BANK LEUMI LE-ISRAEL B.M. AND ITS INVESTEE COMPANIES

Annual Report 2011

Bank Leumi le-Israel B.M. Head Office: 34 Yehuda Halevi Street, Tel Aviv 65546, Israel

The Bank has received the consent of the Supervisor of Banks to the publication of the annual financial report on a consolidated basis only, with condensed statements of the Bank (not consolidated) in Note 30 to the Financial Statements.
The figures of the Bank alone are available on request from the offices of the Bank at 34 Yehuda Halevi Street, Tel Aviv or on its website: www.bankleumi.com.
This is a translation from the Hebrew and has been prepared for convenience only. In the case of any discrepancy, the Hebrew will prevail.

Bank Leumi le-Israel B.M. and its Investee Companies
Annual Report 2011

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Board of Directors

David Brodet, Chairman

David Avner[1]

Reuven Adler, C.P.A. (Isr.)

Zipora Gal-Yam

Prof. Arieh Gans

Moshe Dovrat

Yehuda Drori

Doron Cohen

Adv. Miriyam (Miri) Katz

Yoav Nardi

Zipporah Samet[2]

Amos Sapir[1]

Prof. Efraim Sadka

Prof. Gabriela Shalev[3]

(1) Elected as director in the Bank at the General Meeting held on 24 May 2011. The term of office of Mr David Avner took effect on 25 July 2011. The term of office of Mr. Amos Sapir took effect on 31 October 2011.
It should be noted that until 25 July 2011, Avraham Guzman, Adv. Yaakov Mashaal and Mr. Zvi Koren served as directors in the Bank. In addition, on 4 October 2011, Dr. Ehud Shapira resigned from his position as director in the Bank.

(2) Elected as external director pursuant to sections 239 and 245 to the Companies Law, 1999, for a three-year period commencing 25 July 2011 at the General Meeting held on 24 May 2011.

(3) Elected as external director pursuant to sections 239 and 245 to the Companies Law, 1999, for a three-year period commencing 1 February 2011 at the general meeting held on 28 December 2010.

It should be noted that Professor Israel Gilead served as external director until 31 January 2011.

Members of Management and their Positions

Galia Maor (1) (2)
President and Chief Executive Officer

Rakefet Russak-Aminoach, C.P.A. (Isr.) (2) (3) (6)
Senior Deputy Chief Executive Officer, Acting CEO in the absence of the President and CEO
Head of Corporate Division

Zvi Itskovitch (4)
First Executive Vice President, Head of International and Private Banking Division

Baruch Lederman
First Executive Vice President, Head of Banking Division

Itzhak Malach (6)
First Executive Vice President, Head of Operations and Information Systems

Prof. Daniel Tsiddon
First Executive Vice President, Head of Capital Markets Division

Gideon Altman
Executive Vice President, Head of Commercial Banking Division

Yaacov (Kobi) Haber
Executive Vice President, Head of Finance and Economics Division

Dan Cohen(5)
Executive Vice President, Head of Human Resources

Menachem Schwartz, C.P.A. (Isr.)
Executive Vice President, Chief Accounting Officer, Head of Accounting

Dr. Hedva Ber(6)
Executive Vice President, Chief Risk Officer. Head of Risk Management Division

Adv. Nomi Sandhaus
Executive Vice President, Chief Legal Advisor, Head of Legal Division, Manager of Legal Risks

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Sasson Mordecai (7)
Executive Vice President, Chief Internal Auditor, Head of Internal Audit Division

Adv. Yael (Ben Moshe) Rudnicki
Bank and Group Secretary

Somekh Chaikin Kost Forer Gabbay & Kasierer
Joint Auditors of the Bank

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(1) On 1 January 2012, the President and Chief Executive Officer, Galia Maor, informed the Board of Directors of the Bank that she intended to retire from her position as President and Chief Executive Officer of the Group in the second quarter of 2012.
(2) On 12 February 2012, the Board of Directors of the Bank convened for discussion resolved to appoint Ms. Rakefet Russak-Aminoach as the next President and Chief Executive Officer of the Group. On 18 March 2012 the Bank received the confirmation of the Supervisor of Banks that he had no objection to the appointment, of Ms. Rakefet Russak-Aminoach as President and CEO of the Group effective 1 May 2012.
(3) Serves in the position of Senior Deputy Chief Executive Officer, and Acting CEO in the absence of the President and CEO with effect from 1 July 2011. Until 30 June 2011, Mr. Zeev Nahari, C.P.A. (Isr.) served as Senior Deputy Chief Executive Officer, Acting CEO in the absence of the President and CEO, Senior Member of Management for Finance, Accounting and Capital Markets, Manager of Market Risks.
(4) On 19 February 2012, the Board of Directors of the Bank, after accepting the recommendation of the Administration Committee of the Board of Directors and after approval from the Audit Committee, approved the request of Mr. Zvi Itskovitch, First Executive Vice President, Head of International and Private Banking Division. to advance the date of his retirement from the Bank, such that his employment in the Bank will actually terminate in the third quarter of 2012.
(5) Serves in the position of Head of Human Resources from 1 April 2011. Until 31 March 2011, Mr. David Bar-Lev served as Head of Human Resources.
(6) The transfer of authority for certain risks from the present risk officers to the Chief Risk Officer was effected during the second quarter of 2011.
(7) Serves as Chief Internal Auditor and Head of Internal Audit Division with effect from 1 March 2011. Until 28 February 2011, Adv. Joseph Horowitz served as Chief Internal Auditor and Head of Internal Audit Department.

Bank Leumi le-Israel B.M. and Investee Companies

Directors' Report

The following is the sixty-first annual report of Bank Leumi le-Israel B.M. and the one hundred and tenth report of the business founded in 1902. This report will be presented to the Bank's Annual General Meeting. This report is based on an analysis of the data included in the Bank's Financial Statements and Management Review, and upon additional data as required. This report is prepared in accordance with the public reporting directives of the Supervisor of Banks at the Bank of Israel.

B. General Developments in the Group's Business

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

Bank Leumi and its subsidiary companies constitute one of the largest banking groups in Israel, continuing activities that began 110 years ago. The Bank's predecessor, the Anglo Palestine Company, was established in London in 1902 by Otsar Hityashvuth HaYehudim Jewish Colonial Trust Limited, the predecessor of Otsar Hityashvuth HaYehudim B.M.[1]

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

The Leumi Group is involved in a variety of banking, financial and non-banking activities, in Israel and overseas. The Group's activities are carried out through the Bank and subsidiary and associate companies, through 270 branches located throughout Israel, and through 61 branches, agencies and representative offices in 17 countries throughout the world.

The Group's policy, in Israel and overseas, is to provide comprehensive banking and financial solutions to its customers and a high level of professional service, to enable them to make use of varied distribution channels and to offer them a wide variety of products, adapted to their needs.

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

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

Corporate banking concentrates on servicing major and international companies, commercial banking concentrates on servicing middle market companies, international and private banking is aimed at high net worth customers requiring investment solutions at a highly sophisticated level, retail banking concentrates on providing banking services mainly to households and small businesses, and Capital Markets and Financial Management coordinates the activities of all the dealing rooms and the nostro within one division, with a view to improving and expanding the range of services to customers active in the capital and financial markets, including institutional customers.

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[1] Otsar Hityashvuth HaYehudim B.M. was the controlling shareholder of the Bank until the equalization of voting rights in the Bank in 1991. In 1993, most of the shares of the Bank passed to the ownership of the State, under the Bank Shares Arrangement Law) (Temporary Provision), 1993, see page 18. On 3 September 2007, the company ceased to be an interested party in the Bank.

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

Further, the Group invests in non-banking corporations operating in the fields of infrastructures, Israeli and overseas real estate, communications and the media, energy, shipping, food, retail trade and the chemical industry. The management of the non-banking investment portfolio is conducted through the subsidiary, Leumi Partners Ltd.

On the basis of banking system data as of 30 September 2011, as published by the Bank of Israel, Leumi Group's market share in relation to the Israeli banking system was as follows:

	30.9.2011	**31.12.2010**	**31.12.2009**	**31.12.2008**	**31.12.2007**
	In percentages				
Total assets	29.5	29.3	29.6	29.3	30.0
Credit to the public	29.0	28.9	28.3	29.1	29.7
Deposits of the public	29.7	29.5	29.9	29.8	30.2
Operating profit before taxes	24.9	30.4	35.0	1.5 (1)	37.9
Operating profit after taxes	23.5	29.8	35.8	- (2)	38.4

(1) After canceling the effect of losses of Bank Hapoalim.
(2) Operating loss after taxes.

The Leumi Group operates in a competitive market in all its operating segments. The main competitors are currently other Israeli banks, although, in certain segments, there are additional competitors whose numbers are constantly growing, such as overseas banks and non-bank competitors such as insurance companies and other institutional entities.

2011 was typified by a global economic slowdown as a consequence of the political upheaval in some Arab states and a further deterioration in the economic position of some European countries, particularly, Italy, Ireland, Greece, Spain and Portugal. Nevertheless, the Israeli economy grew by some 4.7%, similar to the growth rate in 2010. For details, see the Economic Review on page 36.

Total assets under management of the Group (both balance sheet and off-balance sheet*) amounted to NIS 898 billion as at 31 December 2010, as compared with NIS 889 billion at the end of 2010, a decrease of some 1.1%, resulting primarily from an increase in the scope of activity, which was partially offset by a fall in market values in Israel and throughout the world.

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

As a result of the slowdown in the global and local economy, there was a decline in the Group's results, mainly due to falls on the capital market which impacted a decrease in operating and other income and salary expenses, which was partly offset by an increase in the level of activity and from a change in deferred taxes.

The net profit of the Group for 2011 totaled NIS 1,891 million, compared with a profit of NIS 2,334 million in 2010, a decrease of 19.0%.

The net profit for the fourth quarter of 2011 totaled NIS 618 million, compared with a net profit of NIS 496 million in the fourth quarter of 2010, an increase of 24.6%.

The operating profit of the Group totaled NIS 1,889 million in 2011, as compared with a profit of NIS 2,151 million in 2010, a decrease of 12.2%.

The decrease in the value of the securities available-for-sale portfolio in 2011 amounted to NIS 686 million, net (after tax), compared with an increase in value of NIS 159 million, net (after tax), in 2010. Until 29 February 2012, the increase in value of securities amounted to NIS 171 million after tax.

For a discussion of the financial results and additional details, see Part D below, page 75

Return on equity of net profit reached 8.3%, compared with 10.3% in 2010.

