The Consumer Price Index posted a moderate first quarter rise of 0.8% which, with the inflation environment subsiding, enabled the Bank of Israel to proceed to a moderate reduction of the nominal shekel interest rate. Share prices were up in the capital market, with the trend accelerating in April and May, primarily due to the consolidation of the US victory in the war with Iraq and the approval of the economic plan by the government and the Knesset (on first reading). Yield to maturity on long-term, primarily unlinked, shekel debentures was down, for similar reasons.

Relatively large provisions for doubtful debts continued to be posted in the first quarter of the year, in view of the economic situation.

#### **Economic Sectors**

The first quarter of 2003 showed some alleviation of the downturn in economic activity that had characterized the business sector since the end of 2000, with some sectors posting a certain increase in activity. The business sector's product shrank by some 0.2% compared with the first quarter of 2002, but expanded by some 3.1% on an annual basis, compared with the last quarter of 2002. Increased activity in the industrial sector and certain trade and services sectors contributed to this.

The first-quarter activity of the tourism sector continued to decrease, primarily due to the preparations for and expectations of the war in Iraq. Tourism overnight stay figures point to a slide of 24% compared with the first quarter of 2002, to some half a million overnight stays. The number of overnight stays recorded by Israelis in hotels was also down to some 1.8 million overnight stays, a decrease of some 20% compared to the corresponding period in 2002. Thus total overnight stays posted a downturn of some 21%.

#### **The Government Budget**

The government recorded a deficit of some NIS 4.5 billion in its budget (exclusive of net credit granted) for the first quarter of the year. This resulted from a domestic budget deficit of some NIS 5.3 billion, which was offset by a surplus of some NIS 0.8 billion in the government's overseas activity, deriving mainly from US civilian aid received for 2002, in the amount of some NIS 2 billion. The major deficit in the domestic budget, that constitutes some half of the planned domestic deficit for the entire year, may be ascribed to a downturn of some 10% in real terms in tax revenues for the first quarter of the year compared with the corresponding quarter in 2002. This, resulted from the economic recession, that made its mark chiefly in the decline in the collection of income tax, as an outcome of the erosion of wages and the increase in tax refunds, together with the effects of the tax reform that came into effect at the beginning of 2003. It was the sharp decline in tax revenues and the large budget deficit that formed the backdrop to the economic recovery plan presented in March.

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<sup>(\*)</sup> Source of data: publications of the Central Bureau of Statistics, the Bank of Israel, the Ministry of Finance and the Tel Aviv Stock Exchange.

## **Foreign Trade**

In the first three months of the year, export of goods amounted to some \$7.0 billion, import of goods totaled about \$8.0 billion and the trade deficit came to some one billion dollars. Export of goods expanded by some 11%, compared with the corresponding quarter in 2002, while import was up by about 4%. This reduced the trade deficit by some 27%.

The increase in the export of goods derived from a rise in industrial export (exclusive of diamonds), particularly to the European Union, to the United States and to Asia. This rise was recorded thanks to the improvement in export profitability, notwithstanding the slow economic growth in those parts of the world. The increase in the import of goods was due to a dollar term increase of energy product imports (as their prices rose in global terms), and an increase in the import of diamonds. By contrast, there was a decrease (-18%) in the import of consumer products, whereas the rate of decrease in the import of raw materials and investment products became more moderate.

## **Inflation**

In the first quarter of the year, the Consumer Price Index was up 0.8%, mainly as a result of the rise in the transport and communications item by 3.0% (carrying a weight of about one fifth of the index). This was due, *inter alia*, to the effect of rising fuel prices. An especially steep, seasonally influenced, decline in prices was recorded in clothing and footwear (-14.8%). In the past 12 months (March 2002 – March 2003), the index recorded a 4.8% rise, while the core index (exclusive of fruit and vegetables and exclusive of housing) posted a sharper rise of 6.2%. Inflation expectations for the coming 12-month period, as computed by the Bank of Israel, reached some 3.2% on average for the first quarter compared with the 1%-3% inflation target for 2003. In April and May, expectations were down to less than 2.0%.

## **Exchange Rate**

In the first three months of the year, the shekel appreciated against both the dollar and the currency basket. The shekel rose by some 1.1% against the dollar, and posted a slight gain of some 0.2% against the currency basket. This strengthening of the shekel occurred mainly in March, in the then prevailing atmosphere of expectations of a decrease in the level of uncertainty, with the progress of the military campaign in Iraq and the presentation of the Government's economic plan. Worth bearing in mind is the underlying fact that the first quarter recorded an improvement in the trade deficit and that there was also a certain increase in net capital flows by the non-banking private sector. The months of April and May (prior to the closing of the financial statements on 27 May) marked a reinforcement of the trends outlined above, with the shekel gaining about another 5.0% against the dollar.

Israel's foreign currency reserve balances amounted at the end of March to some \$23.5 billion, down by some \$0.1 billion as compared with the end of December 2002. The decrease in reserves is explained by the government's foreign spending and withdrawals made by the banks from their deposits with the Bank of Israel, these being offset by receipt of the 2002 civilian aid grant from the US administration and the Bank of Israel's income from its foreign currency reserves.

## **Monetary Policy**

In the first quarter of the year, the Bank of Israel slightly reduced the interest rate which had been holding steady at the level determined as of July 2002. The interest rate, which in December 2002 stood at 9.1%, was lowered to 8.9% and this level was maintained through March. In the monetary program for the months of April to June, the interest rate was again lowered, to 8.0%. The principal reason for lowering the interest rate was the decrease in inflation expectations, and the possibility that the 1%-3% inflation target might be achieved with a lower interest rate. This approach was based on the appreciation of the shekel and the decrease in long-term interest rates.

### **Financial Assets Held by the Public**

In the first three months of the year, the value of the financial assets portfolio held by the public rose by some 0.5%. This increase derived, for the most part, from a rise in the value of marketable assets such as stocks and debentures following the upswing in their market prices. Accordingly, no significant change took place in their proportion of the assets portfolio in the hands of the public.

### **Credit to the Public**

Bank credit to the public throughout the banking system (the data is based on monthly averages of the banking system as a whole, including mortgage banks) was down by some 0.9% in real terms in the first quarter of the year. The main explanations of this decrease were the economic recession and the appreciation of the shekel against the dollar. Where credit is examined in terms of linkage sectors, a real decrease is seen in unlinked and CPI-linked loans.

### **The Capital Market**

The first quarter of the year was characterized by a moderate upward trend in stock prices, while the average daily trading turnover on the Tel Aviv Stock Exchange declined from NIS 219 million in 2002 to some NIS 168 million in the first quarter of 2003. The high level of uncertainty, especially in view of preparations for the war with Iraq, was a principal cause of the reduced volume of activity. In March and, more markedly in April and May, the upswing in stock prices intensified while trading volumes increased. The background to this trend were expectations that the economic recovery plan would be approved, and also the US victory in the war with Iraq.

The stock and convertible securities index rose in the first quarter of 2003 by some 4.2% in nominal terms, while the Tel-Aviv 100 index posted a 2.8% rise. All principal trading sectors posted gains, except for the stocks of investment holding companies and banks.

In view of the positive expectations as described, the Tel-Aviv 100 index rose by some 21.7% in April and May (until shortly before the closing of the financial statements).

Unlinked debenture prices rose conspicuously in the first quarter, posting sharp gains, mostly in March. This was due to the lowering of the inflation environment and the lessening of the uncertainty that had hitherto been reflected in unlinked debenture yields. The unlinked debentures total return index rose by some 4.9%, while the fixed-interest ("*Shachar*") debentures index was up by some 5.1%. In April and May the *Shachar* index went on to gain another 6.1%. Thus, the nominal yield to maturity of *Shachar* 9–10-year debentures, which in March stood at 10.7%, fell in May to some 8.5%.

The prices of CPI-linked government bonds were up in the first quarter by 2.9%, and the longer the term to maturity, the higher the rise. Thus, 10-15-year debentures posted gains of 4.1%. Expectations that the economic recovery plan would bring about a decrease in the budget deficit and the grant of guarantees from the US administration resulted in marked downturns in yield to maturity during April and May, to some 5.0% in debentures with a yield to maturity of ten years. (By comparison, in January 2003, the yield to maturity on such debentures stood at 5.9%).

Trade in foreign currency denominated and linked debentures in January-March was marked by slight downslides resulting from the strengthening of the shekel against the dollar. The prices of these debentures fell by about one percent.

### **Israel's Economic Recovery Plan**

On 30 April 2003, the Knesset approved, on first reading, the Proposed Plan for Israel's Economic Recovery Law (Legislative Amendments for achieving the Goals of the Budget and Economic Policy for the Financial Years 2003 and 2004), 5763-2003. This was part of the economic recovery plan for Israel approved by the government.

The plan includes reforms designed to promote economic growth. These include, *inter alia*, measures for reducing government spending by some NIS 9 billion, long-term structural rationalization of the public sector, such as improving the efficiency of the wage system and reforming long-standing pension funds. The plan features proposals for privatization and reform in the capital market and for boosting infrastructure investments, instituting reforms in the labor market and in various economic sectors, and bringing forward taxation system reforms and changes. Changes are also proposed in the composition of the budget, along with further structural changes.

Implementation of the plan is expected to produce effects, currently being studied, on the business of the Bank and the Group.

### **The Credit Rating of the State of Israel and Bank Leumi**

In October 2002, Standard & Poor's announced that it was lowering the local currency long-term rating from (AA-) to (A+) and the short-term rating from (A-1)+ to (A-1). The foreign currency credit rating remains unchanged at (A-).

In October 2002 the credit rating agency, Fitch, announced no change in the long-term foreign currency credit rating of the State of Israel (A-), but lowered the long-term local currency rating from (A+) to (A-). The outlook for the ratings remained "negative".

In March 2003, the credit rating agency, Moody's, published its annual report on the Israeli economy, in which it announced that Israel's credit rating would remain unchanged at a level of A2, and that its outlook was stable.

**The Bank** is accorded a (BBB+) credit rating by the international rating companies Fitch and Standard & Poor's, and an A2 rating by the Moody's credit rating company.

In February 2003, the credit rating agency, "Maalot", a strategic partner of S&P, announced the lowering of the Bank's credit rating from AAA to AA+.

In April 2003, Fitch announced the lowering of the credit rating of a number of Israeli banks. The Bank's rating was lowered from (A-) to (BBB+). The rating forecast was revised from "negative" to "stable". The lowering of the rating was explained by the deterioration in asset quality and weak capital levels by international standards (although in line with domestic levels).

Below are details of changes in the consumer price index and in the exchange rates:

	For three months ended 31 March		For the year
	2003	2002	2002
	(Percentages)		
Rate of increase of the "known" CPI	<b>0.30</b>	1.77	6.69
Rate of increase (decrease) of the "actual" CPI	<b>0.78</b>	2.36	6.50
Difference	<b>(0.48)</b>	(0.59)	0.19
Rate of increase (decrease) in the rate of the US dollar -			
nominal:	<b>(1.1)</b>	5.7	7.3
real:	<b>(1.8)</b>	3.3	0.7
Rate of increase (decrease) in the rate of the currency basket -			
nominal:	<b>(0.2)</b>	5.2	13.0
real:	<b>(1.0)</b>	2.8	6.1
Rate of increase in the rate of the euro -			
nominal:	<b>2.8</b>	4.4	27.2
real:	<b>2.0</b>	2.0	19.2

## **Legislation Affecting the Banking System**

### **Memorandum of the Banking (Licensing) (Amendment No. 13) Law, 5762-2002**

The said Memorandum was circulated by the Ministry of Finance, with the consent of the Bank of Israel, and it reflects the recommendations of the committee headed by the Director-General of the Ministry of Finance, that was established to examine the aspects relating to the sales of the State's holdings in the Bank through the capital market, and was also an appendix to the committee's report. The Memorandum contains amendments the object of the majority of which is to adapt the regulation, supervision and control over the banking corporations and the holders of the means of control therein to a situation in which there is no identified controlling core that holds a control permit from the Governor of the Bank of Israel.

The principal recommendations were detailed in the financial statements for 2002.

### **Engagement in Investment Counseling and Investment Portfolio Management (Regulation) Law, 5755-1995 - OM 431/01 Association of Banks v. Securities Authority**

On 23 October 2002 the said judgment was given by the District Court.

The judgment deals with the interpretation of the expression "counseling" in the Engagement in Investment Counseling and Portfolio Management (Regulation) Law, 5755-1995. The Association of Banks applied to the Court following a letter and a series of clarifications that were issued in consequence thereof by the Securities Authority, whereby the Authority clarified its position with regard to the meaning of the expression "counseling" in the said Law, as follows: "giving information about a security or other financial instrument, where the choice of the information is made in accordance with the discretion of the person giving the information or the entity with whom he is employed and the information may lead the recipient thereof to a conclusion as to the appropriateness of an investment in a specific security or financial instrument, also constitutes investment counseling, even if an express investment recommendation is not given".

The meaning of the Authority's position was that certain types of information could be given only by investment counselors.

The District Court did not accept the Association of Banks' application to cancel the Authority's directive, but laid down a series of directions and restrictions with regard to the giving of information by bank officials who are not investment counselors, and directed that the Authority's directives be adapted in accordance with its directions.

The Court held that the banks should cooperate with the Securities Authority in formulating the principles and guidelines for implementing the judgment, and mainly with regard to the following questions:

- (a) What is information that leads the recipient thereof to a conclusion about the advisability of the transaction?
- (b) What is negative information that may almost certainly detrimentally affect the advisability of the transaction?