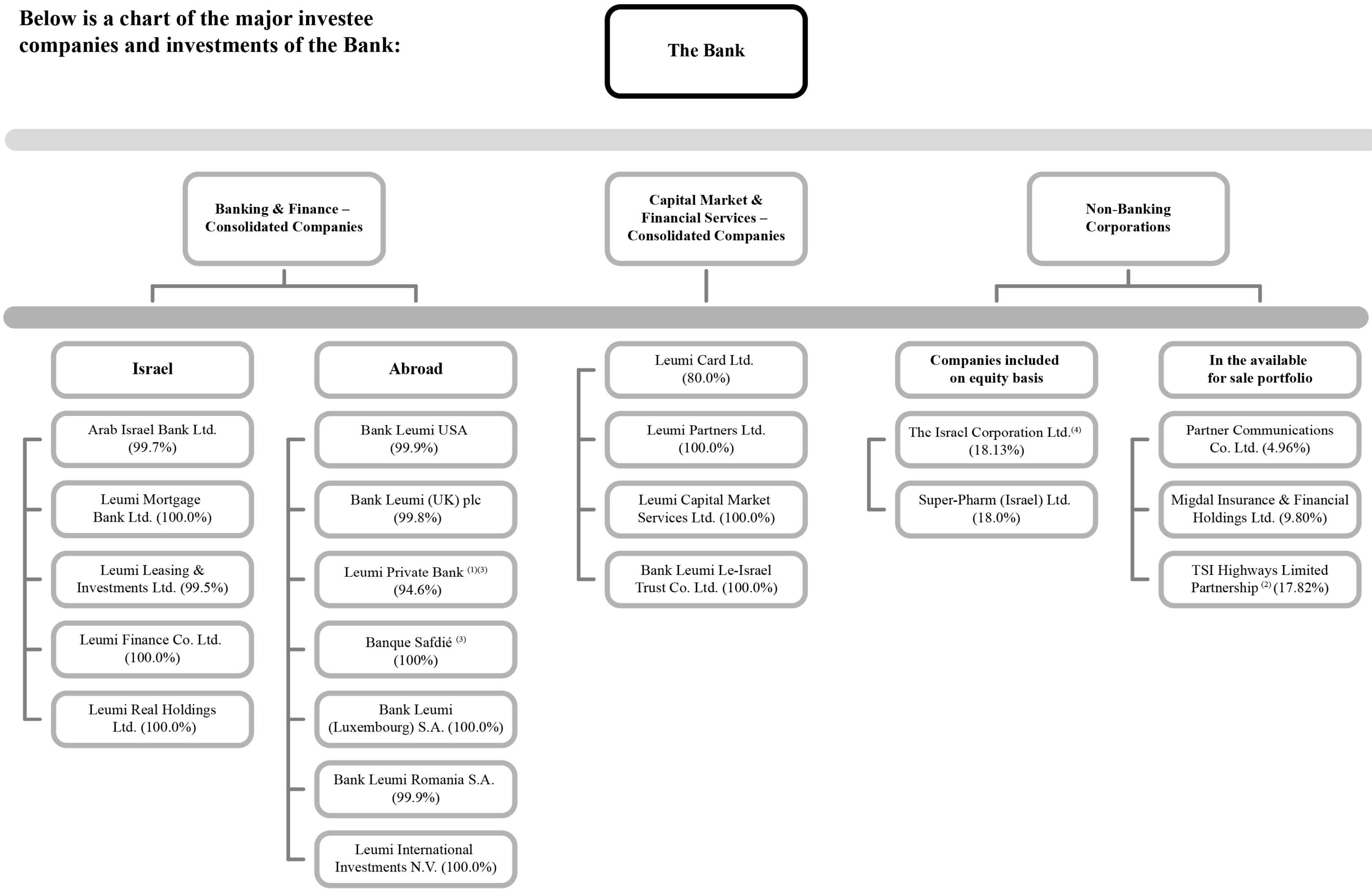
The net profit per share in 2011 was NIS 1.28 compared with NIS 1.58 in 2010.

The following table sets out a breakdown of the contribution of profit centers in the Group to the net operating profit:

	2011			2010 (4)		
	Scope of investment	Contribution to net operating profit		Scope of investment	Contribution to net operating profit	
		(1)	(2)		(1)	(2)
	NIS billions	NIS millions		NIS billions	NIS millions	
The Bank	**9.6**	**1,143**	**957**	10.5	1,260	1,433
Subsidiary companies in Israel (3)	**7.1**	**432**	**432**	7.1	639	639
Overseas subsidiary companies	**4.8**	**209**	**395**	4.0	(103)	(276)
Companies included on equity basis	**1.8**	**105**	**105**	1.7	355	355
Total	**23.3**	**1,889**	**1,889**	23.3	2,151	2,151

(1) After cancelling the effect of exchange rate differentials at the Bank and the foreign subsidiaries in respect of the financing of overseas investments.
(2) According to the Financial Statements (without cancelling the effect of exchange differentials).
(3) Including the profit and/or loss of companies included on equity basis of Leumi Partners
(4) The profit of the Bank and subsidiaries in Israel has been restated. See Note 1s.2.

Below is a chart of the major investee companies and investments of the Bank:



(1) 98% in voting rights
(2) The partnership purchased 50% in Derech Eretz Highways (1997) Ltd.
(3) Until 3 January 2012, the name of the bank was Bank Leumi (Switzerland) Limited. On 3 January 2012, Banque Safdié was merged with Bank Leumi (Switzerland). The name of the merged bank was changed to Leumi Private Bank.
(4) 17.8% in voting rights

Basel II General (Table 1 – Basel II):

A. Bank Leumi Le-Israel B.M. ("Leumi"), whose head office is located in Tel-Aviv, Israel, is the parent company of the Leumi Group.

B. In the table on the previous page is a chart of the Group structure and the principal investee companies.

For details see below in the section "Description of the Group's Activities" by sector and area of activity, and Note 6 to the Financial Statements.

The consolidation of consolidated companies and the recording of the book value of companies included on equity basis are in accordance with accepted accounting principles and Bank of Israel directives. However, in the calculation of supervisory capital, goodwill and intangible assets and the investments in the banking subsidiaries and financial companies which have not been consolidated are deducted from accounting capital (some NIS 440 million).

C. The principal regulatory restrictions on transferring liquid means between Group companies in Israel and abroad are:

(1) The Bank of Israel makes no restriction on the Bank making deposits in Group companies in Israel and abroad, but has imposed restrictions on capital investments by the Bank in companies abroad. Every material investment requires the prior approval of the Bank of Israel.

(2) Regulations of the authorities in the United States place restrictions on total exposures of any type for related companies of domestic banks. The maximum amount of exposure to a related company is 10% of the equity of the Bank in the U.S., and with regard to the group to which the Bank belongs in the U.S., the maximum amount is 20% of equity.

(3) Regulations of the authorities in the U.K. place restrictions on total deposits by domestic banks in any group company, and jointly in total, to a maximum share of 25% of equity of the Bank in the U.K.

(4) Regulations of the authorities in Switzerland oblige the Bank in Switzerland to deduct from its equity deposits amounts greater than 25% of equity of the Bank in Switzerland.

Business Strategy

Leumi's Vision

In the past year, Leumi's vision has been updated by the Board of Directors. The Leumi Group has devised a multi-year business strategy, based on the revised vision:

- To be a stable banking group supplying the financial requirements of all of its customers, relying on values of fairness, transparency, professionalism and innovation.

- To be the most profitable banking group in Israel (in terms of risk-adjusted return) over the long term, operating to create value for its stakeholders.

- To be the first choice of its employees, by being a solid and stable work-place that cares for its human resources and encourages excellence.

- To be a banking group that maintains proper corporate governance, and is socially responsible, being involved in, and contributing to, to the welfare of the community in which it operates.

- To be an Israeli group with an international presence corresponding to its customers' needs.

Background Conditions

The competitive and business environment in which Leumi operates is complex and influenced by many varied exogenic factors. The financial markets around the world and in Israel, regulation in Israel and abroad, and changes and trends in areas such as technology and the customers' preferences affect Group activity and the strategy derived as a result thereof.

The situation worldwide: The economic situation around the world was notable for Europe's entry into recession, which had a very different effect among the various countries of Europe. In Germany, the trend remains positive, while in the "PIIGS" states, the position is weak. On the other hand, economic growth in the United States continues to recover, reflected in positive trends in the labor and financial markets. For the time being, it appears that the crisis in Europe is being handled effectively and the fear of a further deterioration in the situation there has reduced considerably. These background conditions, with a weakness of world demand, in particular, those in the developed countries, albeit without the added severity of a crisis, are reflected in the growth forecast for the Israeli economy for 2012. Accordingly, there was a noticeable growth trend in the share in global economic activity of the emerging states, at the expense of a decline in the share of the developed countries.

The situation in Israel: The slowdown in growth rates around the world was also noticeable in the domestic market – the growth forecast in the Israeli economy for 2012 was recently revised downwards and is now significantly lower than in 2011. The moderation of the growth rate, together with the continuing high level of uncertainty and the increasing regulation constitute far-reaching challenges for the economic environment in which Leumi operates.

Last year, social-consumer protest broke out in Israel and around the world, in which the new consumer power was significantly demonstrated for the first time, backed up by the traditional media and other social media. The social protest raised awareness of the possibilities of influence currently available to consumers, both among the consumers themselves and among the organizations in the economy, and it appears that its results will continue to influence the business environment in 2012 as well.

Competitive environment

Domestic banks:

2011 continued the trend of increase in the level of competition in all segments of banking activity. The domestic banks continue to operate to recruit new customers and increase the level of activity, focusing strategic efforts on finding areas of profitability and future growth engines for developing technological tools for improving the customer experience and for enhancing in their operating efficiency. The intensified competition is reflected in an increase in banks' marketing expenses, a decline in margins and the giving of significant discounts in commissions. Furthermore, in the past three years, there has been a clear trend of growth in the number of branches that have been opened in the system, in comparison with previous years.

Non-banking competitors

- The non-banking credit market /financing by the capital market and institutional entities – the rate of financing of the corporate segment by the institutional bodies, for example: insurance companies, investment houses, provident funds etc. increased in the past against the background of regulation and competitive factors, but in recent years, it has remained stable. The status of the Israeli banks as sole financers of the companies has gradually weakened, and in most areas of activity in the corporate segment, the banks do not operate on an exclusive basis. 2011 saw an increasing trend in the volume of private loans extended to firms by institutional investors – the volume of private loans increased 2.5 times compared with 2010. In contrast, last year was characterized by several debt arrangements ""for debentures resulting from the inability of borrowers to repay their debt to lenders.

  Against the background of the increase in financing activities of the institution entities, regulatory supervision of these bodies is being tightened. In light of the crisis, the view that regulation should be broad-based and encompass all financial entities has gained strength. An example of the tightening of supervision is the "Hodak Committee" whose recommendations came into force in October 2010, restricting the institutional entities insofar as this affects the extension of credit through the purchase of corporate debentures. Also, the recommendations of the Concentration Committee published in February 2012 prescribed restrictions on the volume of credit extended by the institutional entities to a single borrower and a group of borrowers. These restrictions were detailed in the Supervision of Financial Services Regulations (Provident Funds) (Investment Rules Applicable to Institutional Entities) 2012, which were approved by the Knesset Financial Committee on 14 March 2012. Further examples of the tightening of supervision include the requirement to appoint a risk manager, corporate governance management, minimum capital requirements, etc. The increased supervision of institutional entities and the increased number of debt arrangements may restore some of the non-bank credit back to the banks.

- Capital market and brokerage activity – traditionally, the main competition in these areas of activity was on the part of investment houses and other management entities (provident funds, supplementary training funds, insurance etc.) Competition was focused both on institutional customers, on companies and business customers and on high net-worth/private banking customers. Recently, the banks have recently been reestablishing their status in the field in light of their ability to offer these customers an overall value proposition.

Increased regulation

The impact of regulation on the banking sector is intensifying and expanding in Israel and throughout the world. The financial crisis has further increased the power of the regulator and all the various aspects of supervision and has become a key element in the stabilization of the financial system.

As well as the local regulatory activities, the banks are also affected by global regulation. In 2011 the provisions of Basel III were published, further toughening the capital adequacy requirements and adding more requirements for maintenance of liquidity. Additional laws have been published affecting the international banking model. An example is the Foreign Account Tax Compliance Act (FATCA), which was enacted in the United States and which will require banks around the world, including those in Israel, to report on the accounts and assets of American customers.

Increased regulation creates material pressures in terms of costs, in addition to the management inputs required for careful preparation and compliance with directives. In addition, regulation has an impact on competition and growth of the banking system in Israel, as it imposes restrictions on the banks regarding the purchase of banks and financial entities.

Leumi's strategy

In order to realize Leumi's vision of being the leading bank in Israel in terms of risk-adjusted long-term profitability, and in accordance with the changes in the business environment, the Leumi Group set multi-year goals for increasing shareholder value through improved profitability, in both local and international activities. Improved profitability will be sought while managing the risk levels as reflected in the capital adequacy ratios and with the Group's risk management policy described below.

Although Leumi strives to adapt its activities to its strategy, and to achieve excellence in all of the areas described above, strategic planning, by its nature, involves a not insignificant amount of uncertainty. The achievement of the strategic plan depends on many variables, including: the state of the markets in Israel and abroad, especially in light of the financial crisis, the security situation and the ongoing effects of regulatory changes, the extent of whose effects in the long term cannot yet be definitely defined.

In order to ensure continued growth and profitability in the long-term, Leumi is focusing its strategic efforts and its resources – capital, human and managerial - on business areas that produce high yields and require relatively little capital, while taking steps to improve profitability in areas where such level is low. Additionally, Leumi is investing in building-up its abilities in order to ensure good results in the long-term.

Leumi's main strategic goals, as determined by the Board of Directors, are:

1. To position Leumi as at the forefront of retail banking in Israel, centering on increasing the market share in growth segments and small businesses, basing itself on an effective and focused operating model, consulting and selling, and on advanced and innovative technological infrastructures.

2. To expand the scope and range of Leumi's activities vis-à-vis institutional customers through the implementation of a focused management model which adapts their customers' unique needs and to develop cooperation in the areas of syndication, sale of credit and securitization.

3. To make significant improvements in the flexibility of human resource management, adapting its size to the needs of the organization and improving the efficiency of the IT, procurement, construction and maintenance systems.

4. To nurture the human resource in the Group through optimal personnel management and the assimilation of the values of excellence and transparency over the long term, adapted to the changing environment.

5. To strengthen Leumi's leading status in the middle market area by upgrading the overall and distinct value proposition through the development of advanced technological tools and infrastructures.

6. To improve profitability in the existing overseas subsidiaries, while increasing the focus on their activity, upgrading capabilities and applying streamlining programs.

7. To continue the upgrade of management, measurement and pricing ability of Group risk, furthering the development of advanced methods and models to ensure the Bank's preparedness

for challenges in the changing risk and regulatory environment, and stable profitability over the long term.

8. To exhaust the Group's synergy potential, while, at the same time, assimilating a company culture of cooperation, intensifying administrative focus and measurement, with the aim of ensuring much more flexibility in the ability to withstand changing situations.

9. To expand the dialogue between Leumi and its customers, to increase their satisfaction and develop the social awareness of the Bank and its employees.

10. To take steps in implementing the Group's non-banking investment policies in a way that will support the range of its revenue sources.

Group strategy is implemented in accordance with the risk appetite approved by the Board of Directors, alongside the use of advanced procedures and tools for managing the different types of risk, and the completion of preparations for regulatory requirements, including those of Basel II and Basel III.

For details of risk factors in Group activity, see page 211 below.

The above-mentioned Group objectives have been adapted to the lines of business in which Leumi operates and which are described below. Each business line specializes in a particular market segment with the aim of creating a relative advantage among its target markets.

Savings and efficiency

One of the pillars in Leumi Group's work program is the streamlining plan to be spread over the next three years (2012-2014), and its goals are to bring savings estimated at NIS 350-400 million per annum.

The plan includes:

a. An anticipated reduction in the workforce of 300 positions in 2012, and in total, around 800 positions by the end of 2014. The cutback in the number of employees is based on natural retirement and a reduction in the intake of new employees, made possible, *inter alia,* as a result of the "Advancing Together" project, which promotes the removal of Back Office activity from the branches to the centers of expertise.

b. An expectation of a reduction of some 10% of branch space by 2014, at the same time as advancing the "Advancing Together" project.

For further information regarding the "Advancing Together" project, see below on page 137.

c. A goal of a reduction in annual procurement expenses by some 10% in the coming two years as a result of an improvement in processes, the effective employment of areas and infrastructure, etc.

d. Restraint in routine expenditure in various areas of activity of Leumi Group.

The streamlining plan has been devised on the basis of existing data and could be changed as a result of changes in business environment and regulatory changes. In addition, as part of the 2012 work plan, it was decided to merge Leumi Mortgage Bank with the Bank.

For details, see page 193 below.

Part of the information in this chapter is "forward looking information". For the meaning of this term, see the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" on page 61 below.

Control of the Bank

The State of Israel became a shareholder of the Bank on 31 October 1993, under the Bank Shares Arrangement and the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (the "Bank Shares Law"). As determined in the Bank Shares Law, the transfer of the shares in the Bank to the State and the exercise of the rights by virtue of the shares under this Law do not require a permit under the Banking (Licensing) Law, 1981.

On 31 December 2011 and on 15 March 2012, the State held 6.028% of issued share capital and 6.46% of the voting rights in the Bank, as a result of the sale of 5% of the issued share capital and voting rights in the Bank by the State on 19 January 2011 (see "Sale of the Bank's Shares by the State" below) and the sale of 0.43% of the issued share capital and voting rights in the Bank by the State to Group employees on 17 May 2011 (see "Sale of Shares to Employees" below).

Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (hereinafter "the Bank Shares Law")

The Bank Shares Law authorized the Shares Committee of the Bank to use for and on behalf of the State the voting rights by virtue of the State's holdings in the Bank.

On 19 March 2012, the Banking Law (Legislative Amendments), 2012 was published in the Official Gazette (*Reshumot*). The law amends the Banking Law (Licensing), the Banking Ordinance, and clause 37 of the Securities Law, such that it regulates, *inter alia*, the proposal of directors, their appointments and their terms of office, in a banking corporation without a controlling core (hereinafter: "**the amendment**"). In light of the amendment, and in light of the finishing of the term of office of the Bank's Shares Committee on 23 March 2012, from 24 March 2012, the Bank is defined, according to the provisions of the law, as a bank without a controlling core. For further details regarding the amendment and the implications of the Bank being a bank without a controlling core, see page 49.

A brief description of the legal position which applied before the introduction of the amendment and before the Bank becomes a bank without a controlling core is as follows:

The Bank's last Shares Committee was appointed by virtue of the Bank Shares (Arrangement Shares) (Temporary Provision) Law (Appointment of Other Committees and Terms of Office, 2009 and as stated in the resolution of the Public Committee for Shares in the Arrangement. It completed its term of office on 23 March 2012.

On 24 May 2011, the Bank held its Annual Meeting, the agenda of which included the election of four directors to the Board of Directors of the Bank. Prior to 24 May 2011, all of the directors serving on the Board of Directors of the Bank were appointed in accordance with the Bank Shares Law, and all the serving directors were proposed to the general meetings of the Bank by the Bank's Shares Committee, and the committee voted for them by virtue of the State's shares in the Bank. At the meeting, two directors who had been proposed by Shlomo Eliahu Holdings Ltd. and two directors, who had been proposed at the Annual Meeting by the Bank's Shares Committee, were elected. The Supervisor of Banks confirmed that he had no obligation to the appointments as directors of all of the candidates elected at the meeting – see "Annual General Meeting and Election of Directors" below.

From this, it may be learned that, as long as over 50% of the directors of the Bank are appointed on the recommendation of the Appointments Committee, pursuant to the Bank Shares Law, the State of Israel held over 50% of one of the means of control of the Bank and in accordance with the presumption regarding the definition of control in the Securities Law, it held control of the Bank, subject to the restrictions determined by the Bank Shares Law. It should be noted that there is also another interpretation. To the best of the Bank's knowledge, none of the holders of the means of control had obtained a control permit. It should be further noted that Shlomo Eliahu Holdings holds 9.59% of the issued and paid share capital of the Bank and the State of Israel through M.I. Properties hold 6.03% of the issued and paid share capital of the Bank (see details below).

Sale of Shares in the Bank by the State

On 9 June 2010, the Minister of Finance requested the Knesset Finance Committee to approve the sale of up to 10.46% of the State's holdings in the Bank to financial entities for marketing to investors in Israel and abroad, as part of one or more competitive procedures ("block trade"). On 3 November 2010, the Finance Committee decided to approve the said request in principle, although any sale would be subject to the approval of the closed sub-committee of the Finance Committee. The said approval was in force for six months, with effect from 30 November 2010.

On 19 January 2011, the Bank was notified by the Ministry of Finance that the sale in a competitive procedure (off the stock exchange) of 73,677,561 ordinary shares of NIS 1.00 par value each (constituting 5% of the Bank's issued share capital) owned by the State to UBS Limited, for consideration of NIS 17.611 per share (aggregate proceeds of NIS 1,297.5 million). Following the sale, 95,179,941 ordinary shares of NIS 1.00 par value each of the Bank, constituting 6.46% of the Bank's issued share capital, remain in the hands of the State.

On 17 May 2011, the Bank was informed by the Finance Ministry of the completion of the off-stock exchange sale of 6,339,730 ordinary shares of NIS 1.00 par value each of the Bank (constituting 0.43% of the issued share capital of the Bank), owned by the State to the employees of the Bank Group, in consideration of NIS 13.3002797 per share (a total of NIS 84.3 million). In addition, on 30 May 2011, the Bank was informed by the Ministry of Finance that on 29 May 2011 of the completion of the off-stock exchange sale to the Chairman of the Board of Directors of the Bank of 9,442 ordinary shares of NIS 1.00 par value each of the Bank (constituting 0.0006% of the Bank's issued capital), in consideration of NIS 13.37813 per share (aggregate total of NIS 126.3 thousand), following the approval of the Annual General Meeting held on 24 May 2011. The sale of the shares to employees, as aforesaid, is subject to the provisions of the outline prospectus published by the Bank on 6 April 2011.

Following the abovementioned sales, 88,830,769 ordinary shares of NIS 1.00 par value each of the Bank, constituting 6.028% of the issued capital of the Bank, was still held by the State.

It should be noted that, pursuant to the provisions of the outline prospectus, during the blocked period of the shares and as long as the State's shareholding percentage in the Bank exceeds 5%, an irrevocable power of attorney is given to the State to vote by virtue of the shares sold as aforesaid, and to make use of the right to appoint directors by virtue of the shares.

Sale of Shares to Employees

In accordance with the agreements concerning the privatization of the Bank, and in accordance with agreements reached between the Accountant-General in the Finance Ministry and the employees of the Bank, , an outline prospectus was published on 6 April 2011 for the offer by the State of Israel of the Bank's shares to employees of the Bank, Arab-Israel Bank Ltd., Leumi Mortgage Bank Ltd., and the Restaurant Association of Employees of Bank Le-Israel B.M. (registered association) ("the participants", "the outline prospectus").

On 17 March 2011, the purchase was completed by the participants, in accordance with and subject to arrangements and conditions detailed in the outline prospectus, 6,339,730 shares held by the State of Israel representing 0.43% of the Bank's issued and paid-up share capital of the Bank, as at the date of publication of the outline prospectus. On 24 May 2011, the General Meeting of the Bank approved the offer of 9,442 shares to the Chairman of the Board of Directors of the Bank, and the grant of a loan by the Bank to purchase the shares. On 30 May 2011, the Bank was informed by the Ministry of Finance that on 29 May 2011, the sale of the shares to the Chairman of the Board of Directors was completed.

The price per share for purposes of the offer to participants according to the outline prospectus was NIS 13.20825 per share as at 19.1.2011, and this share price was linked to the Consumer Price Index using the "last known index" method, with the base index being the index for the month of December 2010, that was published on 14 January 2011.

The share price was NIS 13.3002797. (The price of the shares purchased by the Chairman of the Board of Directors was NIS 13.37813).

The allocation of shares to the participants and the determination of the number of shares offered to each participant were made relative to the salary serving as a basis for social provisions for those participants for the month of January 2011, in accordance with the terms of the outline prospectus. The Chairman of the Board (as mentioned above) and the President and CEO of the Bank are included in the participants.

The shares are blocked for a period of four years from the determining date (as defined in the outline prospectus) and are deposited with a trustee.