The Bank has instructed its employees as to the significance of the judgment in respect of the Bank's activity in the information and investment counseling sphere and discussions were held on the subject, through the Association of Banks, with the Securities Authority, but the parties did not reach agreement.

In April 2003 the parties filed appeals against the judgment with the Supreme Court.

A hearing has not yet been held by the Supreme Court.

## Development of Income, Expenses and Tax Provisions<sup>(1)</sup>

The net profit of the Bank Leumi Group in the period from January to March of 2003 totaled NIS 176 million, compared with NIS 230 million in the corresponding period in 2002, a decrease of 23.5%. The decrease in the net profit of the Group in the period from January to March 2003 as compared with the corresponding period in 2002 can mainly be explained by the following factors:

- (a) Effect of net negative exchange rate differences in respect of overseas investments.
- (b) Voluntary retirement expenses.
- (c) Salary costs deriving from implementing Accounting Standard No. 14.
- (d) A decrease in the operating and other income.

On the other hand, the following factors partially offset the said effect:

- (a) An increase in interest income before provision for doubtful debts.
- (b) An increase in profits of companies included on the equity basis.
- (c) An increase in the value of the assets of the severance fund and the provident fund, which serve as a reserve for the Bank's severance and pension obligations.
- (d) A lower inflation level in the period from January to March of the year, 0.78% as compared with 2.36% in the corresponding period in 2002, resulted in a lower erosion of the surplus of the financial assets mainly in the unlinked segment.

Following is a quantitative itemization of the said effects\*:

1. Effect of net negative exchange rate differences in respect of overseas investments offsetting exchange rate differences after tax from financing the foreign investments in the sum of NIS 36 million, compared with positive exchange rate differences in the corresponding period in 2002 of NIS 46 million after the effect of tax.
2. Voluntary retirement expenses in the sum of NIS 55 million, before the effect of tax.
3. An increase in salary expenses in the sum of NIS 49 million, before the effect of tax.
4. A decrease in operating and other income in the sum of NIS 46 million before the effect of tax.
5. An increase in operating and other expenses, without salary and voluntary retirement, in the sum of NIS 50 million.

\* Before minority interests in consolidated companies.

The decrease in net profit was partially offset by:

1. An increase in interest income before provision for doubtful debts in the sum of NIS 108 million (8.1%), before the effect of tax.

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<sup>(1)</sup> The Financial Statements were prepared on a cost basis adjusted to changes in the general purchasing power of the shekel. The consumer price index increased by 0.78% in January-March 2003. The shekel appreciated nominally during this period: against the US dollar by 1.1% and depreciated against the euro by 2.8%. The representative exchange rate of the US dollar on 31 March 2003 was NIS 4.687.

The increase principally derived from an increase in the market value of debentures for trading and also from a decrease in the inflationary erosion of the surplus of the financial assets in the unlinked shekel sector in consequence of the decline in the inflation level.

See “Net interest income before provision for doubtful debts” on this page below for further details of the increase in interest income.

2. An increase in the Group’s share in profits of companies included on the equity basis of NIS 48 million, net.

**The effect on net profit during the period from the difference between the rise in the “actual” index and the rise in the “known” index**

Pursuant to a provisional directive of the Supervisor of Banks and the instructions of the Supervisor in respect of the manner of calculating the effect on the net profit, the following data explain the effect:

	For the three months ended 31 March	
	2003	2002
	(NIS millions)	
Reported net profit	176	230
Effect of differences between the “actual” and the “known” indices on net interest income before provision for doubtful debts	31	57
Effect of the related tax	(14)	(26)
Effect on the provision for taxes deriving from adjustment of capital on the basis of the “actual” index instead of the “known” index	18	22
Total effect on net profit	35	53
Profit after the effect	211	283

**Operating Profit**

**Net interest income before provision for doubtful debts** of the Bank Leumi Group in the period from January to March 2003 amounted to NIS 1,439 million, compared with NIS 1,331 million in the corresponding period in 2002, an increase of 8.1%.

The increase in net interest income before provision for doubtful debts in the Group stemmed mainly from:

1. An increase in net market value of derivatives in the sum of NIS 28 million, compared with a loss in the sum of NIS 89 million in the corresponding period in 2002.
2. Profits realized from the sale of debentures and profits that have not been realized from adjustments to fair value of debentures held for trading in the sum of NIS 80 million, compared with a loss in the sum of NIS 51 million in the corresponding period in 2002.
3. The effect of the increase in the index by 0.78% in the first quarter of 2003, compared with 2.36% in the corresponding period of 2002, which caused a smaller erosion of the financial assets in the surplus of financial assets in the unlinked sector.

On the other hand, the increase in non-accrual credit as compared with the corresponding period in 2002 partially offset the said increases.

**The overall interest spread** (excluding transactions in derivatives) in the period from January to March of 2003 was 1.23%, compared with 2.66% in the corresponding period in 2002. The interest spread including transactions in derivatives was 1.65% in the period from January to March 2003, compared with 1.78% in the corresponding period in 2002.

Pursuant to the Supervisor of Banks' directives the financial derivatives are presented as from 1 January 2003 according to new rules relating to "accounting for derivatives and hedging activities" as detailed in Note 9 of the Financial Statements.

In consequence of the said changes, the average balance sheet balances in respect of the activity in the majority of the derivatives were increased, while in the past the majority of them were presented as offset.

In consequence of the "inflation" in the activity volumes in 2003, as mentioned above, the interest spread is lower than in 2002. In the Bank's assessment, had the interest spread been calculated in 2003 without these changes, the interest spread would have reached 2.06%, compared with 1.78% in 2002, that is to say an improvement of some 0.3%. This improvement stems principally from the non-linked shekel sector as a result of profits in lieu of losses in respect of derivatives and also erosion of the surplus at a lower rate in consequence of the decline in the inflation rate.

**Provision for doubtful debts** amounted to NIS 375 million in the period from January to March 2003, compared with NIS 370 million in the corresponding period in 2002, an increase of 1.4%.

The Group continued to increase the specific provisions for doubtful debts against the background of the economic situation.

The additional and general provisions for doubtful debts in respect of unidentified risks in the credit portfolio and which are based on the risk characteristics in the credit portfolio and also in respect of a sectoral excess of credit increased by NIS 11 million in the first quarter of the year, compared with a decrease of NIS 8 million in the corresponding period in 2002 and an increase of NIS 53 million in all of 2002.

The total rate of the provision for doubtful debts in the period from January to March of 2003 was 0.87% of total credit to the public (in annual terms), compared with a rate of 0.86% in the corresponding period in 2002 and compared with 1.11% in all of 2002.

The aggregate balance of the general provision and the additional provision for doubtful debts (according to risk characteristics defined by the Supervisor of Banks) at the Bank and its consolidated companies amounted to NIS 1,125 million on 31 March 2003 (representing 0.65% of total credit to the public), compared with NIS 1,114 million at the end of 2002.

Set forth below is the development of problem loans according to the classifications determined in the Supervisor of Banks' directives:

	<b>31 March 2003</b>	31 March 2002	31 December 2002
	(NIS millions)		
Non-accrual	<b>4,298</b>	2,705	4,107
Restructured	<b>139</b>	552	573
To be restructured	<b>65</b>	83	76
In temporary arrears	<b>1,523</b>	1,608	1,342
Under special supervision*	<b>11,088</b>	11,562	10,945
Total balance sheet credit	<b>17,113</b>	16,510	17,043
Off-balance sheet credit risk	<b>2,177</b>	1,021	1,918
Total overall credit risk	<b>19,290</b>	17,531	18,961
*Of which: debts for which there is a specific provision	<b>5,369</b>	5,198	5,507
credit for housing for which there is a provision according to the extent of the arrears	<b>476</b>	413	429

\* Classified as 'under special supervision' are debts in respect of which, in accordance with Bank of Israel definitions, the Bank's management considers it necessary to intensify the monitoring and control, but does not anticipate losses in respect thereof; and also the balance of a borrower's liability another part of which was defined as a problem loan in another classification.

**Net interest income after provision for doubtful debts** of the Bank Leumi Group in the period from January to March 2003 amounted to NIS 1,064 million, compared with NIS 961 million in the corresponding period in 2002, an increase of 10.7%.

**Total operating and other income** of the Bank Leumi Group amounted to NIS 734 million in the period from January to March 2003, compared with NIS 780 million in the corresponding period in 2002, a decrease of 5.9%.

The decrease in operating and other income principally derived from a decrease in commissions from customers' operations on the capital market, which was partially offset by the increase in income from credit cards and account management charges.

The proportion of operating and other income to total income (*i.e.* net interest income before provision for doubtful debts and operating and other income) was 33.8%, compared with 36.9% in the corresponding period of 2002.

Operating and other income covered 50.7% of operating and other expenses, compared with 60.2% in the corresponding period last year and 55.1% in the whole of 2002.

**Total operating and other expenses** of the Bank Leumi Group in the period from January to March 2003 amounted to NIS 1,449 million, compared with NIS 1,295 million in the corresponding period in 2002, an increase of 11.9%.

Salary expenses (including the cost of voluntary retirement) increased by 12.6% in the period from January to March 2003 as compared with the corresponding period in 2002. The increase in salary expenses primarily derived from an increase in the voluntary retirement costs in the sum of NIS 55 million, and from the effects of applying Accounting Standard No. 14, in calculating the reserves for severance and pensions, for holidays and jubilee grant. On the other hand, the increase in the value of the assets of the severance fund and provident fund, which constitute reserves for the Bank's liabilities for severance pay and pensions, partially offset the said effects. See Note 10 to the Financial Statements for further particulars.

In other operating expenses (maintenance of buildings and equipment, depreciation and other expenses) there was an increase of 10.7% in the period from January to March 2003 as compared with the corresponding period in 2002. Part of the increase derived from provisions relating to the reorganization in France.

Operating expenses constituted 66.7% of total income, compared with 61.3% in the corresponding period in 2002 and 65.8% for the whole of 2002.

Total operating and other expenses (in annual terms) constituted 2.37% of total income, compared with 2.14% in the corresponding period in 2002 and compared with 2.16% in the whole of 2002.

**Operating profit before taxes** of the Bank Leumi Group amounted to NIS 349 million in the period from January to March 2003, compared with NIS 446 million in the corresponding period in 2002, a decrease of 21.7%.

**Provision for taxes on operating profit** of the Bank Leumi Group in the period from January to March 2003 amounted to NIS 205 million, compared with NIS 189 million in the corresponding period in 2002. The rate of provision in the said period was some 58.7% of pre-tax profit, compared with 42.4% in the corresponding period in 2002.

The increase in the rate of the provision for taxes in the period from January to March 2003 was principally due to the effect of exchange rate differences in respect of overseas investments that are not included in the basis for computing taxes and which were negative as compared with positive exchange rate differences in the corresponding period in 2002.

**Operating profit after taxes** totaled NIS 144 million in the period from January to March 2003, compared with NIS 257 million in the corresponding period in 2002, a decrease of 44.0%.

**The Group's share in net operating profit of companies included on the equity basis** in the period from January to March 2003 amounted to NIS 36 million, compared with a loss of some NIS 12 million in the corresponding period in 2002, an increase of NIS 48 million.

**Minority interests in the Group's profits** amounted to a profit of NIS 1 million in the period from January to March 2003, compared with a profit of NIS 14 million in the corresponding period of 2002.

**Loss from extraordinary items after taxes** totaled a loss of NIS 3 million in the period from January to March 2003, compared with a loss of NIS 1 million in the corresponding period of 2002.

**Ratio of operating profit before taxes to net shareholders' equity<sup>(\*)</sup>** in annual terms was 11.6% in the period from January to March 2003, compared with 15.4% in the corresponding period in 2002.

**Ratio of net operating profit to shareholders' equity (net return on equity<sup>(\*)</sup>)** in annual terms was 4.7% in the period from January to March 2003, compared with 8.6% in the corresponding period in 2002.

**Net operating profit per NIS 1 par value of share capital** was NIS 0.127 in the period from January to March 2003, compared with NIS 0.164 in the corresponding period in 2002.

**Net profit per NIS 1 par value of share capital** was NIS 0.125 in the period from January to March 2003, compared with NIS 0.163 in the corresponding period in 2002.

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(\*) Shareholders' equity together with the rights of minority interests less investments in equity of companies included on the equity basis. The profit does not include the profit of companies included on the equity basis.

**Return on shareholders' equity in annual terms (excluding minority interests) of:**

	For the three months ended 31 March	
	2003	2002
	%	
Net profit	5.3	7.1
Net operating profit	5.4	7.1

**Status of Capital Resources**

**Shareholders' equity** increased since the end of 2002 by 1.8% and on 31 March 2003 totaled NIS 13,741 million, compared with NIS 13,504 million at the end of 2002. The growth in shareholders' equity derives primarily from the profit for the period and from changes in adjustments in respect of the presentation of securities available for sale according to fair value.

In the (nostro) securities portfolio there are mainly government debentures, which generally represent the use of raised sources. The majority of the securities portfolio is classified as securities available for sale and is included in the balance sheet on a fair value basis. The income in the profit and loss statement is recorded on an accrual basis and the difference between the value according to accrual with regard to debentures and according to cost with regard to shares and the fair value is directly recorded in the capital reserves account.