In addition, the Audit Committee and the Board of Directors approved the granting of loans to the participants for the purchase of the shares offered in the outline prospectus.

The value of the benefit to the employees and to the Chairman of the Board of Directors in respect of the aforesaid purchase, which was assessed by an external valuer, includes a number of components and amounted to some NIS 13 million. This amount was recorded as a salary expense at the value of the benefit on the date of the grant and this amount remains fixed. A benefit of NIS 13 million was recorded in a net capital reserve.

To finance the purchase of the shares, the Bank extended loans to the employees who elected to receive them, amounting to some NIS 43 million, with repayment in a single payment at the end of the blocked period of the shares. Loans amounting to NIS 12 million are linked to the Consumer Price Index, and bear interest at 1.55%, and loans amounting to NIS 31 million are unlinked based on the prime rate less 0.75%. The loans are not under non-recourse conditions. The amount of the loans was deducted from the Bank's capital.

Annual General Meeting and the Election of Directors

In accordance with the Bank's articles, at the Bank's Annual General Meeting, four directors retire, as follows: Miriam (Miri) Katz, Adv., Mr. Rami Avraham Guzman, Yaakov Mishal, Adv., and Mr. Zvi Koren.

On 24 May 2011, the Annual General Meeting of the Bank was held and the incumbent director, Miriam (Miri) Katz, Adv., was re-elected and Mr. David Avner and Mr. Amos Sapir were elected to serve as new directors of the Bank.

Ms. Zipora Samet was elected to serve as external director in the Bank, pursuant to the Companies Law, 1999, for a period of three years.

Ms. Samet and Mr. Sapir were proposed for election at the Annual General Meeting by Shlomo Eliahu Holdings Ltd. Mr. Avner and Ms. Katz were proposed for election at the Annual General Meeting by the Bank's Shares Committee.

The Supervisor of Banks has confirmed that he has no objection to the appointment as director of all of the candidates elected at the meeting. As a result, the term of office of Ms. Samet and Mr. Avner commenced on 25 July 2011, while the term of office of Mr. Sapir commenced on 31 October 2011, at the end of the cooling-off period which he is obliged to fulfill as an external director according to Proper Conduct of Banking Business Regulation 301.

Resolution of the Board of Directors of the Bank and the Special General Meeting

The Audit Committee of the Board of Directors, and thereafter, the Board of Directors of the Bank, at its meeting in September 2011, recommended to the General Meeting to amend the Bank's Regulations as set forth below and to revise and amend the letters of indemnity given by the Bank to the directors. In addition, the Audit Committee and the Board of Directors approved the granting of indemnification to all of the Bank's employees for expenses and/or payment to a victim of a breach pursuant to and subject to the provisions of the Streamlining of Enforcement Proceedings in the Securities Authority Law (Legislative Amendments), 2010 ("the Streamlining of Enforcement Proceedings Law").

On 30 October 2011, a special meeting of the Bank was held. The Special Meeting approved the following resolutions:

1. To amend Rule 143 of the Bank's Regulations regarding insurance, indemnification and exemption with the aim of enabling the bank to indemnify and/or insure officers in the Bank in accordance with the Streamlining of Enforcement Proceedings Law, according to the amended version, published by the Bank in an immediate report regarding the convening of and the general meeting on the distribution website of the Securities Authority (Magna) on 22 September 2011.

2. Pursuant to the resolution of the general meeting as set forth in item 1 of the agenda, to approve an amendment to the version of the letter of indemnification granted by the Bank to directors, according to which the obligation for advance indemnification will also be in respect of expenses and/or with regard to the payment to the victim of a breach according to, and subject to, the provisions of the Streamlining of Enforcement Proceedings Law, in the amended version published by the Bank in an immediate report regarding the convening of and the general meeting on the distribution website of the Securities Authority ("Magna") on 22 September 2011.

3. To approve additional revisions and amendments to the version of the indemnification letter granted by the Bank to directors including according to Amendment no. 14 of the Companies Law, 1999, and including a revision of the appendix of events, which, in the opinion of the audit committee and the Board of Directors, are expected in the light of the Bank's actual activity, and this, paying attention, to the changes and developments in the nature and scope of the legal risks applicable to the Bank and the Group, and all as set forth in the version of the amended indemnification letter published by the Bank in an immediate report regarding the convening of and the general meeting on the distribution website of the Securities Authority (Magna) on 22 September 2011.

Description of Operating Segments

The Bank in Israel is organized in five lines of business, operated though five divisions of the Bank, each headed by a member of the Management of the Bank. Each business line specializes in the provision of service to segments of customers with similar characteristics and needs. This specialization allows for the provision of a high level of professional service. In addition, there are a number of management units that provide various services to the business divisions.

The subsidiary companies in Israel and abroad have been assigned to the relevant business line within the Group according to the nature of their activities and the characteristics of their customers.

The following are details of the Bank’s five major lines of business:

Retail banking deals with private and small business customers. The aim of the retail banking is to provide a multi-channel, integrative customer experience, in the branch channel and in the direct channels (Leumi CALL, the Internet, cellular, electronic terminals, information booths and ATM's), supported on a modern, operational service model, adapted to customer requirements. The main strategic goals of retail banking are expanding the customer base in segments and areas of activity with potential and increasing levels of activity with customers through constant improvement of the level of service and the adaptation of value proposals to the needs of the customer in accordance with his way of life.

Commercial banking deals with middle-market business customers and their interested parties. The strategic goal of commercial banking is to continue to strengthen its leading position by means of expanding the volume and range of activities with existing customers and by recruiting new customers, whilst providing comprehensive solutions for its customers operating in Israel and abroad.

Corporate banking deals with the segment of large business customers and the multi-national corporations, including entrepreneurial and contract companies involved in large projects in the area of real estate and infrastructure and the support of projects in a C/L format of any size, which are handled within the framework of the real estate and construction industry. Among those managed in the corporate division are customers whose business activity is complex, whose business is all-embracing and/or whose activity is managed in several of the Bank's overseas subsidiaries. Its strategic goal is to continue to be a leading financial center in the economy, providing a variety of financial solutions and associated services to the major corporations in the economy. The objectives of corporate banking are to provide the entire spectrum of customers with all required financial services, while involving the various units in the Leumi Group, in Israel and abroad, as necessary, so as to increase the variety of products and services offered to customers.

Private and international banking is responsible for the banking activity of the Group abroad and the management of private banking dealing with wealthy private clients in Israel and worldwide. Activities are carried out through specialist centers in Israel that are designated for foreign and Israeli residents and also through the Bank's subsidiaries in the USA, the UK, Switzerland, Luxembourg, Romania, Uruguay and Jersey and the representative offices in Europe, Latin America, Canada, Hong Kong and Australia. The strategic goal is to expand the customer base and to enlarge the scope of activities of customers of the sector, in Israel and overseas, primarily by providing high quality professional service based on specialist service centers, having a competitive advantage in the professionalism of their employees and their products, which are adapted to the customers' requirements. The Bank's foreign subsidiaries and representative offices operate by virtue of permits of the Banking Supervision Department in the Bank of Israel, and are also subject to local regulation in their own country.

Capital markets banking and financial management deals with the management of the Bank’s nostro and the operation of all the Bank’s dealing rooms for the purpose of securities trading and brokerage activities in foreign currency, interest rates, derivatives and securities. Financial management includes the development of financial and investment products, management of market risks, and the Bank's assets and liabilities management (ALM). The division also manages the relationships with overseas financial institutions and is responsible for providing services to customers active in the capital and money markets, including institutional customers.

Principal Operating Segments

Pursuant to Bank of Israel directives, an operational segment is a component which has three characteristics:

1. It engages in business activities from which it is likely to produce income and bear expenses (including income and expenses from transactions with other segments at the Bank);

2. Its operating results are regularly examined by the Management and the Board of Directors in order to make decisions relating to the allocation of resources to the segment and the appraisal of its performance;

3. There is separate financial information with regard to the segment.

The principal operating segments that have been determined under the directives of the Bank of Israel in accordance with the said characteristics are as follows:

1. Households	-	providing comprehensive banking services to households and private customers, at every stage of life.
2. Small Businesses	-	providing banking services to small businesses and local authorities.
3. Corporate Banking	-	providing banking and financial services to the major and international companies for their operations in Israel and abroad.
4. Commercial Banking	-	providing banking and financial services to the middle market companies and their interested parties.

5. Private Banking	-	providing local and global financial services and solutions to private customers resident in Israel and abroad with large financial asset portfolios.
6. Financial Management and Capital Markets	-	the nostro activities and dealing rooms, the provision of services to institutional clients and foreign financial institutions, including the operating results of investments in (non-banking) companies included on equity basis and investment in shares in the available-for-sale portfolio.
7. Others	-	activities not assigned to other segments. This includes other activities of the Group, none of which constitutes a profit center according to the directives of the Supervisor of Banks.

Segmented operations also include inter-segment activity, such as services that are provided to customers of another segment and also activities (derived from products) such as mortgages, credit cards and capital market services.

For further details, see page 134 below and Note 28 to the Financial Statements.

The criteria for the attribution of customers according to the operating segments at the Bank in Israel are generally as follows:

A. Business Customers:

Division/Segment	Scope of Obligo	Business Turnover of Borrower
Corporate	above NIS 120 million*	above NIS 400 million
Commercial	above NIS 10 million and up to NIS 120 million (inclusive)*	above NIS 20 million and up to NIS 400 million
Small businesses	up to NIS 10 million (inclusive)	up to NIS 20 million

(*) The corporate division will also deal with customers with an obligo of more than NIS 80 million, where they have an overall obligo in the banking system exceeding NIS 250 million.

B. Private Customers:

Division/Segment	Israeli Residents	Overseas Residents
	Financial wealth	
Private Banking	above NIS 5 million	above US$ 0.5 million
Households	up to NIS 5 million	up to US$ 0.5 million
Commercial	up to NIS 5 million	up to US$ 0.5 million

It should be noted that attribution to a specific operational segment is sometimes carried out in accordance with additional criteria to those indicated above – e.g. the size of the obligo with regard to business customers, and financial wealth, in connection with private customers. Criteria such as the nature of a corporation's business operations and the scope of its business, such as activity volumes, international trade volumes, complex and special transactions, complex projects and construction financing, can change the segmental attribution of a certain customer.

As stated above, the Bank is organized according to lines of business, and its policy is to attribute customers – to the extent possible – to the appropriate business line/operational segment, according to the customers' characteristics and activities. Nevertheless, it should be noted that segmental attribution is determined according to the sector in which the customer's account is actually operated, and so long as segmentation has not been carried out among the segments – i.e., so long as the customer does not receive service from the segment to which the customer should be attributed according to the above criteria, the segmental classification does not change, and the financial respects in respect of the customer are recorded in the segment in which the customer's account actually operates.

C. Banking Subsidiaries have been attributed to the operating segments as follows:

- The Arab Israel Bank Ltd. – to households, to small businesses, to commercial banking and to financial management.
- Leumi Mortgage Bank Ltd. – to households and small businesses. In January 2012, Leumi's Board of Directors approved the management's intention to incorporate Bank Leumi Mortgage Bank Ltd, which until now was a wholly-owned subsidiary.
- Leumi USA – to commercial banking, to private banking and to financial management.
- Leumi Switzerland and Luxembourg – to private banking.
- Leumi UK – to households, to commercial banking, to corporate banking and to private banking.
- Leumi Romania – to households, to small businesses, to commercial banking and to private banking.

The segment data provided here, on a consolidated basis, is the result of a summarization of the segments based on the segment definitions within each of the Group's organizations, which are not identical in terms of size. In terms of materiality, the Bank generally constitutes some 80% of each segment.

Financial Measurement System

The attribution of income and expenses by activity segment in the Bank is obtained as follows:

Profit according to lines of business and additional classifications

Objectives of the system:

- measuring the profitability of the various profit centers;
- measuring the business activity volume of the various profit centers according to various classifications;
- measuring performance against the goals in the work plan;
- uniformity in analyzing the business activity;
- overall control of the business activity and the profitability from such activity;
- directing the branches and other business units to achieve the Bank's targets, including profitability targets;
- to provide a tool for allocating the Bank's resources in a rational manner, on the basis of cost-benefit analysis;
- to provide a basis for appraisal and remuneration.

The basis of the Bank's existing system ("the Bahan system") is the "data warehouse" that centralizes all the Bank's transactions and, with the assistance of an appropriate index, enables transactions to be sorted and classified between the various profit centers.

The data presented below regarding operating segments includes the Bank's data according to the principles of the "Bahan" system as explained below, while the segmented data of the subsidiaries in Israel and abroad has been taken from their financial statements, and as defined by them.

In measuring the profitability of overseas subsidiaries, the exchange rate differentials after the effect of taxes arising from financing the investment in overseas subsidiaries, are allocated to the net interest income of the overseas subsidiaries.

Net Interest Income:

The profit center is credited with the interest received from the loans that it granted or is debited with the interest that is paid on deposits it raised.

At the same time, the profit center granting the loan is debited, and the profit center receiving the deposit is credited with transfer prices. The transfer prices are usually determined according to market prices following certain adjustments and generally reflect risk-free returns or the marginal costs of raising funds with the same linkage sector and currency and for a similar term. The effects arising from exchange rate differentials between the shekel/foreign currencies, including adjustments from translating data of overseas subsidiaries, and also changes in the CPI on surplus uses and/or sources are attributed in the Group to the financial management segment. With the method described above, the profit centers bear credit risks but do not bear market risks.

The profit and loss statements of each of the segments also take into account the capital allocated to the segment. Every profit center is credited on the Tier 1 capital that was allocated to it in respect of the risk assets in accordance with risk-free yield and is charged in respect of the additional cost of the Tier 2 capital. In this way, the available capital attributed to the segment is credited with interest equal to the marginal cost of raising funds in accordance with the segment that it is financing, or invested in the capital market.

The income from the management of the nostro is reflected in the financial management and capital markets segment.

Expenses in respect of credit losses are charged to the profit center in which the customer's account is managed. The same applies to the collective allowance required pursuant to the directives of the Bank of Israel.

Operating Income

All the operating income (commissions and other operating income), which the Bank charges its customers and/or subsidiaries in respect of various services, is credited to the profit center in which the customer's account is managed. Income from nostro securities, profits of the severance reserve and dividends that the Bank receives are credited to the financial management and capital market profit center.

Expenses

Expenses are attributed to the lines of business (division of the Bank) according to the segmental association of the customers dealt with in those lines of business.

In a minority of cases in which a line of business operates in several operational segments, expenses of lines of business are attributed to relevant segments and products on the basis of the multi-dimensional pricing of transactions.

Pricing is a system in which the cost of the transaction is calculated taking into account the type of transaction, the type of customer making it and the channel in which the transaction is executed.

Expenses that are not connected with the direct activities of the profit center (operational segment), such as expenses in connection with the actuarial pension liability, are not charged to the profit centers, but are reflected in the financial management segment.

For further details regarding operating segments, see page 134 below and Note 28 to the Financial Statements.

Measuring the return on capital

As part of the intensification of measurement of the performance of units and its adjustment to the unique risk characteristics for each unit, measurement is made of the rate of return on risk-adjusted capital (RORAC) of operational segments and their contribution to the Group's profit (economic value added - EVA), taking into account the cost of capital according to the multi-year return approved by the Board of Directors. The allocation of capital to risk components among the segments was done in accordance with the various risk characteristics inherent in each segment, in accordance with Basel II.

From 2010, the allocation of First Pillar capital (in respect of credit, market and operational risks) is according to Basel II – the standardized - credit risks - approach on the basis of weighted risk assets in the units, market risks and operating risks (from 31 December 2011) according to the standardized measurement method.

Second Pillar Capital is allocated to the units divided into its various components according to models designed by the Bank.

The profit of the operational segments is adjusted for the risk capital in each segment. The risk-adjusted return adjusted was calculated as a ratio of the adjusted profit to the average shareholders' equity allocated to the sector, which constitutes a part of the risk capital allocated (First Pillar capital, Second Pillar capital and the balance of the capital in respect of extreme scenarios and retained earnings).

For each segment, the profit is calculated, taking into account the cost of Tier 1 and Tier 2 risk capital allocated to each segment. At the Group level, the value added for the shares (EVA) is the net profit, calculated as aforesaid, less the cost of the shareholders' equity, according to the required long-term return over the shareholders' equity, as determined by the Board of Directors.

Evaluating the performance of the units

The BSC (Balanced Score Card) is a management tool for managing the performance of the Bank and its lines of business in a variety of quantitative and qualitative matters which Bank management determined to be matters under focus in the framework of Leumi's strategic program.

Among other things, the following is measured within the BSC framework: finance and risk management (targets such as return-adjusted return, savings and efficiency and capital management), customer satisfaction, processes, capabilities and infrastructure.

The list of targets measured in the BSC framework and the weighting of each target are updated annually in accordance with emphases determined by Bank management in the framework of discussions of the work plan. Targets for the lines of business of the Bank are derived from the targets measured at Bank level.

In the context of the focus on the subject of savings and efficiency which was implemented in 2012, the measurement of relevant targets for this subject in the BSC was enhanced.

This system is discussed every year by the Board of Directors and receives its approval as it is, *inter alia*, a basis for evaluation and remuneration.

Capital Resources and Capital Adequacy

Shareholders' Equity of the Group at 31 December 2011 amounted to NIS 23,374 million, compared with NIS 23,293 million at the end of 2010, an increase of 0.3%. Comparative figures for shareholders' equity have been restated following the directive of the Supervisor of Banks to banking corporations to make an allowance in respect of "employees who are expected to leave and the benefits they are expected receive in excess of contractual conditions", see below page 66 and Note 1s.2. The increase in shareholders' equity mainly derives from the profit for the year, which was partly offset by the impact of the change in respect of the initial transition to the method for calculating allowances for credit losses according to the regulations of the Supervisor of Banks, which are based in United States Financial Accounting Standard FAS 114 (the effect amounted to NIS 721 million, net after tax), from the distribution of a dividend in the first half of the year and a fall in the value of available-for-sale securities portfolio.

The securities portfolio (nostro) mainly holds debentures of governments, banks and foreign financial institutions, which generally represent the use of raised sources and the available capital. The majority of the securities portfolio is classified as available-for-sale securities and is included in the balance sheet on the basis of fair value. The income is recorded in the profit and loss statement on the accrual basis, and the difference between the value on an accrual basis with regard to debentures and on a cost basis with regard to shares and the fair value is recorded in a separate item in shareholders' equity, following the deduction of the effect of related taxes.

The total net accrued balance of adjustments in respect of securities held in the available-for-sale portfolio at fair value as of 31 December 2011 amounted to a negative sum of NIS 218 million (after the effect of tax), compared with a positive summary of NIS 468 million (after tax) as at 31 December 2010.

According to the rules for computing capital adequacy – Basel II, the balance in respect of the adjustment of securities to fair value is taken into account in the computation of capital for the purposes of the capital-to-risk components ratio.

In 2011, a fall in the value of the securities available-for-sale portfolio of NIS 686 million, net, was recorded in shareholders' equity, compared with a decrease in value amounting to NIS 159 million in 2010 (all of the amounts are net after the effect of related taxes).

Structure of components of capital for purposes of calculating the capital ratio – (Table 2 Basel II):

	31 December 2011	31 December 2010
	NIS million	
Tier 1 capital:		
Share capital	**7,059**	7,059
Premium	**1,129**	1,129
Retained earnings	**15,406**	15,063*
Capital reserves from share-based payment transactions and other funds	**50**	35
Adjustments from translation of financial statements of companies included on equity basis	**(21)**	(460)
Loans to employees for the purchase of shares of the Bank	**(31)**	(1)
Non-controlling interests	**254**	318
Amounts deducted from Tier 1, including goodwill, investments and other intangible assets	**(403)**	(246)
Unrealized et losses from adjustments to fair value of available-for-sale securities	**(218)**	-
Total Tier 1 capital	**23,225**	22,897
Tier 2 capital:		
45% of the amount of net profits, before the effect of relevant tax in respect of adjustments to fair value of available-for-sale securities	**-**	314
General provision for doubtful debts	**428**	428
Innovative and non-innovative hybrid capital instruments	**6,012**	5,911
Subordinated notes	**11,646**	11,217
Amounts from Tier 2 capital	**(66)**	(154)
Total Tier 2 capital	**18,020**	17,716
Total capital base for purposes of capital adequacy	**41,245**	40,613

*Restated pursuant to the directive of the Supervisor of Banks, see below Note 1s.2.
For further details see Note 13c to the financial statements.

In accordance with Basel II directives, the elements of capital in the Bank for the purposes of calculating capital adequacy are divided into two tiers, Tier 1 capital and Tier 2 capital (according to Basel I "primary capital" and "secondary capital" respectively). The total of these tiers is called "the capital base for purposes of calculating capital adequacy".

The main characteristics of Tier 1 capital are as follows:

Tier 1 capital includes share capital, accumulated reserves, premium, capital reserve in respect of share-based payment transactions and others, other funds in respect of companies included on equity basis, adjustments from translation of autonomous investee companies abroad, less loans to employees for the purchase of the shares of the Bank, with the addition of rights not conferring control of capital (minority interests) and less goodwill, intangible and other assets and unrealized net losses (after tax) in respect of adjustments to fair value of available-for-sale securities. Tier 1 capital can include hybrid capital instruments. There are no hybrid capital instruments in this Tier in the Leumi Group.

Tier 1 capital without hybrid capital instruments – hereinafter: "core capital".

The main characteristics of Tier 2 capital are as follows:

Tier 2 capital includes 45% of the amount of unrealized profits, net (after the effect of tax) in respect of adjustments to fair value of securities available-for sale, general provision for doubtful debts, hybrid capital instruments (Upper Tier 2 capital) up to 100% of Tier 1 capital and subordinated notes up to the level of 50% of total Tier 1 capital (Lower Tier 2 capital). Total Tier 2 capital (upper and lower) is limited to 100% of Tier 1 capital.

Capital instruments included in Upper Tier 2

- Non-innovative hybrid capital instruments: subordinated capital notes issued for a period of at least 49 years. The issuer (only) can make an early redemption after 5 years provided that it will be replaced by an instrument of the same or higher quality. The capital instruments will be issued by Leumi or by means of issues by Leumi Finance.
- Innovative hybrid capital instruments: capital notes which meet the definition of non-innovative hybrid capital instruments and in addition include a step-up mechanism, which represents a stimulus for early redemption. A step-up mechanism which determines the rate of increase of interest to investors will be used only once, after at least 10 years from the date of issue.

Capital instruments included in Lower Tier 2

- Subordinated notes will be issued for a term of at least 5 years. Leumi raises subordinated notes directly, or by means of issues by Leumi Finance and/or LII. The rights of the subordinated notes are subordinated to other creditors except for holders of Upper Tier 2 and Tier 1 capital instruments. In addition, Lower Tier 2 also includes non-negotiable subordinated deposits.

As well as that stated above, investments in unconsolidated banking and financial subsidiaries are deducted from both capital tiers and also deductions connected with securitization exposures.

Shareholders' equity relative to total assets at 31 December 2011 reached 6.4% in comparison with 7.1% at 31 December 2010.

Capital adequacy structure

Equity to risk components ratio on 31 December 2011 was as follows:

According to Basel II - Pillar 1, the ratio of total equity to risk assets is 14.34% (compared to 14.96% at the end of 2010); the ratio of core capital to risk assets is 8.07% (compared to 8.43% at the end of 2010). The 2010 data has been restated pursuant to the directive of the Supervisor of Banks, see below Note 1s.2.