In consequence of an increase in the market value of debentures in all the sectors, provisions for a decrease in value were reduced by NIS 67 million net in capital reserves, compared with a decrease in value of NIS 151 million in the corresponding period in 2002 and a decrease in value of NIS 236 million in all of 2002. All the amounts are net after the effect of taxes.

The total net aggregate balance of the decline in value of securities held in the available for sale portfolio as at 31 March 2003 amounted to NIS (72) million (after the effect of taxes).

According to the capital adequacy calculation rules, this reduction of the capital does not affect the capital adequacy calculation.

**Shareholders' equity relative to total assets** was 5.6% on 31 March 2003, compared with 5.4% at the end of 2002.

**Shareholders' equity relative to risk assets** was 10.8% on 31 March 2003, compared with 10.31% at the end of 2002, of which some 7.09% and 6.83% respectively were Tier I capital.

In the period from January to March 2003 the Group raised some NIS 370 million in Tier II capital (subordinated deposits and subordinated capital notes).

**Issue of Capital Notes**

In 2003 the Group continued to issue subordinated capital notes, as follows:

1. NIS 360 million subordinated capital notes were issued under the prospectus published by Leumi Finance Company Ltd. in March 2003.
2. Furthermore, the Bank raised some NIS 10 million in subordinated deposits.

## Development of Assets and Liabilities\*

**Total assets** of the Bank Leumi Group on 31 March 2003 amounted to NIS 246.6 billion, compared with NIS 250.1 billion at the end of 2002, a decrease of 1.4% and compared with 31 March 2002, an increase of 1.1%.

The value of assets in or linked to foreign currency was some NIS 107.2 billion, some 43.5% of total assets. In the period from January to March 2003 the shekel appreciated in real terms against the US dollar by 1.8% and appreciated in real terms against the basket of currencies by 1.0%. On the other hand, the shekel depreciated against the euro in real terms by 2.0%. The change in the rate of exchange contributed to a decrease of 0.6% in total assets.

**Deposits of the public** totaled NIS 206.6 billion on 31 March 2003, compared with NIS 210.6 billion on 31 December 2002, a decrease of 1.9%, and compared with 31 March 2002, an increase of 1.8%.

**Credit to the public** totaled NIS 173.5 billion on 31 March 2003, compared with NIS 176.4 billion on 31 December 2002, a decrease of 1.6%, and compared with 31 March 2002, an increase of 0.2%.

**Credit to governments** totaled NIS 1,387 million on 31 March 2003, compared with NIS 1,464 million on 31 December 2002, a decrease of 5.3%, and compared with 31 March 2002, a decrease of 12.2%.

**Securities** totaled NIS 38.7 billion on 31 March 2003, compared with NIS 37.1 billion on 31 December 2002, an increase of 4.3%, and compared with 31 March 2002, a decrease of 0.2%.

### Assets and Liabilities Classified According to Linkage Basis

Assets and liabilities classified according to linkage basis are presented on pages 42 to 44 and include the balances of the assets and liabilities and also off balance sheet transactions.

Set forth below is a summary of the net assets and liabilities classified according to linkage basis:

	<b>As at 31 March 2003</b>				
	Israeli currency		Foreign currency		Non-Monetary
	Unlinked	CPI-	incl. Foreign	currency linked	
		linked			Total
(in NIS millions)					
Assets	<b>70,122</b>	<b>63,533</b>	<b>107,210</b>	<b>5,773</b>	<b>246,638</b>
Liabilities	<b>76,800</b>	<b>55,606</b>	<b>99,368</b>	<b>854</b>	<b>232,628</b>
Difference	<b>(6,678)</b>	<b>7,927</b>	<b>7,842</b>	<b>4,919</b>	<b>14,010</b>
Net forward transactions	<b>6,782</b>	<b>(428)</b>	<b>(6,354)</b>	-	-
Net options (in underlying asset terms)	<b>(249)</b>	<b>(2)</b>	<b>251</b>	-	-

\* The differences in percentages were calculated according to the balances in NIS millions.

As at 31 December 2002					
	Israeli Currency		Foreign Currency	Non-Monetary Items	Total
	Unlinked	CPI-linked	incl. Foreign currency linked		
(in NIS millions)					
Assets	71,533	62,608	110,288	5,706	250,135
Liabilities	79,018	56,008	100,348	833	236,207
Difference	(7,485)	6,600	9,940	4,873	13,928
Net forward transactions	9,263	(701)	(8,562)	-	-
Net options (in underlying asset terms)	523	(4)	(519)	-	-

On 31 March 2003 the surplus of liabilities over assets (including forward transactions and options in underlying asset terms) in the unlinked shekel sector amounted to NIS 145 million, compared with a surplus of assets of NIS 2,301 million at the end of 2002.

The surplus of assets in the CPI-linked sector amounted to NIS 7,497 million, compared with NIS 5,895 million at the end of 2002.

The surplus of assets in the foreign currency sector, including the foreign currency-linked shekel sector, amounted to NIS 1,739 million, compared with a surplus of assets of NIS 859 million at the end of 2002. The increase in the surplus assets principally derives from hedging that the Bank carried out in respect of problem foreign currency credit that was defined as non-accrual.

The basis exposures reflected in assets and liabilities classified according to linkage basis comply with the limitations determined by the Board of Directors.

## Funding and Liquidity

### Liquidity Status (at the Bank)

Against the background of the geopolitical situation and the war in Iraq, the first quarter was typified by the instability of the financial markets.

In the first quarter of the year, against a background of the preparations for the war with Iraq and the uncertainty as regards the budget and meeting the government's deficit, the shekel appreciated by some 1.1% against the dollar, the yields on government index-linked and shekel debentures maintained their high level and embodied great uncertainty.

In March, with rapid progress in the war on the one hand and the formulation of an economic program on the other, the uncertainty level declined somewhat. In consequence, there was a sharp strengthening of the shekel and price increases in the majority of investment channels.

The decline in inflationary expectations led the Bank of Israel to commence reducing the monetary interest rate, and in March the interest rate decreased by 0.2%.

During the period, the high level of unlinked debenture yields, the forecast for a slow decrease in the interest rates in the economy and the tax advantages of investing in short term shekel debentures intensified the process of shifting financial assets from deposits with banks to traded investments, particularly *Makam* shekel debentures.

### **Unlinked Shekels:**

Against the background of the public's preference for traded assets, the volume of the public's unlinked shekel deposits with the Bank declined by some NIS 2.4 billion, representing a real decline of 3.2%.

The monies that were withdrawn from the deposits were, as aforesaid, *inter alia*, used to purchase government debentures (*Makam*). During the quarter the volume of the public's investments in *Makam* increased by some NIS 5.4 billion.

The volume of unlinked monetary tenders of the Bank of Israel for absorbing funds from the banking system increased on average during the first quarter of 2003 by some NIS 1.7 billion as compared with the last quarter of 2002. These included tenders for placing interest-bearing deposits with the Bank of Israel and tenders for shekel/dollar swaps. The balance of the tenders at the end of March 2003 reached some NIS 40 billion, and the Bank's share in the balance of the tenders was some 18%.

Utilization of monetary loans that the Bank of Israel places at the banks' disposal remained very small compared with the aforesaid absorption of funds, at an average level of some NIS 0.8 billion.

During the quarter, the Bank launched a number of new products, some against the background of the tax reform, in the context whereof the Treasury's regulations to encourage savings were repealed. The prominent among them are:

- Index-linked savings schemes for periods from one year, "one year's index linked savings". With the shortening of the period this product also constitutes an alternative for longer deposits.
- Monthly income for long periods – index-linked savings with monthly income for periods of eight and 15 years, with adjusted interest of around 6% and also a shekel deposit for a period of five years paying a monthly income.
- "Index falls - grant rises" - a deposit giving fixed shekel interest less the increase in the index.

In addition, the activity in structured derivatives was intensified. Among the products that were marketed were deposits and securities linked to various share indices, deposits and securities guaranteeing high foreign currency interest conditional upon the interest level in the euro market and deposits guaranteeing high shekel interest conditional upon the level of the foreign exchange rates.

Total credit to the public in unlinked shekels declined by some NIS 1.3 billion, a decrease of 2.7%.

### **Index-Linked**

In the first three months of 2003 there was no material change in the volume of linked sources. The decrease that was recorded in the volume of savings schemes was fully offset by an increase in the volume of the public's deposits.

The balance of index-linked credit increased by some NIS 1.0 billion, a rate of increase of some 3.6%.

### **Foreign Currency and Foreign Currency-Linked:**

Foreign currency and foreign currency-linked deposits by the public increased by NIS 261 million, an increase of 0.4% (some 2.2% in dollar terms). The major part of the increase derived from an increase in corporate *Pamach*, that rose by some 6.7% in dollar terms, and from an issue of foreign currency-linked subordinated capital notes of some NIS 360 million by Leumi Finance Company, for a period of seven years with floating interest. The capital notes were issued *inter alia* in order to expand the Bank's Tier II capital basis.

The volume of loans declined sharply by some \$ 318 million, a decrease of some 2.9% (in dollar terms), following an increase of some 7.1% (in dollar terms) in 2002, against the background of the reduction in the volume of economic activity alongside the increase in the cost of foreign currency sources that commenced during 2002.

The gradual reduction in secondary liquidity obligations on foreign currency deposits, which commenced in August 2002 and ended in May 2003, increased the balance of the free sources by \$ 4 billion in the system and by \$ 1.3 billion at the Bank.

Against the background of a considerable increase in the foreign currency liquidity level at the Bank, the Bank's foreign securities portfolio was increased by some \$ 200 million in the first quarter.

## **Risk Management Policy**

Market risk management policy is intended to assist in achieving business goals, while limiting the losses that can stem from exposure to changes in the money and capital markets, interest rates, exchange rates and inflation.

The market risk management policy is formulated and controlled within the context of the market risk management committee headed by the Manager of Market Risks and with the participation of the Chief Derivatives Officer, the Head of the Risk Management Control Department and senior staff members from the business divisions and others connected with asset and liability management (ALM).

For this purpose risks are measured by the accepted methods and measurement of the sensitivity of the theoretical economic value of the capital, and of the reported profit to the principal parameters (interest rates, changes in inflation and the currency exchange rates) and also by value at risk (VAR) and by examining the possible damage to the Group in various scenarios.

VAR measures the maximum expected potential damage (the expected decrease in fair value of the assets less the liabilities) from the holding of positions for a given future period, at a given assurance level. The VAR calculations are made daily at the Bank and monthly at the Group.

The expected damage at low probabilities is not measured by VAR, but by extreme scenario analyses. These analyses are also being carried out systematically at the Bank.

In accordance with the directives of the Bank of Israel, the risk measured by VAR relates the damage from holding all balance sheet and off-balance sheet positions, from basis risk, interest risk and equity risk and not only to the traded portfolios' positions. The exposure to embodied options in addition to express ones is also measured.

The model used to estimate potential damage is still undergoing a process of on-going change and development, based on the best information and professional evaluations. Changes in VAR in a given period therefore also represent, in addition to changes in positions of the Bank or in the various risk factors, methodological changes or changes in model assumptions.

The base currency for calculating VAR is the CPI-linked shekel as derived from the daily behavior of CPI-linked assets in the capital market.

The VAR calculations, as detailed below, were made using the parametric VAR system, at an assurance level of 99%, for a holding period of two weeks.

Estimates of the VAR amount:

	<b>31 March 2003</b>	31 December 2002
	(NIS millions)	
The Bank	<b>249</b>	390
Consolidated	<b>318</b>	514

There were no changes in the market risk management policies of the Bank in the period from January to March 2003 compared with the description in the Directors' Report for 2002.

The decrease in the VAR derives primarily from the decline in the interest rates and their volatility.

## Operational Segments

The Group operates in different operational segments through the Bank and its subsidiaries in all spheres of banking and financial services. Furthermore, the Group invests in non-banking corporations that operate in various spheres, such as insurance, real estate, hotels, shipping, energy, industry and more.

The operational segments are according to characteristics that were determined by the Bank of Israel and the manner of their measurement is detailed in the annual report.

Following is the development of the net profit according to operational segments after tax:

	Three months ending 31 March		Year
	<b>2003</b>	2002	2002
	NIS millions		
Corporate and international banking	<b>(21)</b>	(19)	67
Retail banking	<b>96</b>	141	464
Commercial banking	<b>33</b>	77	182
Global private banking	<b>16</b>	41	222
Construction and real estate	<b>38</b>	17	61
Mortgages - housing loans	<b>17</b>	19	117
Credit card operations	<b>2</b>	(15)	(6)
Capital market operations	<b>(3)</b>	(1)	(26)
Others	<b>(2)</b>	(30)	(648)
<b>Total</b>	<b>176</b>	230	433

Following is an explanation of the profitability in the period from January to March 2003:

1. The decrease in the profitability of retail banking derives principally from an increase in the operating expenses.
2. The decrease in the profitability of commercial banking derives principally from a decrease in income, an increase in the operating expenses stemming from reorganization in France, and also the effect of exchange rate differences in respect of overseas investments, that are not included in the tax calculation basis and which were negative in the said period as compared with positive exchange rate differences in the corresponding period last year. On the other hand, there was a decline in the provision for doubtful debts.
3. The decrease in the profitability of global private banking derives principally from an increase in the operating expenses and also from the effect of exchange rate differences in respect of overseas investments that are not included in the tax calculation basis and which were negative in the said period as compared with positive exchange rate differences in the corresponding period last year.