In addition to capital required for Pillar 1, there is a requirement under Pillar 2 of Basel II to keep "capital buffers" in respect of additional risks not taken into account in the framework of Pillar 1. "Capital buffers" provide a response to risks such as: large borrower concentrations, group borrowers, sectoral concentrations, country risk and various market risks. In addition, it is required that the overall capital adequacy ratio be higher than 9% on the materialization of a stress scenario.

The overall capital ratio of Leumi is higher than the minimal rate of 9% (according to Basel I and also according to Basel II) as determined by the Supervisor of Banks. In addition, the core capital ratio is higher than the minimum rate of 7.5% which was prescribed in the interim period by the Supervisor of Banks.

The capital adequacy ratios of Leumi in future years will be adjusted to long-term targets in accordance with the draft "Basel III framework – minimum core capital ratios," published by the Supervisor of Banks on 14 March 2012. For details see page 32 below.

Capital adequacy - (Table 3 Basel II):

Risk assets and capital requirements in respect of credit risk deriving from exposures to:	31 December 2011 Risk assets	Capital requirements (3)	31 December 2010 Risk assets	Capital requirements (3)
	NIS million		NIS million	
Sovereign risk	**855**	**77**	798	72
Debts of public sector entities	**1,859**	**167**	1,874	169
Debts of banking corporations	**5,130**	**462**	6,384	575
Debts of corporations	**158,015**	**14,221**	143,939	12,955
Debts collateralized by commercial real estate	**19,002**	**1,710**	18,800	1,692
Retail exposures to individuals	**21,893**	**1,970**	21,707	1,954
Loans to small business	**9,716**	**874**	9,499	855
Housing loans	**29,831**	**2,685**	25,830	2,325
Securitization	**271**	**24**	267	24
Other assets (5)	**12,029**	**1,083**	10,802	972
Total in respect of credit risk (1) (5)	**258,601**	**23,273**	239,900	21,593
Risk assets and capital requirements in respect of market risk (1)	**9,011**	**811**	10,653	959
Risk assets and capital requirements in respect of operational risk (2)	**20,095**	**1,809**	20,904	1,881
Total risk assets and capital requirements (4) (5)	**287,707**	**25,893**	271,457	24,433
Total capital base for capital adequacy (5)	**41,245**		40,613	
Total capital ratio (5)	**14.34%**		14.96%	
Tier 1 capital ratio (5)	**8.07%**		8.43%	

(1) According to the standardized approach in respect of the First Pillar.

(2) The standardized approach. (December 2010 data according to the basic indicator approach).

(3) Calculated according to the 9% minimum requirement, and does not include the capital buffers in respect of the Second Pillar and stress scenarios.

(4) Additional capital buffers have been calculated in respect of the Second Pillar

(5) Figures for 31 December 2010 have been restated pursuant to the directive of the Supervisor of Banks, see below Note 1s.2.

Below is the capital adequacy ratio on consolidated basis and for principal subsidiaries according to Basel II:

	31 December 2011	31 December 2010
Leumi – on consolidated basis (2)	**14.34**	14.96
Leumi Mortgage Bank (2)	**12.88**	13.92
Arab Israel Bank (2)	**15.60**	14.61
Leumi Card	**14.80**	14.40
Bank Leumi U.S.A. (1)	**13.26**	13.58
Bank Leumi UK	**13.87**	11.25
Bank Leumi Switzerland	**31.82**	25.00

(1) Not required to be reported under Basel II principles, and the figures are according to United States regulations.
(2) Figures for 31 December 2010 have been restated pursuant to the directive of the Supervisor of Banks, see below Note 1s.2.

For further details in connection with capital components, risk assets and the capital ratio of significant banking subsidiaries see Note 13C to the Financial Statements.

Pursuant to the directive of the Supervisor of Banks, the overall capital ratio will not be less than 8% in respect of Pillar I and 1% in respect of Pillar II, a total minimal capital ratio of 9%. The capital requirement is calculated at the rate of 9% of total weighted risk assets.

However, the Supervisor of Banks expects that as a result of the Internal Capital Adequacy Assessment Process (ICAAP) in the framework of the second pillar of Basel II, each bank will determine internally the total "risk capital" required in respect of this pillar and for the purposes of withstanding stress scenarios. The Bank has acted accordingly and forwarded the data to the Bank of Israel in 2011. The revised data for this year are currently being prepared and the report will be submitted to the Bank of Israel as required in April 2012.

For purposes of calculating the risk bearing ability, an analysis is made of the coverage of risks.

a. First Pillar – calculated at 8% of the total risk assets.

b. Second Pillar -"capital buffers" are calculated in respect of risks that are not included in the context of the First Pillar, such as: large borrower concentrations, group borrowers, sectoral concentrations, country risk, and various market risks, as well as capital buffers in respect of risks including in the First Pillar but in respect of which expansion is required.

The results of the calculations according to the aforesaid indicate a higher capital adequacy than that required by the Supervisor of Banks.

Risk assets are calculated in the Leumi Group under the first pillar in the Basel II directives, which includes credit risks, market risks and operational risks. Risk assets in respect of credit are calculated according to the standardized approach. Market risk is calculated according to the standardized approach. With effect from December 2011, operational risk is calculated according to the standardized approach.

Capital planning in the Leumi Group reflects a forward-looking view of risk appetite and the capital adequacy required as a consequence of this. Risk factors are further checked under strict assumptions of stress tests.

Capital planning includes, *inter alia*, consideration of the risk appetite of the Group, desired capital structure and the dividend allocation policy.

Capital Adequacy Target

Group policy, approved by the Board of Directors, is to hold a level of capital adequacy higher than the threshold determined from time to time by the Bank of Israel, and generally higher in relation to the banking system in Israel and in similar relation to the average in OECD countries in the long term.

Group policy, which expresses its risk appetite, in accordance with that mentioned above, has, until now, included long-term targets of total capital ratio of 14.0%-14.5% and a core capital ratio at a rate of 8.0%-8.5%.

In a circular dated 30 June 2010, the Supervisor of Banks announced that the banks were obliged to adopt capital policies for an interim period including a target for a core capital ratio (Tier 1 capital excluding hybrid capital instruments). The target rate set should not be less than 7.5%.

On 14 March 2012, the Supervisor of Banks sent a draft directive to all banking corporations regarding his intention to fix a higher minimum core capital ratio than that currently required. According to this draft, all of the banking corporations will be required to comply with a minimum core capital ratio of 9%, until 1 January 2015.

In addition, a large banking corporation, whose total balance sheet assets on a consolidated basis represents at least 20% of the balance sheet assets in the Israeli banking system, will be required to comply with a minimum core capital ratio of 10%, until 1 January 2017. The Bank is subject to this latter regulation.

The core capital ratio is supposed to be calculated according to the Basel III regulations and adjustments stipulated by the Supervisor of Banks.

The Bank is studying the expected requirements of the Supervisor of Banks as included in this draft directive and it intends to make the requisite preparations in order to comply with the requirements that are prescribed.

The Bank's core capital ratio as at 31 December 2011 was 8.07%.

Further information regarding Basel III, see page 215 below.

In addition, targets that the Group wishes to fulfill in the event of a stress scenario have been defined:

1. First Pillar capital adequacy ratio should not be less than 6.0% at all stages of materialization of the scenario.

2. Overall capital adequacy ratio should not be less than 9.0% at all stages of materialization of the scenario. The capital base will be higher than the required risk capital (First Pillar + Second Pillar) at all stages of materialization of the scenario.

The above capital adequacy policy refers to future activities of the Bank, and is defined as "forward-looking information". For the meaning of this term, see the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report on page 61.

Issue of Subordinated Capital Notes and Subordinated Notes

On 16 May 2011, in accordance with a permit received from the Israel Securities Authority, Leumi Finance published a shelf prospectus allowing it to issue up to 9 series of Debentures (Series 179 to 187) and up to 11 series of Subordinated Notes (series N to X), Each of them at a nominal value of up to NIS 4 billion. In addition, the shelf prospectus allows the issue of NIS 2,950,000,000 par value of Subordinated Notes (Series M) and NIS 3,350,000,000 nominal value of Subordinated Notes (Series L) as part of an expansion of marketable series, initially issued through a shelf offer report dated 14 September 2010. The shelf prospectus dated 16 May 2011 is for two years from the date of its publication.

Pursuant to a shelf offer report dated 7 September 2011, Leumi Finance issued a total of NIS 1.4 billion Subordinated Notes in an expansion of Series L and M, as follows:

Expansion of Series L Subordinated Notes in the amount of NIS 1,142,941,000 nominal value (aggregate proceeds of NIS 1,144,083,941), repayable in one amount on 10 September 2017, principal and interest linked to the Consumer Price Index for July 2010, bearing annual interest at the rate of 2.6% per annum, which will be paid on 10 September in each of the years 2012 to 2017 (inclusive).

Expansion of Series M Subordinated Notes in the amount of NIS 276,039,000 nominal value (aggregate proceeds of NIS 275,486,922), repayable in one amount on 10 September 2017, unlinked (principal and interest) to any index, bearing annual interest at the rate of 5.4% per annum, which will be paid on 10 September in each of the years 2012 to 2017 (inclusive).

The Subordinated Notes have been approved by the Bank of Israel as Lower Tier 2.

According to a shelf offer report dated 9 November 2011, Leumi Finance issued a total of NIS 2 billion Subordinated Notes in an expansion of Series L and the issue of Series N as follows:

Expansion of Series L Subordinated Notes in the amount of NIS 1,078,669,000 nominal value (aggregate proceeds of NIS 1,105,635,725).

For further information in respect of Series L subordinated notes, see above.

Series N Subordinated Notes in the amount of NIS 860,745,000 nominal value, repayable in one amount on 9 November 2020, linked (principal and interest) to the Consumer Price Index for September 2011, bearing annual interest at the rate of 3.4% per annum, which will be paid on 10 November in each of the years 2012 to 2020 (inclusive).

The Subordinated Notes have been approved by the Bank of Israel as Lower Tier 2.

After the balance sheet date:

According to a shelf offer report dated 26 January 2012, Leumi Finance issued a total of NIS 2.3 billion Subordinated Notes in an expansion of Series M and an expansion of Series N, as follows:

Expansion of Series M Subordinated Notes in the amount of NIS 1,280,000,000 nominal value (aggregate proceeds of NIS 1,324,800,000).

For further information in respect of Series M subordinated notes, see above.

Expansion of Series N Subordinated Notes in the amount of NIS 1,010,000,000 nominal value (aggregate proceeds of NIS 1,021,110,000).

For further information in respect of Series N subordinated notes, see above.

The Subordinated Notes have been approved by the Bank of Israel as Lower Tier 2.

Distribution of Dividends

A. Dividend for 2010

Further to the recommendations of the Board of Directors of the Bank, and the approval of the General Meeting, the Bank distributed a cash dividend in 2010 amounting to NIS 1.4 billion. The dividend was paid in the following amounts and on the following dates: NIS 500 million in November 2010, NIS 500 million in January 2011 and NIS 400 million in June 2011.

B. Following are details of cash dividends declared and/or paid in the Group*:

**	**2011**	2010	2009
1. Bank Leumi le-Israel B.M. - in NIS millions	**-**	1,400.0	-
2. The Arab Israel Bank Ltd. - in NIS millions	**-**	60.0	80.0
3. Leumi Card – in NIS millions	**40.0**	10.0	-
4. Various companies - in NIS millions	**119.2**	59.6	12.8
5. Leumi Switzerland – in CHF millions	**70.0**	-	-
6. Leumi Re – in US$ millions	**5.0**	5.2	-
7. Bank Leumi Luxinvest – in US$ millions	**-**	18.6	-
8. Israel Corporation Ltd. – in NIS millions	**43.3**	-	-

* The Group's share in the dividend, as set out in Note 6 to the Financial Statements, relates to the reporting year in respect of which the dividend was declared and not necessarily to the year of payment.

** The dividend for the fiscal year.

Principal Data of Leumi Group

	2011	2010	2009	2008	2007
Income, expenses and profits (in NIS millions):					
Net interest income before expenses in respect of credit losses (f)	**7,550**	7,433	7,023	6,380	7,648
Expenses in respect of credit losses (f)	**734**	584	1,517	2,145	407
Total operating and other income	**3,736**	4,111	4,563	2,800	4,222
Total operating and other expenses (e)	**8,347**	7,951	6,781	7,003	6,937
Of which: costs of privatization (issue of shares and options to employees)	**13**	(22)	41	(66)	250
Operating profit before taxes (e)	**2,205**	3,009	3,288	32	4,526
Net operating profit (loss) attributable to shareholders of the banking corporation (e)	**1,889**	2,151	2,061	(158)	2,984
Profit from extraordinary items after tax before attribution to non-controlling interests	**2**	183	28	250	373
Net profit attributable to shareholders of the banking corporation (e)	**1,891**	2,334	2,089	92	3,357
Net operating profit (loss) per share attributable to shareholders of the banking corporation (in NIS)	**1.28**	1.46	1.40	(0.11)	2.11
Net profit per share attributable to shareholders of the banking corporation (in NIS)	**1.28**	1.58	1.42	0.06	2.37
Dividends paid (in respect of the reported year)	**-**	1,400	-	-	1,684
Assets and liabilities at end of period (NIS millions):					
Total assets (total balance sheet)	**365,854**	328,322	321,910	311,008	302,151
Credit to the public, net	**241,320**	223,981	204,669	213,215	198,557
Securities	**47,936**	55,791	57,505	44,910	47,169
Deposits of the public	**279,404**	249,584	250,418	244,783	238,045
Debentures, notes, and subordinated notes	**29,999**	26,939	25,261	20,636	19,248
Shareholders' equity attributable to shareholders of the banking corporation	**23,374**	23,293	21,532	18,267	19,549
Major financial ratios in annual terms (in %):					
Credit to the public, net, to total balance sheet	**66.0**	68.2	63.6	68.6	65.7
Securities to total balance sheet	**13.1**	17.0	17.9	14.4	15.6
Deposits of the public to total balance sheet	**76.4**	76.0	77.8	78.7	78.8
Deposits of the public to credit to the public	**115.8**	111.4	122.4	114.8	119.9
Total shareholders' equity to risk assets according to Basel II (a) (c)	**14.34**	14.96	13.90	11.34	11.52
Tier I capital to risk assets according to Basel II (c)	**8.07**	8.43	8.20	7.35	7.55
Shareholders' equity (excluding minority interest) to total balance sheet	**6.4**	7.1	6.7	5.9	6.5
Net profit to average shareholders' equity (excluding minority interest) (c)	**8.3**	10.3	10.8	0.5	17.4
Net operating profit (loss) to average shareholders' equity (excluding minority interest)	**8.3**	9.5	10.6	(0.8)	15.4
Rate of provision for tax on the operating profit	**19.0**	41.2	38.7	-	38.0
Expenses in respect of credit losses to credit to the public	**0.30**	0.26	0.74	1.01	0.20
Expenses in respect of credit losses to total risk of credit to the public	**0.20**	0.17	0.48	0.67	0.13
Net interest income before allowance for doubtful debts to total balance sheet	**2.06**	2.26	2.18	2.05	2.53
Total income to total assets (b)	**3.08**	3.52	3.60	2.95	3.93
Total income to total assets managed by the Group (b) (d)	**1.26**	1.30	1.48	1.41	1.55
Total operating and other expenses to total assets (e)	**2.28**	2.42	2.11	2.25	2.30
Total expenses to total assets managed by the Group (d) (e)	**0.93**	0.89	0.87	1.08	0.91
Net profit to total average assets (e)	**0.56**	0.72	0.63	0.03	1.13
Net operating profit (loss) to total average assets (e)	**0.56**	0.67	0.57	(0.05)	1.01
Financial margin including income and expenses from derivative financial instruments	**1.00**	1.22	1.10	1.63	1.71
Operating expenses (excluding voluntary retirement) to total income (b) (e)	**74.0**	68.9	58.5	76.3	58.4
Operating and other income to operating and other expenses (e)	**44.8**	51.7	67.3	40.0	60.9
Operating and other income from total income (b)	**33.1**	35.6	39.4	30.5	35.6

(a) Shareholders' equity – after adding the interests of minority shareholders and after deducting investments in the equity of companies included on equity basis and various adjustments.
(b) Total income – net interest income before expenses in respect of credit losses and after adding operating and other income.
(c) The data for 2006-2008 are according to Basel I.
(d) Including off-balance sheet activity.
(e) Restatement of data for 2009-2010
(f) As of 1 January 2011, the directive on impaired debts has been implemented.

C. Other information

Principal Developments in the Economy*

General

In 2011, the Israeli economy grew at rate of 4.7%, compared with a growth rate of 4.8% in 2010. However, comparison between the different quarters indicates a decreasing growth rate starting the second quarter of the year, with the growth rate in the fourth quarter amounting to 3.2%, in annual terms. This is a result of a slowdown in economic activity against a backdrop of a crisis in the global economy, particularly in the Eurozone, and uncertainty arising therefrom, affecting local demand as well. (Private consumption indeed expanded by some 3.6% in the past year, though there was a slight increase of 0.1% in the second half of the year.) Against this background, the exchange rate of the shekel fell by 7.7% against the dollar and by 4.2% against the euro. The slowdown in economic activity during the past year led to a shortfall in the collection of tax, compared to the planned figure, as a result, the State budget deficit increased to 3.3% of GDP, compared to the target of 2.9% of GDP.

The Consumer Price Index rose by 2.2% in 2011, a rate within the price stability target range of 1%-3%. Until September 2011, the Bank of Israel acted to gradually raise the interest rate, to adapt it to the situation in the market. However, with effect from the interest rate decision for October, there was a change in policy and there began a reduction in the interest rate down to 2.75% in December 2011 and 2.50% in February 2012, a level that was also maintained in March 2012. The policy change was explained as a negative turning-point in the global economy and a desire to support growth in Israel.

The shares and convertible securities index fell during 2011 by some 22.1%, with the decrease in the third quarter of the year amounting to some 15.7%. The main explanations for the fall in prices were the situation in the global economy and the impact of the geo-political situation in the region alongside local influences.

The Committee on Increasing Competitiveness in the Economy

On 24 October 2010, the Prime Minister, the Minister of Finance and the Governor of the Bank of Israel appointed the Committee on Increasing Competitiveness in the Economy. The Committee's object was to examine the effects of the present structure of holdings of the corporate groups on the Israeli economy, and in light of this examination, to recommend desirable policy measures, including legislative amendments and operative steps.

On 15 September 2011, the Committee submitted its interim recommendations. The Committee set up three teams to examine the question of the control of the non-banking companies in financial corporations, the issue of control in a public company through a pyramidal holding structure and a team to study the conditions for allocating public assets.

On 18 March 2012, the Committee submitted its final report to the Prime Minister, Minister of Finance and Bank of Israel Governor.

Among the Committee's main recommendations were the following:

1. Separating between a holding in significant non-banking activity and significant financial activity.
2. Limiting the term of office of directors in a significant financial entity and in a significant non-bank entity.
3. Placing structural limits on the incorporation on a pyramidal structure.
4. Strengthening the authorities of the Antitrust Commissioner in dealing with, in particular, concentration groups, and bestowing authority for administrative compliance including the use of **monetary sanctions.**
5. Examining considerations competition and concentration in State's allocation of rights.

The Bank is studying the significance for its activity of the recommendations published.

* Source of data: publications of the Central Bureau of Statistics, the Bank of Israel, the Ministry of Finance and the Tel Aviv Stock Exchange

Committee for Socio-Economic Change: Trajtenberg Committee

In July and August of 2011, there began a wave of protests in Israel, including various claims on the part of those demonstrating for reliefs on the middle classes of society. On 10 August 2011, the Prime Minister appointed a professional committee, headed by Professor Manuel Trajtenberg, comprising professional personnel from within and outside of the government. The purpose of the committee was to formulate measures that would bring relief to the burden of subsistence in Israel.

On 26 September 2011, the committee submitted the report, which included recommendations in the area of the tax system, social services, competition and the cost of living, housing and fiscal policy.

On 30 October 2011, the Government approved the chapter on taxation in the committee's report. See reference on page 48.

On 18 March 2012, the Government approved the chapter on housing in the committee's report.

The Bank is examining the significance of the decisions, which were approved by the Government, relating to the implementation of the committee's report on for its activity.

Team examining increasing competition in the banking sector

On 7 December 2011, the Minister of Finance and the Bank of Israel Governor announced the establishment of a team to examine increasing competition within the banking sector, headed by the Supervisor of Banks. This team was set up as a consequence of the Trajtenberg Committee.

The team is required to examine and recommend various means and ways of increasing competitiveness in the Israeli banking market, render it opinion to simplify the banking product, to increase customers' bargaining power and improve and perfect the area of credit data service in the household and small business segment.

The team is required to submit its recommendations to the Minister of Finance and to the Governor of the Bank of Israel within 120 days from the date of its establishment.

The Global Economy

At the beginning of 2011, a wave of socio-political disquiet arose in a number of countries in the Arab world, characterized largely by violence, starting in Tunisia and followed by Egypt, Libya, Syria and other countries. As a consequence, geopolitical uncertainty with regard to the Middle East increased. Since then, throughout the world, there have been negative repercussions in financial markets, on the stock exchanges of the leading economies, in the exchange rates of emerging markets and in the prices of commodities (notably oil), etc. These trends, particularly, in Egypt and Syria, have continued at the beginning of 2012.

In March 2011, there was a massive earthquake in Japan and as a result, tsunami waves engulfed part of the coast of Japan, The destruction suffered by some parts of Japan was severe, both for man and for infrastructure, the latter including nuclear reactors, causing substantial environmental damage, even far away from the area of the reactors. Preliminary estimates of the impairment to the Japanese economy indicate an adverse effect on growth in 2011, with a recovery in 2012, mainly led by investments in construction and infrastructure. The International Monetary Fund's January 2012 forecast for growth in Japan is -0.9% and 1.7% for 2011 and 2012, respectively.

At the beginning of August 2011, Standard & Poor's announced a downgrading of the credit rating of the United States from AAA to AA+. In addition, since June 2011, the credit rating of a number of European companies has been reduced, by other credit ratings, as well. In contrast, on 9 September 2011, S&P announced an increase in Israel's credit rating from "A" to "A+".

In January 2012, the International Monetary Fund revised its forecast for world growth for 2011and 2012, in comparison with the previous forecast published in September 2011. Against the background of the revision stood the Fund's assessments that the economy of the Eurozone was expected to suffer a slight recession in 2012 and a slowdown in expected growth, even in developing and emerging states. According to the Fund’s revised forecasts, growth in the United States and the Eurozone in 2011 is expected to be 1.8% and 1.6%, respectively, while in 2012, the Fund expects growth of 1.8% and -0.5%, respectively. According to the Fund, global activity has weakened and become less balanced, confidence has fallen significantly recently and the downwards risks are increasing.

Business Product and Economic Sectors

The business sector product expanded during 2011 by a real rate of 5.2%, compared to a growth rate of some 5.8% in 2010. This reflects a continuation of the fast growth rate of the corporate sector, resulting in a fall in unemployment, to a low point of some 5.6%, on a yearly average. However, in the second half of the year, there was a slowdown in the growth rate, which amounted to 3.8%, in annual terms, compared with the first half, in which the business sector expanded by 5.8%, in annual terms.