4. The increase in the profitability of the construction and real estate segment derives principally from a decrease in the provisions for doubtful debts and an increase in income.
5. The increase in the profitability of the credit cards segment derives from an improvement in the profitability of Leumi Card.
6. The reduction in the losses of the “others” sector derives principally from an increase in the market value of securities for trading and derivatives, a decrease in the erosion of the unlinked financial assets surplus in consequence of the lower inflation rate and an increase in the profits of companies included on the equity basis.

See pages 45 and 46 for further details.

## **Activities of Major Subsidiaries and Affiliates by Activity Sector**

### **Consolidated Subsidiaries in Israel**

The Bank's investments in consolidated subsidiaries in Israel amounted to NIS 3,711 million on 31 March 2003, compared with NIS 3,640 million on 31 December 2002. The contribution to net profit in the period from January to March 2003 was NIS 51 million, compared with NIS 25 million in the corresponding period in 2002, an increase of 104%.

See Notes 3, 5 and 6 to the Financial Statements concerning legal claims and other subjects relating to consolidated subsidiaries and the Bank.

### **Overseas Consolidated Subsidiaries**

The Bank's investments in overseas consolidated subsidiaries amounted to NIS 3,719 million on 31 March 2003, compared with NIS 3,576 million on 31 December 2002.

The nominal profit of the overseas consolidated subsidiaries, as reported by them, in the first quarter of 2003 amounted to US\$ 14.4 million, compared with US\$ 13.5 million in the corresponding period in 2002, an increase of 6.7%.

The contribution of overseas consolidated subsidiaries to the Group's net adjusted profit, in shekels, in the period from January to March 2003 amounted to a loss of NIS 11 million, compared with a profit of NIS 135 million in the corresponding period in 2002.

The decrease in the contribution derives from the effect of the appreciation in the rate of the shekel against the US dollar and sterling. The effect of the negative exchange rate differences was a decrease in profit of NIS 61 million in 2003, compared with an increase in profit of NIS 80 million in the corresponding period in 2002. Net financing income which was generated in the Bank and offset part of these exchange rate differences amounted to some NIS 36 million in 2003, compared with a set-off of NIS 46 million in the corresponding period in 2002.

### **Banque Leumi France S.A.**

On 16 May 2003, the board of directors of Banque Leumi France S.A. authorized the general manager of Banque Leumi France to commence discussions with its employees as part of an examination of possible measures being considered with a view to terminating its operations, which will be carried out in full cooperation with the relevant authorities in France.

In parallel, the Bank is taking steps to set up a representative office in France.

## **Activities of Subsidiaries in the Capital Market**

### **Mutual Funds**

The value of the assets of the mutual funds in the Group in Israel on 31 March 2003 was NIS 15.1 billion, compared with NIS 15.0 billion at the end of 2002. The value of the assets of the mutual funds in the Group at the end of March 2003 constituted 31.82% of the assets of all mutual funds in the system.

The Group has three mutual fund management companies in Israel:

**Leumi-Pia** - As at 31 March 2003 Leumi-Pia managed 40 mutual funds with total assets amounting to some NIS 7.8 billion, similar to 2002. Its share of the sector's total assets was 16.46% at the end of March 2003.

**Psagot** - As at 31 March 2003 Psagot managed 36 mutual funds with total assets amounting to some NIS 6.7 billion, similar to the end of 2002. Its share of Israel's mutual fund sector was 14.14% at the end of March 2003. At the end of March Psagot issued four new funds: Psagot Euro, Psagot Dollar, Psagot Index and Psagot Shekel.

**Ofek Mutual Funds Ltd.** – As at 31 March 2003 Ofek managed 10 mutual funds, with total assets amounting to NIS 0.6 billion, constituting some 1.22% of the assets of the sector.

### **Provident Funds**

The provident funds managed by the Bank Leumi Group include seven funds for the self-employed, four funds for salaried employees and four central funds for severance pay and a fund for the payment of sick pay. In addition, funds are also managed for employees of the Bank and Leumi Mortgage Bank. The Group, through Leumi Gemel Ltd, provides services for specialized funds, including the Electricity Corp's employee's supplementary training fund and the engineers and architects' provident fund.

The value of the assets of the provident funds managed by the Group amounted to some NIS 27.5 billion on 31 March 2003, compared with some NIS 28.4 billion at the end of 2002.

During the period from January to March 2003, the provident funds managed by the Group produced positive real yields, except for Signon Foreign Currency and the foreign currency path of the Central Fund for Severance Pay that recorded negative yields in consequence of weakness of the dollar against the shekel.

### **Reorganization Arrangement/Merger between the Provident Funds and Leumi Gemel Ltd.**

Proceedings are being conducted in the Tel Aviv District Court to approve a reorganization/merger arrangement between the provident funds and Leumi Gemel, which was approved at the provident funds' members' general meetings, under which the provident funds will be changed from companies to schemes that will be managed by Leumi Gemel.

The said change will not impair the rights of the members of the provident funds.

The arrangement is being made in accordance with the policy of the Capital Market, Insurance and Savings Department in the Ministry of Finance, and the Commissioner of the Capital Market, Insurance and Savings has approved the arrangement in principle.

The Court has approved the arrangement with regard to a number of provident funds in respect whereof objections to the implementation thereof were not filed and in some of them the reorganization process has been completed and they have become schemes managed by Leumi Gemel. With regard to some of the provident funds, the Court's decision on the objection to the arrangement has not been given.

## **Supplementary Training Funds**

**Kahal Employees Supplementary Training Fund Ltd. ("Kahal")** (jointly managed by the Bank and Israel Discount Bank) - the value of the assets of Kahal and Kahal Paths Supplementary Training Fund reached some NIS 8.2 billion on 31 March 2003, compared with some NIS 8.3 billion at the end of 2002. The number of employers contributing to the fund is some 37,000; the number of accounts in the fund is some 392,000.

Kahal's real net yield for the period from January to March 2003 was positive in all paths (except for the foreign currency path, which recorded a negative yield of 3.3%).

## **Non-Banking Activities of Companies Included on the Equity Basis**

Total investments of the Group in companies included on the equity basis amounted to NIS 1,402 million on 31 March 2003, compared with NIS 1,387 million on 31 December 2002.

In the period from January to March 2003 the contribution to net profit amounted to a profit of some NIS 36 million, compared with a loss of some NIS 12 million in the corresponding period in 2002.

## **Africa Israel Investments Group**

The consolidated assets as at 31 March 2003 totaled some NIS 6.2 billion.

Shareholders' equity was NIS 1,102 million on 31 March 2003, compared with NIS 1,217 million at the end of 2002. The net profit in the period from January to March 2003 amounted to some NIS 30 million, compared with some NIS 53 million in the corresponding period in 2002. Net return on equity in annual terms was 10.3%, compared with 20.8% in the corresponding period in 2002.

## **Migdal Insurance and Financial Holdings Group**

The group has total assets of some NIS 38.5 billion, of which some NIS 31.4 billion are life insurance reserves and some NIS 3.2 billion are general insurance reserves. Shareholders' equity as at 31 March 2003 totaled some NIS 2.1 million.

The group's net profit for the period from January to March 2003 was NIS 75.5 million, compared with NIS 36.3 million in the corresponding period in 2002. The net return on equity in annual terms was 14.8%, compared with 7.5% in the corresponding period in 2002.

See Note 7.A with regard to Migdal Holdings' permanent investment in shares of the Bank.

The profit from life insurance amounted to some NIS 115.9 million, compared with a profit of some NIS 63.2 million in the corresponding period in 2002, an increase of 83.4%.

The profit from general insurance amounted to some NIS 31.7 million, compared with some NIS 14.3 million in the corresponding period in 2002, an increase of 121.7%.

See Note 7.B to the Financial Statements concerning the pending claims against the Migdal Group and others.

## **Israel Corporation Ltd.**

Israel Corporation Ltd. is a holding company whose principal holdings are in the sphere of chemicals (holding 53% of the shares of Israel Chemicals Ltd.), shipping (holding some 49% of Zim Israel Navigation Co. Ltd.), energy (holding some 26% of Oil Refineries Ltd.) and additional interests.

The consolidated assets of Israel Corporation totaled some NIS 16.0 billion as at 31 March 2003, compared with NIS 16.7 billion at the end of 2002.

Shareholders' equity totaled some NIS 2,026 million as at 31 March 2003, compared with some NIS 2,045 million at the end of 2002.

The net profit in the period from January to March 2003 totaled some NIS 96 million, compared with a loss of NIS 57 million in the corresponding period last year.

See Note 8 to the Financial Statements regarding the pending claims against Israel Corporation Group.

At the meeting of the Board of Directors held on 29 May 2003, it was decided to approve and publish the Group's unaudited consolidated Financial Statements as at 31 March 2003 and for the periods ending on that date. During the period from January to March 2003 the Board of Directors held seven plenary meetings and 15 committee meetings.

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Eitan Raff  
Chairman of the Board of Directors

\_\_\_\_\_  
Galia Maor  
President and Chief Executive Officer

**29 May 2003**

**Bank Leumi le-Israel B.M. and its Subsidiaries and Affiliates**  
**Main Financial Data for the Bank Leumi Group**

	Jan.-March 2003	Jan.-March 2002	Year 2002
<b>Income, Expenses and Profit (NIS millions):</b>			
Net interest income before provision for doubtful debts	1,439	1,331	5,221
Provision for doubtful debts	375	370	1,959
Total operating and other income	734	780	2,974
Total operating and other expenses	1,449	1,295	5,394
Of which: Costs of Voluntary Retirement	56	1	345
Operating profit before taxes	349	446	842
Provision for taxes	205	189	269
Net operating profit	179	231	424
After-tax net profit (loss) from extraordinary items	(3)	(1)	9
Net profit for the period	176	230	433
Net operating profit per NIS 1 par value of share capital (in NIS)	0.127	0.164	0.300
Net profit per NIS 1 par value of share capital (in NIS)	0.125	0.163	0.306
<b>Assets and Liabilities at End of Period (NIS millions):</b>			
Total assets	246,638	244,037	250,135
Credit to the public	173,539	173,138	176,427
Securities	38,708	38,773	37,125
Deposits of the public	206,600	203,046	210,570
Shareholders' equity	13,741	13,406	13,504
<b>Major Financial Ratios in Annual Terms (%):</b>			
Credit to the public/Total assets	70.4	70.9	70.5
Securities/Total assets	15.7	15.9	14.8
Deposits of the public/Total assets	83.8	83.2	84.2
Shareholders' equity (excluding minority interest)/Total assets	5.6	5.5	5.4
Shareholders' equity/Risk assets (a) (b)	10.8	10.2	10.3
Tier I capital/Risk assets (a)	7.1	6.8	6.8
Net profit/Shareholders' equity (excluding minority interest)	5.3	7.1	3.3
Net operating profit/Shareholders' equity (excluding minority interest)	5.4	7.1	3.2
Rate of tax provision	58.7	42.4	31.9
Provision for doubtful debts/Credit to the public	0.87	0.86	1.11
Provision for doubtful debts/Net interest income before provision for doubtful debts	26.1	27.8	37.5
Net interest income before provision for doubtful debts/Total assets	2.4	2.2	2.1
Total income/Total assets (c)	3.57	3.51	3.28
Total operating and other expenses/Total assets	2.37	2.14	2.16
Financial margin including income and expenses from derivatives	1.65	1.78	1.79
Operating expenses (excluding costs of voluntary retirement)/Total income (c)	64.1	61.3	61.6
Operating and other income/Operating and other expenses (excluding costs of voluntary retirement)	52.7	60.3	58.9
Operating and other income/Total income (c)	33.8	36.9	36.3

(a) Ratio calculated in accordance with Bank of Israel directives.

(b) Shareholders' equity - plus minority interests and less investments in the capital of companies included on the equity basis and various adjustments.

(c) Total income - net interest income before provision for doubtful debts plus operating and other income.

**Rates of Financing Income and Expenses (on a Consolidated Basis) (a)**  
**In terms of NIS of March 2003**

	For the three months ended 31 March							
	2003				2002			
	Average balance (b) (NIS millions)	Financing income (expenses)	Rate of income (expenses)		Average balance (b) (NIS millions)	Financing income (expenses)	Rate of income (expenses)	
			Excluding The effect of derivatives %	Including The effect of derivatives %			Including derivatives Hedge and ALM (j) %	
<b>Israeli currency - unlinked</b>								
Assets (c) (d)	69,196	1,222	7.25	69,576	(513)	(2.92)		
Effect of derivatives (e)	10,945	149		9,644	(195)			
Total assets	80,141	1,371	7.02	79,220	(708)	(3.52)		
Liabilities (d)	75,641	(781)	(4.20)	77,525	1,187	5.98		
Effect of derivatives (e)	3,388	19		-	-			
Total liabilities	79,029	(762)	(3.91)	77,525	1,187	5.98		
Interest margin			3.05			3.06	2.46	
<b>Israeli currency – linked to the CPI</b>								
Assets (c) (d)	62,731	588	3.80	61,243	499	3.30		
Effect of derivatives (e)	316	5		(822)	8			
Total assets	63,047	593	3.82	60,421	507	3.40		
Liabilities (d)	53,537	(355)	(2.68)	50,617	(309)	(2.47)		
Effect of derivatives (e)	935	(13)		-	-			
Total liabilities	54,472	(368)	(2.73)	50,617	(309)	(2.47)		
Interest margin			1.12			0.83	0.93	
<b>Foreign currency – local operations (including Israeli currency linked to foreign currency)</b>								
Assets (c) (d)	71,691	(137)	(0.76)	70,709	2,812	16.88		
Effect of derivatives (e)	50,111	327		(8,822)	(302)			
Total assets	121,802	190	0.63	61,887	2,510	17.23		
Liabilities (d)	64,515	76	0.47	62,772	(2,212)	(14.86)		
Effect of derivatives (e)	56,786	2		-	-			
Total liabilities	121,301	78	0.25	62,772	(2,212)	(14.86)		
Interest margin			(0.29)			2.02	2.37	
<b>Foreign currency – Foreign operations (integrated operations)</b>								
Assets (c) (d)	34,170	(302)	(3.48)	31,819	1,300	17.37		
Effect of derivatives (e)	138	4		-	-			
Total assets	34,308	(298)	(3.43)	31,819	1,300	17.37		
Liabilities (d)	32,615	443	5.32	31,283	(1,149)	(15.52)		
Effect of derivatives (e)	214	(8)		-	1			
Total liabilities	32,829	435	5.19	31,283	(1,148)	(15.50)		
Interest margin			1.84			1.85	1.87	

**Rates of Financing Income and Expenses (on a Consolidated Basis) (a)**  
**In terms of NIS of March 2003**

	For the three months ended 31 March					
	2003			2002		
	Average balance (b) (NIS millions)	Rate of income (expenses)		Average balance (b) (NIS millions)	Rate of income (expenses) including derivatives	
		Financing income (expenses)	Excluding the effect of derivatives		Including the effect of derivatives	Financing income (expenses)
		%	%		%	%
<b>Total:</b>						
Monetary assets generating interest income (d) (f)	<b>237,788</b>	<b>1,371</b>	<b>2.33</b>	233,347	4,098	7.21
Effect of derivatives (e)	<b>61,510</b>	<b>485</b>		-	(489)	
<b>Total assets</b>	<b>299,298</b>	<b>1,856</b>	<b>2.51</b>	233,347	3,609	6.33
Monetary liabilities generating interest expenses (d)	<b>226,308</b>	<b>(617)</b>	<b>(1.10)</b>	222,197	(2,483)	(4.55)
Effect of derivatives (e)	<b>61,323</b>	-		-	1	
<b>Total liabilities</b>	<b>287,631</b>	<b>(617)</b>	<b>(0.86)</b>	222,197	(2,482)	(4.55)
<b>Interest margin</b>			<b>1.23</b>			<b>2.66</b>
In respect of options		(31)			-	
In respect of other derivatives (excluding options, hedging derivative instruments, ALM derivatives and embedded derivatives which have been separated) (i)		2			24	
Financing commissions and other financing income (g)		196			(k) 257	
Other financing expenses		33			(77)	
Net interest income before provision for doubtful debts		1,439			1,331	
Provision for doubtful debts (including general and supplementary provision)		(375)			(370)	
<b>Net interest income after provision for doubtful debts</b>		<b>1,064</b>			<b>961</b>	
Monetary assets generating interest income (d) (f)	<b>237,788</b>			233,347		
Assets derived from derivative instruments (h)	<b>3,071</b>			2,133		
Other monetary assets (d)	<b>3,644</b>			3,490		
General provision and supplementary provision for doubtful debts	<b>(1,112)</b>			(1,059)		
<b>Total monetary assets</b>	<b>243,391</b>			237,911		
Monetary liabilities generating interest expenses (d)	<b>226,308</b>			222,197		
Liabilities derived from derivative instruments (h)	<b>2,794</b>			2,076		
Other monetary liabilities (e)	<b>5,658</b>			5,645		
<b>Total monetary liabilities</b>	<b>234,760</b>			229,918		
Total monetary assets exceed monetary liabilities	<b>8,631</b>			7,993		
Non-monetary assets	<b>5,706</b>			6,910		
Non-monetary liabilities	<b>833</b>			1,579		
<b>Total capital resources</b>	<b>13,504</b>			13,324		

- (a) The data in this exhibit includes before and after the effect of derivative instruments (including the effect of off-balance sheet derivative instruments).
- (b) Based on monthly opening balances except for the unlinked Israeli currency sector where the average balance is based on daily figures, and after deduction of the average balance sheet balance of the specific provision for doubtful debts.
- (c) The average balance of unrealized profits and losses from adjustment to fair value of debentures in the amount of NIS (102) million in the CPI linked Israeli currency sector, NIS (169) million in the unlinked Israeli currency sector, and NIS 3 million in the foreign currency including foreign currency-linked Israeli currency sector has been deducted from or added to the average balance of the assets.
- (d) Excluding derivative instruments.
- (e) Including derivatives (ALM) which constitute part of the Bank's asset and liability management system, as well as hedging derivatives.
- (f) The average balance of unrealized losses on adjustment to fair value of bonds and debentures, in the amount of NIS (268) million in the various sectors, has been added to the average balance of the assets.
- (g) This includes profits and losses on sales of investments in debentures and adjustments to fair value of debentures held for trading.
- (h) Includes the average balance for derivative instruments (does not include average of off-balance sheet derivative instruments).
- (i) Includes other derivative instruments (excluding options, hedging derivatives, ALM derivatives and embedded derivatives which have been separated). Comparative figures relate to commission from brokerage transactions with risk.
- (j) The Bank implemented beginning January 1, 2003 the instructions of the Supervisor of the Banks as stated in Note 9 of the financial statements. The figures for the first quarter of 2003 can not be compared with the figures for the first quarter of 2002.
- (k) Reclassified.

**Rates of Financing Income and Expenses (on a Consolidated Basis) (a)**  
**Nominal U.S. \$**

	For the three months ended 31 March						
	2003				2002		
	Average balance (b) (\$ millions)	Rate of income (expenses)		Rate of income (expenses) Including derivatives	Average balance (b) (\$ millions)	Rate of income (expenses)	
		Financing income (expenses)	Excluding the effect of derivatives			Including the effect of derivatives	Financing income (expenses)
		%	%		%	%	
<b>Foreign currency:</b>							
<b>local operations (including Israeli currency linked to foreign currency)</b>							
Assets (c) (d)	14,936	171	4.67	14,518	114	3.17	
Effect of derivatives (e)	10,417	148		(1,727)	(24)		
Total assets	25,353	319	5.14	12,791	90	2.85	
Liabilities (d)	13,407	(117)	(3.55)	12,959	(63)	(1.96)	
Effect of derivatives (e)	11,804	(68)		-	-		
Total liabilities	25,211	(185)	(2.98)	12,959	(63)	(1.96)	
Interest margin			1.12	2.16		1.21	0.89
<b>Foreign currency – Foreign operations (integrated operations)</b>							
Assets (c) (d)	7,156	62	3.51	6,691	68	4.10	
Effect of derivatives (e)	29	1		-	-		
Total assets	7,185	63	3.54	6,691	68	4.10	
Liabilities (d)	6,831	(30)	(1.76)	6,578	(36)	(2.23)	
Effect of derivatives (e)	45	(2)		-	1		
Total liabilities	6,876	(32)	(1.86)	6,578	(35)	(2.19)	
Interest margin			1.75	1.68		1.87	1.91
<b>Total:</b>							
Monetary assets in foreign currency generating financing income							
	22,092	233	4.30	21,209	182	3.46	
Effect of financial derivatives (e)	10,446	149		(1,727)	(24)		
Total assets	32,538	382	4.79	19,482	158	3.28	
Monetary liabilities in foreign currency generating financing expense							
	20,238	(147)	(2.94)	19,537	(99)	(2.05)	
Effect of financial derivatives (e)	11,849	(70)		-	1		
Total liabilities	32,087	(217)	(2.74)	19,537	(98)	(2.04)	
Interest margin			1.36	2.05		1.41	1.24

- (a) The data in this exhibit includes before and after the effect of derivative instruments (including the effect of off-balance sheet derivative instruments).
- (b) Based on monthly opening balances for the Bank and subsidiaries in Israel and on quarterly opening balances for foreign subsidiaries, and after deduction of the average balance sheet balance of the specific provision for doubtful debts.
- (c) The average balance of unrealized profits from adjustment to fair value of debentures in the amount of US\$ 1 million has been deducted from the average balance of the assets.
- (d) Excluding derivative instruments.
- (e) This includes derivatives (ALM) which constitute part of the Bank's asset and liability management system, as well as hedging derivatives.
- (f) The Bank implemented beginning January 1, 2003 the instructions of the Supervisor of the Banks as stated in Note 9 of the financial statements. The figures for the first quarter of 2003 can not be compared with the figures for the first quarter of 2002.

To the Board of Directors of Bank Leumi le-Israel B.M.

Dear Sirs,

Re: **Review of the Unaudited Interim Consolidated Financial Statements for the Period Ended 31 March 2003**

At your request, we have reviewed the condensed interim consolidated balance sheet of Bank Leumi le-Israel B.M. and its subsidiaries as at 31 March 2003 and the condensed interim consolidated statements of profit and loss and changes in shareholders' equity for the three month period then ended.

Our review was carried out in accordance with the procedures prescribed by the Institute of Certified Public Accountants in Israel and included, *inter alia*, reading the said financial statements, reading the minutes of the Shareholders' Meetings and the Meetings of the Board of Directors and its committees, as well as making inquiries of the persons responsible for financial and accounting matters at the Bank.

We were given reports issued by other auditors regarding their review of the interim financial statements of the foreign subsidiaries, whose assets constitute some 14% of the total consolidated assets in the condensed interim consolidated balance sheet as at 31 March 2003, and whose net interest income before provision for doubtful debts constitutes some 12% of the total consolidated net interest income before provision for doubtful debts included in the condensed consolidated statement of profit and loss for the three month period then ended.

Since our review was limited in scope and does not constitute an audit in accordance with generally accepted auditing standards, we do not express an opinion on the interim consolidated financial statements.

In carrying out our review, including reading the above mentioned reports of other auditors, nothing came to our attention to indicate that there is a need for any material modifications in the said condensed interim financial statements in order for them to be considered as interim financial statements that are drawn up in conformity with generally accepted accounting principles and with directives and guidelines of the Supervisor of Banks.

We draw attention to the contents of Note 3 to the financial statements concerning a claim against the Bank and a subsidiary, to the contents of Note 4 concerning a claim against the Bank, to the contents of Note 5 concerning uncertainties concerning a subsidiary, to the contents of Note 6A and B concerning uncertainties concerning claims against the Bank and Israel Credit Cards Ltd., and to the contents of Notes 7B and 8 concerning uncertainties concerning companies included on the equity basis. The Bank is unable to estimate the effect on the Bank, if any, on its financial position and on its operating results, of the said matters, and whether or not they will be of a material nature.

**Luboshitz Kasierer**  
Certified Public Accountants (Isr.)

**Somekh Chaikin**  
Certified Public Accountants (Isr.)

29 May 2003

**Condensed Consolidated Balance Sheet as at 31 March 2003**  
**In terms of NIS of March 2003**

	<b>31 March 2003</b>	31 March 2002	31 December 2002
	(Unaudited)	(Unaudited)	(Audited)
	(NIS millions)		
<b>Assets</b>			
Cash and deposits with banks	22,574	20,688	24,417
Securities	38,708	38,773	37,125
Credit to the public	173,539	173,138	176,427
Credit to governments	1,387	1,580	1,464
Investments in companies included on the equity basis	1,402	1,444	1,387
Buildings and equipment	2,643	2,501	2,621
Other assets	6,385	5,913	6,694
<b>Total assets</b>	<b>246,638</b>	244,037	250,135
<b>Liabilities and equity capital</b>			
Deposits of the public	206,600	203,046	210,570
Deposits from banks	3,893	4,359	3,771
Deposits from governments	2,877	3,471	3,012
Debentures, bonds and subordinated notes	10,800	10,648	10,503
Other liabilities	8,458	8,634	8,351
<b>Total liabilities</b>	<b>232,628</b>	230,158	236,207
Minority interest	269	473	424
Shareholders' equity	13,741	13,406	13,504
<b>Total liabilities and equity capital</b>	<b>246,638</b>	244,037	250,135

\_\_\_\_\_  
**Eitan Raff**  
Chairman of the  
Board of Directors

\_\_\_\_\_  
**Galia Maor**  
President and Chief  
Executive Officer

\_\_\_\_\_  
**Zeev Nahari**  
Deputy Chief Executive Officer  
Head of Finance and Accounting Division

The accompanying notes are an integral part of these Financial Statements.

**Date of approval of the Financial Statements: 29 May 2003**

**Condensed Consolidated Statement of Profit and Loss**  
**For the Period Ended 31 March 2003**  
**In terms of NIS of March 2003**

	For the Three Months Ended 31 March		For the Year Ended 31 December
	2003	2002	2002
	(Unaudited)	(Unaudited)	(Audited)
	(NIS millions)		
Net interest income before provision for doubtful debts	1,439	(a) 1,331	5,221
Provision for doubtful debts	375	370	1,959
Net interest income after provision for doubtful debts	1,064	961	3,262
<b>Operating and other income</b>			
Operating commissions	617	638	2,498
Profits (losses) from investments in shares, net	15	(a) 9	(7)
Other income	102	133	483
Total operating and other income	734	780	2,974
<b>Operating and other expenses</b>			
Salaries and related expenses	932	828	3,570
Building and equipment maintenance and depreciation	259	233	1,016
Other expenses	258	234	808
Total operating and other expenses	1,449	1,295	5,394
Operating profit before taxes	349	446	842
Provision for taxes on operating profit	205	189	269
Operating profit after taxes	144	257	573
Equity in after-tax operating profit (loss) of companies included on the equity basis	36	(12)	(33)
Minority interest in after-tax operating profits of subsidiaries	(1)	(14)	(116)
Net operating profit	179	231	424
After-tax profit (loss) from extraordinary items	(3)	(1)	9
Net profit for the period	176	230	433
	(NIS)		
<b>Profit per NIS 1 par value of share capital</b>			
Net operating profit	0.127	0.164	0.300
After-tax profit (loss) from extraordinary items	(0.002)	(0.001)	0.006
Total	0.125	0.163	0.306
	(NIS thousands)		
Par value of share capital used in the above computation	1,414,233	1,414,233	1,414,233

(a) Reclassified.

The accompanying notes are an integral part of these Financial Statements.

**Condensed Consolidated Statement of Changes in Shareholders' Equity**  
**For the Period Ended 31 March 2003**  
**In terms of NIS of March 2003**

	For the Three Months Ended 31 March (Unaudited)					
	2003			2002		
	Capital and capital reserves (NIS millions)	Retained earnings	Total shareholders' equity	Capital and capital reserves (NIS millions)	Retained earnings	Total shareholders' equity
Balance at the beginning of the period	7,202	3,026	13,504	7,202	6,122	13,324
Net profit for the period	-	176	176	-	230	230
Adjustments in respect of presentation of securities available for sale at fair value	-	125	125	-	(268)	(268)
Related tax effect	-	(58)	(58)	-	117	117
Translation adjustment for companies included on the equity basis	-	(6)	(6)	-	3	3
Balance at the end of the period	7,202	(a) 6,539	13,741	7,202	(a) 6,204	13,406

	For the Year Ended 31 December 2002 (Audited)		
	Capital and capital reserves (NIS millions)	Retained earnings	Total shareholders' equity
Balance as at 1 January 2002	7,202	6,122	13,324
Net profit for the year	-	433	433
Adjustments in respect of presentation of securities available for sale at fair value	-	(434)	(434)
Related tax effect	-	198	198
Translation adjustment for companies included on the equity basis	-	15	15
Loan to employees for purchase of Bank's shares	-	(32)	(32)
Balance as at 31 December 2002	7,202	(a) 6,302	13,504

(a) The retained earnings at the end of the period include:

- Adjustments from translation of the financial statements of autonomous foreign investees in the amount of NIS (385) million, (NIS (389) million as at 31 March 2002 and NIS (379) million as at 31 December 2002).
- Adjustments in respect of presentation of securities available for sale at fair value, less related taxation, in the amount of NIS (72) million (NIS (53) million as at 31 March 2002 and NIS (139) million as at 31 December 2002).

The accompanying notes are an integral part of these Financial Statements.

## NOTES

1. The Financial Statements as at 31 March 2003 and for the period then ended have been prepared in accordance with accounting principles consistent with those applied in the audited annual Financial Statements for 2002, save for the subjects detailed in Notes 9 and 10 below.
2. Various legal actions by third parties are pending against the Bank and certain of its consolidated subsidiaries, mainly claims of customers alleging, *inter alia*, interest charges at rates inconsistent with the law and/or inconsistent with agreements, the conditioning of one service on another service, particularly in respect of the purchase of savings schemes, untimely debiting and crediting of accounts, the manner in which interest and value dates are calculated, the non-execution of instructions for purchase and sale of securities on behalf of customers, and also claims in respect of labor relations.

Furthermore, applications to file class actions are pending against the Bank and certain of its consolidated subsidiaries in respect of various matters primarily relating to bank-customer relations, the amount of none of which is material, or where the amount being claimed by the plaintiff filing the application for the class action is of itself material, but in the Bank's opinion it is without foundation. Details of these actions were given in the notes to the previous financial statements of the Bank and subsidiaries.

In the opinion of the Bank's management and the subsidiaries' managements, based on legal opinions with regard to the chances of the applications to file class actions, adequate provision has been made in the Financial Statements to cover any damages from claims which, in the opinion of the Bank, will not be rejected or dismissed, and this notwithstanding the fact that the Bank denies the said claims.

3. In September 1997 a foreign company in the process of liquidation filed a claim against the Bank, its consolidated subsidiary and certain of their employees in the amount of some NIS 153 million as at the date of filing concerning the transfer of US \$43.4 million by the foreign company to an account at the Bank in the name of a manager of the foreign company. The company's liquidator *inter alia* asserts that the defendants acted in a manner that enabled the foreign company's manager to steal the said amount from it.

The Bank, the subsidiary and the other defendants totally reject all of the plaintiff's assertions and maintain that they acted lawfully and as required. In the opinion of the Bank's management, based on an opinion of the Bank's legal counsel, in accordance with what is known to them and to the Bank at this stage, the defendants have good legal defenses against the claim. It is not possible at this stage to assess the outcome of the claim and no provision has been made for it.

4. On 19 June 2002 the Ramle Municipality filed an application to approve a class action against the Bank, Bank Clearing Center Ltd. and additional banks. The applicant asserts that the defendant banks made a restrictive arrangement with regard to the commission that they charge their customers receiving standing order clearing services and that in consequence of restrictive arrangements to which the defendants are parties, the applicant - and all the public requiring standing order clearing services - are paying unfair and unreasonable amounts for standing order clearing services. The amount of the class action is asserted to be NIS 967.5 million.

In the opinion of the Bank's management, based on an opinion of the Bank's legal counsel, it is not possible at this early stage to assess the outcome of the claim and the application for approval. A provision has not been made.

## 5. **Leumi Mortgage Bank Ltd.**

Proceedings are pending against Leumi Mortgage Bank Ltd. (“Leumi Mortgage Bank”) as follows:

- A. A class action, the proceedings in which are being delayed in consequence of appeal proceedings, in connection with charging borrowers’ life insurance commissions and building insurances, that relates to a petition for declaratory relief “with regard to the restrictive trade arrangement and the issue of the various insurances”.
- B. A petition to the High Court of Justice asserting that the mortgage banks must cease engaging in insurance brokerage.
- C. Applications to approve class actions in respect of various matters: asserted overpayment of premiums for building insurances made through Leumi Mortgage Bank; asserted overcharging of interest on loans with floating interest; fixing high and excessive interest rates on loans that are made available in installments.

In the opinion of Leumi Mortgage Bank’s management, based on opinions of its legal counsel, it is not possible at this stage to assess the outcome of the claims and the prospects of the claims being approved and accordingly no provisions have been included in respect of such proceedings.

See Leumi Mortgage Bank’s financial statements for further details on these proceedings. It should be noted that an application to approve a class action against Leumi Mortgage Bank with regard to an asserted overcharging of default interest was struck out in a judgment of 22 May 2003.

## 6. **Credit Cards**

- A. In the Israel Credit Cards Ltd. (“ICC”) ownership separation agreement between Leumi Financial Holdings Ltd. (a company wholly owned by the Bank) (“Leumi Holdings”) and Israel Discount Bank Ltd. (“Discount Bank”) that was signed on 3 January 2000, Leumi Holdings agreed to indemnify Discount Bank for various amounts that ICC and/or Diners Club Israel Ltd. (“Diners”) might be obligated to pay for defined events, including for legal claims according to a defined list (including class actions).

The indemnity is limited in amount to the consideration paid within the context of the transaction, together with the Leumi Holdings’ share of a dividend that was distributed on 4 January 2000, adjusted for certain deductions that were determined (with the said amount being linked and bearing interest as provided in the ownership separation agreement), and payment thereof is subject to various terms and conditions that were determined, as provided in the ownership separation agreement.

- B. On 17 August 1998 a statement of claim and an application to approve a class action were filed in the Tel Aviv District Court against the Bank, ICC and others concerning the charging of excessive commissions from businesses that honored credit cards. The amount claimed from all the respondents, jointly and severally, was NIS 1.025 billion as at the date of filing of the action.

On 29 January 2003 the Court approved the claim as a class action. The said decision was based, inter alia, on the view of the District Court that “there is a reasonable possibility that material questions of fact and law which are common to the group will be decided upon in a class action in favor of the group”.

The cause of action in respect of which the Court approved the claim as a class action against the Bank (and against Discount Bank) is the existence of a restrictive arrangement, based on the plaintiff's assertion that "according to an agreement between them with respect to matters related to the defendants no. 1 (ICC) and no. 2 (Diners) competition between the banks will be prevented" and with respect to "the conduct of the two banks in all matters related to Visa and Diners credit cards that were issued by the first two defendants".

The Court also approved the filing of a class action against ICC, Diners, Isracard Ltd and Poalim American Express Ltd with respect to the plaintiff's assertion that in the period relevant to the claim, they had a monopoly in the clearing markets (asserted) of Visa, Diners, Isracard and American Express credit cards, respectively, and that they abused their asserted monopolistic status in order to charge the group's members with excessive clearing commissions. On this matter it should be noted that the Bank has made an indemnification commitment towards Discount Bank, as described in 6.A. above.

On 10 February 2003 the District Court allowed the application to stay the hearing of the claim and to postpone the time for filing the defendants' statement of defense and the date for publishing the announcement of the approval of the class action, in consequence of the defendants' intention to file applications with the Supreme Court for leave to appeal against the decision of 29 January 2003, and in light of the plaintiff's intention to appeal against the decision with respect to those matters in his application that had been rejected.

The Bank and the other defendants against whom a class action was approved filed applications for leave to appeal against the decision with the Supreme Court. The plaintiff filed an appeal against the decision with respect to those matters in his application that had been rejected, including matters that were rejected in his application relating to the Bank.

In the opinion of the Bank's legal counsel, in light of the complexity and innovative nature of the matters being deliberated, it is not possible at this stage to evaluate the outcome of the class action or the outcome of the applications for leave to appeal against the decision to approve the claim as a class action or the outcome of the appeal filed by the plaintiff. No provision was made.

- C. On 18 May 2000 the Bank, Leumi Card, ICC, Discount Bank, Alpha Card, The First International Bank and Aureq Gold Investments Ltd. reached an agreement regarding the principles that would prevail in respect of the issue and acquiring of Visa credit cards in Israel within the context of a local agreement (the "agreement").

The agreement, which applied to the parties thereto the provisions of the local agreement dated 7 July 1998, subject to certain changes, was signed following Leumi Card's acquisition of assets, equipment and operating systems from Alpha Card.

The Antitrust General Director granted an exemption to the agreement, subject to certain conditions, pursuant to the provisions of section 14 of the Restrictive Trade Practices Law, 5748-1988, in exemption file 3728, for a period of four years. The validity of exemption 3728 was extended by the General Director from time to time and it will remain in force for one and a half years from 11 August 2002 or until the end of the litigation in the application filed with the Antitrust Tribunal on 6 September 2001, as detailed below, whichever is the earlier. The terms and conditions of the agreement between the parties and the exemption granted thereto by the General Director *inter alia* established a mechanism for determining the interchange fee to be paid by those who use the acquiring services to the issuers and the breakdown and rates thereof and the rates of the interchange fee and their breakdown were also determined until 1 March 2003.

On 8 March 2001 the General Director granted an exemption in file 4428, in which rates and breakdown were determined for the interchange fee (the “General Director’s approval”). The General Director’s approval provided that the parties to the exemption commit themselves to certain reductions in the interchange fee rates. Furthermore, the General Director required the parties to the exemption to commence issuing and acquiring for MasterCard credit cards in accordance with the timetable set by the General Director. The termination date of the General Director’s approval was extended by him to 9 September 2001.

The Bank and Leumi Card have begun issuing MasterCard credit cards. The Bank and Leumi Card applied to the General Director to postpone the commencement of acquiring for MasterCard credit cards to 1 May 2002. The talks with the General Director on this issue are continuing. On 7 August 2002 the Director-General filed an application with the Tribunal for it to approve an agreed order that was formulated between him and the Hapoalim group. According to the General Director, the order is intended to regulate the opening of the MasterCard system in Israel to competition and in order to impose restrictions on the Hapoalim group, primarily in connection with issuing and acquiring for Isracard and MasterCard cards. In the opinion of the Bank and Leumi Card, the order, assuming it is approved, will not provide a full answer to resolving the competitive advantages that will be afforded to the Hapoalim group for so long as acquiring for the Isracard cards is not opened up to Leumi Card.

On 6 September 2001, the Bank and Leumi Card filed an application with the Antitrust Tribunal to approve a restrictive arrangement with regard to interchange fees that would be paid by those using the acquiring services to the issuers of Visa cards at rates and upon terms and conditions that were agreed upon in a new agreement executed between the Bank, Leumi Card, Discount Bank, ICC and The First International Bank of Israel (the “new agreement”) and also an application for the grant of a temporary permit to operate pursuant to the new agreement. After receiving the General Director’s recommendation dated 7 September 2001, the Antitrust Tribunal granted a provisional temporary permit as aforesaid on 9 September 2003. On 22 December 2002 the Antitrust Tribunal granted a temporary permit for the new agreement. In accordance with the Tribunal’s ruling, the temporary permit shall remain in force until a ruling is handed down on the request to approve the new agreement in the principal proceeding.

The average rate of the interchange fees, as determined in the new agreement, was reduced as compared with the average interchange fee rate that was determined in the General Director’s approval and the differences in the interchange fee rates between the various business categories were also reduced.

Superpharm (Israel) Ltd., Ace Marketing Chains - Consumer Products Ltd., Kitan Consolidated Ltd, the Golf A.K. Ltd. group and Supersol Ltd (together the “objectors”) filed objections to the approval of the restrictive arrangement with the Antitrust Tribunal and they also filed objections to the grant of the temporary permit and applications to set aside the provisional temporary permit. The hearing of the application to approve the new agreement has not yet been concluded.

Reduction of the rate of the interchange fee will detrimentally affect the Bank’s income as an issuer. The total interchange fees received by the Bank in the first quarter of 2003 amounted to NIS 13 million, compared with NIS 15 million in the corresponding period of 2002.

- D. In consequence of Leumi Card's notification with regard to charging cardholders with new commissions, a representative of the Antitrust General Director wrote to Leumi Card on 28 January 2002 with a detailed demand to receive documents, data and information with regard to the charging of these commissions. Everything required by the General Director was submitted by Leumi Card as requested.
- E. In the context of the Bank's marketing campaigns for Diners cards, primarily in 1998 and 1999, cases were discovered in which customers were debited with commissions in respect of cards that had been issued to them as aforesaid, but which they had not requested.

The Bank acted and is acting through various means in order to prevent reoccurrence of such cases. In addition, the Bank acted and is acting to refund the commissions that were charged as aforesaid to those customers together with appropriate interest.

In March 2002 the Supervisor of Banks informed the Bank that the material in his possession regarding Diners cards together with the Bank's reply had been sent to the State Attorney's Office for it to consider whether it was necessary to instigate a police investigation into the matter.

- F. In the context of issuing Leumi Visa credit cards to customers of the Bank, the Bank offered some of its customers membership in the "Faithful Traveler" club, a joint club of Leumi Card and El Al, without payment of a club membership fee. Due to a technical fault that occurred, some 3,500 of these customers were erroneously charged with membership fees.

On becoming aware of the error, the Bank took action to locate all the said customers and to credit their accounts with the debited amount plus an appropriate supplement. In March 2002 the Supervisor of Banks informed the Bank that the material in his possession on this issue had been sent to the State Attorney's Office for it to consider whether it was necessary to instigate a police investigation into the matter.

## 7. **Migdal Insurance and Financial Holdings Ltd. ("Migdal Holdings")**

- A. Migdal Holdings' investment in securities item includes "a permanent investment" in listed shares of the Bank. The investment, that is presented on the basis of cost, amounts to NIS 1,011 million.

In November 2002 a valuation was made of the Bank as at 30 September 2002. According to the valuation that was received by Migdal Holdings, the value of the block of shares it holds ranges between NIS 884 million and NIS 960 million.

Following a discussion on the valuation and all the assumptions that formed the basis thereof, Migdal Holdings' board of directors decided to put the book value of the investment in the said shares in the upper range of the valuation and to record the investment on the basis of a value of the Bank of some NIS 12 billion. The implication of the said recording was a reduction of the value of the investment recorded in Migdal Holdings' books by an amount of some NIS 51 million. The market value of the shares as at the date of the financial statements was NIS 529 million.

- B. There are claims and applications for filing class actions against the Migdal group, that are primarily connected with the Migdal group's insurance business, on subjects of premium calculations, drawing management fees and payment of commissions in connection with group life insurance.

With regard to the majority of the said claims and applications, in the assessment of Migdal's management and based upon legal advice it has received, it is not possible to estimate the extent of the exposure nor the outcome of the actions and accordingly provisions in respect of such proceedings were not included.

See Migdal Insurance and Financial Holdings' financial statements for further details of these proceedings.

#### 8. **Israel Corporation Ltd.**

Israel Corporation's major investments include Oil Refineries Ltd. and Israel Chemicals Ltd., in respect whereof the following principal uncertainties exist:

- A. The government has decided on a reform in the refining sector, in the context whereof there is a decision to spin off Oil Refineries into two separate oil refineries with separate ownership.
- B. In December 2002 an arrangement was signed between the Government of Israel, Oil Refineries and Israel Corporation with regard to the period following the end of the licence (18 October 2003) pursuant whereof Oil Refineries operates. The principal aspect of the arrangement is Oil Refineries' continued holding of the assets that it holds on the eve of the end of the licence for 25 years with an option to extend the term for a further 25 years.
- C. There are claims against consolidated companies of Israel Chemicals Ltd. relating to personal injuries, ecological damage, restrictive practices, and patent and copyright infringement. In addition, investigations are being conducted overseas against companies as aforesaid with regard to restrictive practices.

The foregoing may have a material effect on Israel Corporation's financial position, which it is not possible to assess.

See Israel Corporation's financial statements for further details of these proceedings.

#### 9. **Implementation of the Supervisor's Directives with Regard to Derivatives and Hedging Activities**

- A. On 17 January 2000, the Supervisor of Banks published in Circular No. H-06-1992 his directives with regard to "accounting for derivatives and hedging activities" (hereinafter the "Circular") that applied to the banking corporations' financial statements from those of the quarter ending 31 March 2002. The directives prescribed in the Circular were based on the rules prescribed in the USA in FASB Statement No. 133. The Circular prescribes the accounting and reporting rules in respect of derivatives, including certain derivatives that are embedded in other contracts (hereinafter together "derivatives"), and in respect of hedging activities.
- B. In June 2002 the FASB published FASB Statement No. 138, that amended the rules prescribed in Statement No. 133 for measurement and disclosure of derivatives and hedging activities. In order to adapt the provisions of the Circular to the accounting rules, as amended in the USA in Statement No. 138, the Supervisor of Banks published Circular No. H-06-2001 on 1 January 2001.
- C. The date of the commencement of the derivatives directive was postponed by one year pursuant to the Supervisor of Banks' Circular No. H-06-2002 that was published on 18 February 2002.

- D. From 1 January 2003 the Bank Leumi Group is implementing the Supervisor's directives with regard to derivatives and hedging activities. As a result of implementing the directives, transitional adjustments were recorded that affect the Bank's financial position as at 1 January 2003, as set forth below:

Decrease in the Bank's net profit for 2003:	NIS 9 million
Decrease in another component of the overall profit in the corporation's shareholders' equity	NIS 3 million
Increase in assets deriving from derivatives:	NIS 383 million
Increase in liabilities deriving from derivatives:	NIS 395 million

- E. The Bank Leumi Group is exposed to changes in the fair value that may be attributed to changes in an interest rate established in foreign currency (the Libor rate). As part of the Bank's overall strategy for managing the level of the exposure to the interest risk, the Bank uses foreign currency derivatives to replace fixed interest with floating interest. The Bank has derivatives that are designated and qualify for fair value hedging.
- F. If a derivative is not designated for a qualifying hedging relationship, the derivative is recorded according to fair value and the changes in its fair value are recorded on a current basis in the profit and loss account.

The Bank Leumi Group carries out operations in the following types of derivatives: futures transactions and options on underlying assets of interest, currency, shares, commodities and others.

The activity in derivatives that is carried out:

- (1) Derivatives designated for hedging relationships.
  - (2) As part of the Bank's management of assets and liabilities that were not attributed to hedging relationships - ALM management.
  - (3) Brokerage transactions with responsibility between the banks/brokers and the customers.
- G. The Bank Leumi Group may enter into a contract that is not of itself a derivative *per se* but contains an embedded derivative. In respect of each contract, the Bank assesses whether the economic characteristics of the embedded derivative are clearly and closely connected to those of the host contract and determines whether a separate instrument with the same terms and conditions as those of the embedded derivative would meet the definition of a derivative instrument.

Where it is determined that the embedded derivative has economic characteristics that are not clearly and closely connected to those of the host contract and also that a separate instrument with the same terms and conditions would have been suitable as a derivative instrument, the embedded derivative is separated from the host contract and is treated as a derivative *per se*. An embedded derivative that has been separated is presented in the balance sheet together with the host contract and the embedded derivative is measured according to fair value and changes in its fair value are reported on a current basis in the profit and loss account.

- H. The Bank Leumi Group documents all the hedging relationships between hedging instruments and hedged items, and the object and strategy of the risk management through the creation of the various hedging transactions.

The documentation includes specific identification of the asset, the liability, the firm commitment that were designated as a hedged item and a notation of the manner in which the hedging instrument is anticipated to hedge the risks connected with the hedged item. The Bank assesses the effectiveness of the hedging relationships both at the commencement of the hedging and also on a continuing basis in accordance with its risk management policy.

- I. The Bank Leumi Group discontinues hedging accounting when:
- (a) it is determined that the derivative is no longer effective in offsetting the changes in fair value;
  - (b) a derivative expires, is sold, cancelled or exercised;
  - (c) the derivative ceases to be designated as a hedging instrument, since it is almost certain that the anticipated transaction will not be executed;
  - (d) a hedged firm commitment no longer meets the definition of a firm commitment;
  - (e) management cancels the derivative's designation as a hedging instrument.

Where hedging accounting is discontinued because it has been determined that the derivative no longer qualifies as effective fair value hedging, the derivative will continue to be recorded in the balance sheet according to its fair value, but the hedged asset or liability will no longer be adjusted for changes in fair value. Where hedging accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the derivative will continue to be recorded in the balance sheet according to its fair value, and any asset or liability that was recorded in accordance with the recognition of the firm commitment will be removed from the balance sheet and be recognised as a profit or loss in the profit and loss account for the current period.

- J. The Bank Leumi Group designates certain derivatives for fair value hedging. The change in the fair value of derivatives, that hedge exposure to a change in the fair value of an asset, liability or firm commitment, is recognised on a current basis in the profit and loss statement, as is the change in the fair value of the hedged item that can be attributed to the hedged risk.

In the three month period ending on 31 March 2003 the Bank recorded a loss of NIS 17 million (NIS 7 million accrued effect as at 31 December 2002) in respect of lack of effectiveness relating to fair value hedging in part C of the Note "Net Interest Income before Provision for Doubtful Debts", in the "ineffective portion of hedge relationships" item.

10. From 1 January 2003 the Bank Leumi Group is applying Accounting Standard No. 14 – "Financial Reporting for Interim Statements". The Standard prescribes the accounting rules for recognition and measurement in interim financial statements in a manner that will be identical to those that were applied in the annual financial statements.

In consequence of applying the Standard as aforesaid, the Bank does not spread various components of salary costs as it did in the interim financial statements in the past.

The effect on the first quarter of 2002, had Standard No. 14 been applied, would have been an increase of some NIS 167 million in the salaries and related expenses item and a reduction of some NIS 90 million in the net profit.

#### 11. **Future Application of Accounting Standards**

In June 2000 the Israeli Accounting Standards Board published Accounting Standard No. 6 which requires “disclosure of the effect of new accounting standards in the period prior to their application”.

- A. In October 2001 Accounting Standard No. 12 - Discontinuation of Adjustment of Financial Statements from 1 January 2003 - was published. Pursuant to Standard No. 17 of the Accounting Standards Board, adjustment of the financial statements to inflation will be discontinued as from 1 January 2004. Accordingly, until 31 December 2003 the Bank will continue drawing up adjusted statements in accordance with the Supervisor of Banks’ directives on the basis of the rules of the existing opinions of the Institute of Certified Public Accountants in Israel. The extent of the Standard’s effect on the Bank’s Financial Statements depends on the rate of inflation, the asset composition and the financing sources of the Bank.
  
- B. In October 2001 Accounting Standard No. 13, which deals with the effect of changes in foreign currency exchange rates, was published. The Standard prescribes the accounting treatment for foreign currency transactions and translating financial statements of subsidiary and associated companies with foreign activities. Furthermore, the Standard prescribes rules to determine whether the company is an “integrated entity” or an autonomous unit and how the said companies’ financial statements must be translated. According to the Israeli Accounting Standards Board’s Standard No. 17, the new Standard will apply to financial statements for periods after 31 December 2003. In view of the Supervisor’s directive that the overseas banking offices will continue to be classified as “integrated entities” and the classification of a new overseas office as an autonomous unit will be conditional upon obtaining the Supervisor of Banks’ approval, in the Bank’s assessment, the potential effect of applying the new Standard on the financial position and on the financial results is not material.

**Net Interest Income Before Provision for Doubtful Debts (on a Consolidated Basis)  
In terms of NIS of March 2003 (Unaudited)**

	For the three months ended 31 March	
	2003	2002
	(NIS millions)	
<b>A. Income on assets (a)</b>		
Credit to the public	<b>1,105</b>	2,725
Credit to governments	<b>(10)</b>	53
Deposits with Bank of Israel and cash	<b>81</b>	(15)
Deposits with banks	<b>(72)</b>	355
Debentures	<b>(41)</b>	980
<b>B. Expenses on liabilities (a)</b>		
Deposits of the public	<b>(225)</b>	(2,122)
Deposits from governments	<b>(4)</b>	(21)
Deposits from Bank of Israel	<b>(3)</b>	4
Deposits from banks	<b>(14)</b>	(127)
Debentures, bonds and subordinated notes	<b>2</b>	(217)
<b>C. From derivative instruments and hedging activities (b)</b>		
Ineffective portion of hedge relationships	<b>(17)</b>	-
Net income from ALM derivative instruments	<b>406</b>	-
Net income from other derivative instruments	<b>2</b>	-
Commission from brokerage transactions with risk	-	24
Financing income from other transactions	-	433
Financing expenses on other transactions	-	(55)
<b>D. Other income and expenses</b>		
Financing commissions	<b>63</b>	60
Profit from sale of debentures available for sale, net	<b>16</b>	99
Profit (loss) realized and not yet realized in respect of fair value adjustments of trading debentures, net	<b>80</b>	(51)
Other financing income	<b>37</b>	(c) 149
Other financing expenses	<b>33</b>	(77)
<b>Total net interest income before provision for doubtful debts</b>	<b>1,439</b>	1,331

(a) Including hedge transactions.

(b) The Bank implemented beginning January 1, 2003 the instructions of the Supervisor of the Banks as stated in Note 9 of the financial statements. The figures for the first quarter of 2003 can not be compared with the figures for the first quarter of 2002.

(c) Reclassified.

In cases where the rate of interest income (expenses) was lower than the increase in the CPI, an expense is shown with respect to assets and income is shown with respect to liabilities.

**Provision for Doubtful Debts (on a Consolidated Basis)**  
**In terms of NIS of March 2003 (Unaudited)**

	For the three months ended 31 March					
	2003			2002		
	Specific Provision (a)	Supplementary Provision (b)	Total	Specific Provision (a)	Supplementary Provision (b)	Total
(NIS millions)			(NIS millions)			
Balance of the provision at the beginning of the period	<b>5,897</b>	<b>1,114</b>	<b>7,011</b>	4,743	1,061	5,804
Provisions during the period	<b>535</b>	<b>13</b>	<b>548</b>	519	20	539
Decrease in provisions	<b>(166)</b>	<b>(2)</b>	<b>(168)</b>	(137)	(28)	(165)
Collection of past years' write-offs	<b>(5)</b>	-	<b>(5)</b>	(4)	-	(4)
Net amount charged to statement of profit and loss	<b>364</b>	<b>11</b>	<b>375</b>	378	(8)	370
Write-offs	<b>(107)</b>	-	<b>(107)</b>	(183)	-	(183)
Inflationary erosion and adjustments	<b>(52)</b>	-	<b>(52)</b>	(49)	-	(49)
Balance of provision at end of period	<b>6,102</b>	<b>1,125</b>	<b>7,227</b>	4,889	1,053	5,942
Including balance of provision not deducted from credit to the public	<b>33</b>	<b>164</b>	<b>197</b>	33	142	175

- (a) Not including provision for interest in respect of the period after the loans were determined to be doubtful. With respect to loans in arrears for which a provision was established to the extent of the arrears, no accrual for interest was recorded thereon.
- (b) Including the general and special provision for doubtful debts.

**Assets and Liabilities Classified According to Linkage Basis (on a Consolidated Basis) (a)  
as at 31 March 2003 (Unaudited)  
In terms of NIS of March 2003**

	Israeli currency		Foreign currency (b)			Non-mone- tary items	Total
	Unlinked	Linked to the CPI	In U.S. dollars	In Euro	In other currencies		
	(NIS millions)						
<b>Assets</b>							
Cash and deposits with banks	9,586	661	8,325	2,249	1,753	-	22,574
Securities	8,076	5,346	22,267	1,343	626	1,050	38,708
Credit to the public (c)	50,072	57,270	52,104	3,715	10,378	-	173,539
Credit to governments	-	177	1,180	30	-	-	1,387
Investments in affiliated companies	-	-	-	-	-	1,402	1,402
Buildings and equipment	-	-	-	-	-	2,643	2,643
Other assets	2,388	79	1,964	785	491	678	6,385
<b>Total assets</b>	<b>70,122</b>	<b>63,533</b>	<b>85,840</b>	<b>8,122</b>	<b>13,248</b>	<b>5,773</b>	<b>246,638</b>
<b>Liabilities</b>							
Deposits of the public	73,829	43,919	67,261	14,813	6,778	-	206,600
Deposits from banks	513	1,117	1,349	244	670	-	3,893
Deposits from governments	552	1,568	744	10	3	-	2,877
Debentures, bonds and subordinated notes	121	6,695	3,984	-	-	-	10,800
Other liabilities	1,785	2,307	2,287	568	657	854	8,458
<b>Total liabilities</b>	<b>76,800</b>	<b>55,606</b>	<b>75,625</b>	<b>15,635</b>	<b>8,108</b>	<b>854</b>	<b>232,628</b>
<b>Difference</b>	<b>(6,678)</b>	<b>7,927</b>	<b>10,215</b>	<b>(7,513)</b>	<b>5,140</b>	<b>4,919</b>	<b>14,010</b>
Effect of derivative instruments that are not hedging derivatives:							
Derivative instruments (excluding options)	6,782	(428)	(8,523)	7,359	(5,190)	-	-
Options in the money, net (in terms of underlying assets)	83	-	(234)	(26)	177	-	-
Options out of the money, net (in terms of underlying assets)	(332)	(2)	170	134	30	-	-
<b>Total</b>	<b>(145)</b>	<b>7,497</b>	<b>1,628</b>	<b>(46)</b>	<b>157</b>	<b>4,919</b>	<b>14,010</b>
Options in the money, net (discounted par value)	110	-	(328)	(30)	248	-	-
Options out of the money, net (discounted par value)	(925)	(29)	509	463	(18)	-	-

- (a) Includes the effect of hedge transactions.  
(b) Including linked to foreign currency.  
(c) The general and supplementary provisions for doubtful debts have been deducted proportionately from the different linkage bases.

**Assets and Liabilities Classified According to Linkage Basis (on a Consolidated Basis) (a)**  
**as at 31 March 2002 (Unaudited)**  
**In terms of NIS of March 2003**

	Israeli currency		Foreign currency (b)			Non-mone- tary items	Total
	Unlinked (NIS millions)	Linked to the CPI	In U.S. dollars	In Euro	In other currencies		
<b>Assets</b>							
Cash and deposits with banks	6,160	792	10,023	2,291	1,422	-	20,688
Securities	8,400	4,189	22,871	766	900	1,647	38,773
Credit to the public (c)	51,145	55,813	54,223	2,834	9,123	-	173,138
Credit to governments	-	211	1,324	45	-	-	1,580
Investments in affiliated companies	-	12	-	-	-	1,432	1,444
Buildings and equipment	-	-	-	-	-	2,501	2,501
Other assets	2,002	64	1,878	252	238	1,479	5,913
<b>Total assets</b>	<b>67,707</b>	<b>61,081</b>	<b>90,319</b>	<b>6,188</b>	<b>11,683</b>	<b>7,059</b>	<b>244,037</b>
Including: Hedge transactions	-	-	244	(42)	(202)	-	-
<b>Liabilities</b>							
Deposits of the public	72,357	41,366	71,239	11,829	6,255	-	203,046
Deposits from banks	650	1,056	1,657	303	693	-	4,359
Deposits from governments	798	1,893	779	-	1	-	3,471
Debentures, bonds and subordinated notes	(d) 126	(d) 6,056	4,466	-	-	-	10,648
Other liabilities	1,922	2,005	2,450	316	290	1,651	8,634
<b>Total liabilities</b>	<b>75,853</b>	<b>52,376</b>	<b>80,591</b>	<b>12,448</b>	<b>7,239</b>	<b>1,651</b>	<b>230,158</b>
<b>Difference</b>	<b>(8,146)</b>	<b>8,705</b>	<b>9,728</b>	<b>(6,260)</b>	<b>4,444</b>	<b>5,408</b>	<b>13,879</b>
Other transactions:							
Forward contracts, net	9,397	(743)	(10,464)	6,306	(4,496)	-	-
Options in the money, net (in terms of underlying assets)	(300)	(2)	67	201	34	-	-
Options out of the money, net (in terms of underlying assets)	(34)	(1)	111	(51)	(25)	-	-
<b>Total</b>	<b>917</b>	<b>7,959</b>	<b>(558)</b>	<b>196</b>	<b>(43)</b>	<b>5,408</b>	<b>13,879</b>
Options in the money, net (discounted par value)	(447)	(2)	268	155	26	-	-
Options out of the money, net (discounted par value)	(244)	(35)	608	(220)	(109)	-	-

- (a) Includes the effect of hedge transactions.  
(b) Including linked to foreign currency.  
(c) The general and supplementary provisions for doubtful debts have been deducted proportionately from the different linkage bases.  
(d) Reclassified.

**Assets and Liabilities Classified According to Linkage Basis (on a Consolidated Basis) (a)  
as at 31 December 2002 (Audited)  
In terms of NIS of March 2003**

	Israeli currency		Foreign currency (b)			Non-mone- tary items	Total
	Unlinked (NIS millions)	Linked to the CPI	In U.S. dollars	In Euro	In other currencies		
<b>Assets</b>							
Cash and deposits with banks	10,606	688	7,914	3,443	1,766	-	24,417
Securities	7,097	5,088	22,339	930	650	1,021	37,125
Credit to the public (c)	51,494	56,530	54,179	3,688	10,536	-	176,427
Credit to governments	-	207	1,228	29	-	-	1,464
Investments in affiliated companies	-	12	-	-	-	1,375	1,387
Buildings and equipment	-	-	-	-	-	2,621	2,621
Other assets	2,336	83	2,064	938	584	689	6,694
<b>Total assets</b>	<b>71,533</b>	<b>62,608</b>	<b>87,724</b>	<b>9,028</b>	<b>13,536</b>	<b>5,706</b>	<b>250,135</b>
Including: Hedge transactions	-	-	203	(82)	(121)	-	-
<b>Liabilities</b>							
Deposits of the public	76,230	44,189	68,451	14,564	7,136	-	210,570
Deposits from banks	518	1,128	1,048	335	742	-	3,771
Deposits from governments	550	1,676	762	19	5	-	3,012
Debentures, bonds and subordinated notes	120	6,747	3,636	-	-	-	10,503
Other liabilities	1,600	2,268	2,206	649	795	833	8,351
<b>Total liabilities</b>	<b>79,018</b>	<b>56,008</b>	<b>76,103</b>	<b>15,567</b>	<b>8,678</b>	<b>833</b>	<b>236,207</b>
<b>Difference</b>	<b>(7,485)</b>	<b>6,600</b>	<b>11,621</b>	<b>(6,539)</b>	<b>4,858</b>	<b>4,873</b>	<b>13,928</b>
Other transactions:							
Forward contracts, net	9,263	(701)	(10,582)	6,649	(4,629)	-	-
Options in the money, net (in terms of underlying assets)	497	(1)	(451)	(139)	94	-	-
Options out of the money, net (in terms of underlying assets)	26	(3)	(51)	(11)	39	-	-
<b>Total</b>	<b>2,301</b>	<b>5,895</b>	<b>537</b>	<b>(40)</b>	<b>362</b>	<b>4,873</b>	<b>13,928</b>
Options in the money, net (discounted par value)	499	(2)	(470)	(107)	80	-	-
Options out of the money, net (discounted par value)	(100)	(29)	23	(87)	193	-	-

- (a) Includes the effect of hedge transactions.  
(b) Including linked to foreign currency.  
(c) The general and supplementary provisions for doubtful debts have been deducted proportionately from the different linkage bases.

**Condensed Financial Statements by banking Sectors**  
**Information on activity by banking sectors**

Statement of profit and loss for the Three Months Ended 31 March 2003 (Unaudited)										
	Corporate and inter- national banking	Retail banking	Commercial banking	Private banking	Construction and real estate	Mortgages	Credit cards	Capital market	Unallocated amounts and adjustments (a)	Total consolidated
	(NIS millions)									
Net interest income before provision for doubtful debts	215	573	278	57	94	77	4	3	138	1,439
Operating and other income:										
From outside entities	39	230	68	55	7	41	115	187	(8)	734
Intercompany operations	14	112	21	19	1	(4)	(31)	(126)	(6)	-
Total	53	342	89	74	8	37	84	61	(14)	734
Total income	268	915	367	131	102	114	88	64	124	2,173
Net profit (loss)	(21)	96	33	16	38	17	2	(3)	(2)	176

Statement of profit and loss for the Three Months Ended 31 March 2002 (Unaudited) (b)										
	Corporate and inter- national banking	Retail banking	Commercial banking	Private banking	Construction and real estate	Mortgages	Credit cards	Capital market	Unallocated amounts and adjustments (a)	Total consolidated
	(NIS millions)									
Net interest income before provision for doubtful debts	190	536	295	72	78	42	4	2	112	1,331
Operating and other income:										
From outside entities	35	167	66	45	6	55	105	355	(54)	780
Intercompany operations	12	214	49	19	1	(6)	(34)	(258)	3	-
Total	47	381	115	64	7	49	71	97	(51)	780
Total income	237	917	410	136	85	91	75	99	61	2,111
Net profit (loss)	(19)	141	77	41	17	19	(15)	(1)	(30)	230

Statement of profit and loss for the Year Ended 31 December 2002 (Audited) (b)										
	Corporate and inter- national banking (NIS millions)	Retail banking	Commercial banking	Private banking	Construction and real estate	Mortgages	Credit cards	Capital market	Unallocated amounts and adjustments (a)	Total consolidated
Net interest income before provision for doubtful debts	766	2,197	1,234	292	321	260	10	8	133	5,221
Operating and other income:										
From outside entities	180	921	292	207	36	181	433	859	(135)	2,974
Intercompany operations	37	477	109	66	3	(13)	(111)	(563)	(5)	-
Total	217	1,398	401	273	39	168	322	296	(140)	2,974
Total income	983	3,595	1,635	565	360	428	332	304	(7)	8,195
Net profit (loss)	67	464	182	222	61	117	(6)	(26)	(648)	433

- (a) Included in this segment are all the Bank's nostro operations and also the operations of other units, such as the special department and dealing rooms, and adjusted amounts for inflation.  
(b) Reclassified.