The Bank of Israel's survey of companies for the fourth quarter of 2011 indicated further expansion in business activity, although there was a marked moderation in comparison to previous quarters. Expectations and orders for the first quarter of 2012 in industry, trade and business service (excluding hi-tech) sectors and hotels are low and for the most part, are negative. In the context of the real estate market, the Bank of Israel notes that the companies in the industry report a significant increase in demand limitation they are facing, alongside a more moderate increase in the financing limitation, particularly of large and medium-sized corporations. The companies report that a fall in the level of activity in the industry is expected in the first quarter of 2012.

The State Budget and its Financing

During the 2011, the Government had a budget deficit, excluding the net provision of credit, amounting to some NIS 28.6 billion (about 3.3% of GDP). This is in comparison to the planned deficit for 2011 of NIS 25.2 billion (about 2.9% of GDP). The main explanation for the departure from the planned deficit is the shortfall in the collection of taxes, compared to the target for the period, amounting to NIS 6.3 billion. This resulted from lower than forecast revenues in all main revenue items, due to the economic slowdown in the economy, mainly in the second quarter of the year. On the other hand, an examination of Government expenditure indicates a performance rate of 99.1%, which is lower than the performance rate in the past two years.

Foreign Trade and Capital Movements

Israel’s aggregate trade deficit in 2011 amounted to some US$ 15.2 billion, compared to some US$ 7.8 billion in 2010. This increase (94%), in nominal dollar terms, derives from an increase in the volume of imports (24%), which was higher than the increase in exports (13%). It is worth noting that in the second half of the year, there was a reduction in the trend, both in imports and in exports, this, against a background of a slowdown in economic activity around the world.

Foreign currency capital inflows to Israel in 2011 were characterized by a balancing of capital inflows over outflows. Thus, investments of foreign investors in Israel (direct investments through banks and financial investments) amounted to some US$ 2.6 billion, while investments of Israeli residents abroad amounted to some US$ 2.7 billion. However, it is worth noting that the direct investments of Israeli residents increased this year in relation to the previous two years, amounting to some US$ 6.9 billion, while financial investments fell by some US$ 4.3 billion. This was mainly due to the sales of foreign residents amounting to some US$ 4.0 billion in the fourth quarter of the year, in the item including T-Bills and Government bonds.

In this context, Bank of Israel data on the holdings of foreign investors on T-Bills indicate that their weight in the market, which ranged in the first half of the year from 33.4% to 35.7%, fell by up to 12.2% in December 2011. This came in the wake of a change in the taxation rules (set out below), On the other hand, their weight in the Government marketable bond market reached some 6.6% in December 2011, almost double their weight in June 2011.

On 19 January 2011, the Bank of Israel announced that it intended to apply the new reporting regulations relating to shekel/foreign currency swap transactions and foreign currency future transactions to Israeli and foreign residents. On 20 January, the central bank announced that from 27 January 2011, banking corporations in Israel would be subject to a 10% liquidity obligation on transactions in foreign currency derivatives of foreign residents, which would increase the cost of these transactions for customers. This was in light of the fact that, in recent months, there had been a substantial increase in the volume of transactions in foreign currency derivatives executed by foreign residents. A significant part of the increase derived from the short-term activity of the foreign residents. This measure was intended to strengthen the Bank of Israel's ability to achieve the monetary policy targets, foreign currency policies and financial stability.

For details of the reporting regulations, see page 53.

On 27 January 2011, the Minister of Finance announced that he intended to take steps to cancel the tax exemption granted to foreign investors on profits arising from investment in T-Bills and short-term government debentures. Were it not for this exemption, those profits would be liable to tax at 15% or company tax, depending on the type of customer. With effect from 16 December 2011, the cancelation of the exemption on capital gains came into force. On 7 July 2011, the cancelation of the exemption for foreign investors in respect of interest/discounting fees, capital gains from future transactions, and income from a taxable trust fund, arising from investment in these securities, came into force.

Exchange Rates and Foreign Currency Reserves

In 2011, there was a devaluation of some 7.7% in the rate of the shekel against the dollar, while the shekel depreciated by some 4.2% against the euro. The weakening of the shekel against the dollar in the final third of the year was attributable to signs of an economic slowdown around the world and in Israel, which led to an increase in the Israel's trade deficit and a strengthening of the dollar compared to the euro around the world.

Foreign currency balances in the Bank of Israel at the end of December 2011 amounted to some US$ 74.9 billion. This compared with US$ 70.9 billion at the end of December 2010. During this period, the Bank of Israel purchased some US$ 4.6 billion in the foreign currency market, in an attempt to prevent a further strengthening of the shekel. However, since July, the Bank of Israel has not purchased foreign currency on the market.

Inflation and Monetary Policy

During 2011, the Israeli consumer price index increased by some 2.2%, a rate which is within the Government's price stability target of between 1% and 3%. The largest contribution to the increase in the index was in the housing sector, which increased by some 5.1%, contributing some 57% of the increase.

In the past year, until September 2011, the Bank of Israel acted to gradually increase interest rates. Thus, the interest rate, which, in December 2010, stood at 2.0%, increased in June, to 3.25%, a level at which it stayed in September. According to the Bank of Israel, the gradual increase was defined as part of a "normalization" process of the level of interest. In October, the Bank of Israel changed its policy and began a process of reducing interest rates. Thus, interest rates for October 2011 were reduced to 3.0% and 2.75% in December 2011. The Bank of Israel explained the change in the direction by a negative turnaround in the global economy and in the desire to support growth, with support achievable by bringing inflation back within the price stability target. Interest for February 2012 was reduced to 2.50% and was kept at this level at the end of March 2012.

The increase in the prices of apartments, measured by the Central Statistical Bureau (though not constituting a part of the consumer price index) led the Bank of Israel in 2011 to take regulatory (macro-stability) measures in the period as an alternative to the direct increase of interest rates. These measures are intended to act to moderate demand for housing loans and to hold down price rises. For details regarding the new directives and the measures adopted by the Bank of Israel, see page 108. Towards the end of 2011, apartment prices began to fall.

Capital Market

The shares and convertible securities index fell by some 22.1% in 2011, following an increase of some 12.6% in 2010. The TA-100 index fell by some 20.1% during the year. The main reasons for the fall in prices was the global situation, particularly, the fear of a worsening of the sovereign debt and the state of the banking system in Europe and the uncertainty in the American market (including a downgrading of the United States' credit rating). To this may be added the impact of the geopolitical situation in the region, as well as local influences.

Average daily trading volumes of shares and convertible securities fell in 2011 by some 15%, compared to the average for 2010, and amounted to some NIS 1,727 million. This fall was the outcome of a significant reduction in trading volumes commencing the second quarter of the year.

The Government bond market in 2011 was characterized by price rises, in both index-linked and unlinked bonds. These increases occurred mostly in the third quarter of the year. The price of index-linked government bonds increased by some 4.3%, while unlinked bonds rose by some 5.2% (the fixed interest (*Shahar*) bond indices rose by some 5.9% and the variable interest (*Gilon*) bond index increased by some 2.0%).

In the index-linked non-government debenture market (corporate bonds), there were falls in price of some 1.8% in the year, with the third quarter of the year seeing price falls of 2.9%. This was against a backdrop of the fear of the possible implications of the geopolitical situation and an increase in uncertainty in the world economy for the background conditions of the activities of the Israeli business sector and the ability of companies to service their debt.

Financial Assets held by the Public

During 2011, the value of the portfolio of financial assets held by the public decreased nominally by some 0.9% to some NIS 2,521 billion. This fall in the value of the portfolio derived from a decrease in a fall in the value of the share component (the effect of a fall in market prices). The rest of the components of the portfolio increased in this period. The weight of shares (in Israel and abroad) in the financial assets portfolio of the Israeli public reached some 21.5% at the end of December 2011, having been on a downward trend since the beginning of the year. In December 2010, the weight of shares in Israel and abroad reached some 26.9%.

Total financial assets of the public managed by **the Group** (deposits of the public, debentures and capital notes, securities portfolios, including securities in the custody of mutual funds, provident and pension funds, and supplementary training funds for which operational management and custodial services, as well as pension counseling, are provided) amounted to some NIS 842 billion at the end of December 2011, compared to some NIS 837 billion at the end of December 2010, an increase of 0.6%.

Bank Credit

Bank credit in the economy granted to the private sector (before allowances for credit losses) from the end of January 2011 to the end of December 2011 increased by some 5.5%. This was a consequence of an increase in credit extended to the household sector (with credit granted for housing expanding by some 11.3% and consumer credit increasing by some 8.5%). In contrast, there was a slower increase of some 1.8% in the credit allocated to the business sector.

It is worth noting that in July 2011, the data on bank credit in the system published by the Bank of Israel for 2011 was retroactively revised, as a result of new regulations issued by the Supervisor of Banks relating to allowances for credit losses. Data on the debt of the business sector to banks, before allowances for credit losses, fell significantly as a result of accounting writing offs of impaired debts in accordance with the new regulation. In addition, in credit to the public (excluding housing), the figures for 2011 were revised downwards, albeit by lower rates. Consequently, the reporting of the rates of change since the beginning of the year (end-December 2010) is biased, and the change in bank credit in the market, before allowances for credit losses, in this report is from the end of January 2011.

The significant expansion in housing credit in the market, which was accompanied by a significant increase in housing prices in Israel, led the Bank of Israel, as aforesaid, to take a number of macro-stabilizing measures, intended to act to restrain demand housing credit and hence, suppress price rises.

For details of the measures, see page 108.

Credit to the public, net, in **the Bank** amounted to some NIS 151.6 billion at the end of December 2011, compared to NIS 143.4 billion at the end of December 2010, an increase of 5.7%. Housing credit in Leumi Mortgages increased in 2011 by 10.3%, an increase of NIS 5 billion.

Foreign and local rating agencies' credit ratings

On 18 April 2011, Moody's announced that it was reducing Leumi's long-term credit rating in foreign currency and local currency from A1 to A2, with the rating outlook changed from "negative" to "stable", the background being a re-assessment of the Bank's financial solidity. The reduction in the Bank's rating was part of the reduction in rating of the five major Israeli banks.

On 9 September 2011, the Standard and Poor's rating agency announced an increase in the long-term foreign currency credit rating of the State of Israel from "A" to "A+". The increase in the rating reflects the company's assessment that there has been an improvement in the flexibility of economic policy in Israel resulting from the rapid growth and prudent macroeconomic management.

	Rating agency	Short-term rating	Long-term rating	Long-term ratings outlook	Last update
State of Israel's rating in foreign currency	Moody's	P-1	A1	stable	May 2011
	S&P	A-1	A+	stable	September 2011
	Fitch	F1	A	stable	May 2011
Leumi's rating in foreign currency	Moody's	P-1	A2	stable	January 2012
	S&P	A-2	BBB+	stable	December 2011
	Fitch	F2	A-	stable	July 2011
Leumi's rating in local currency	Moody's	P-1	A2	stable	May 2011
Leumi's rating in local currency for debentures and standard deposits	Ma'alot	-*	AA+	stable	November 2011
	Midroog	P-1	Aaa	stable	March 2011
Leumi's rating in local currency for subordinated capital notes	Ma'alot	-*	AA	stable	January 2012
	Midroog	-*	Aa1	stable	January 2012
Leumi's rating in local currency for subordinated capital notes (Upper Tier II)	Ma'alot	-*	(AA- ,A)**	stable	November 2011
	Midroog	-*	Aa2	stable	March 2011

* Not relevant
** A: Upper Tier II capital with compulsory conversion of principal into shares of the fund (rating updated in November 2011).
AA-: "New" Upper Tier II capital, not convertible into shares (rating updated in November 2011).

Developments in Leumi Share Price

From the beginning of the year until 31 December 2011, the price of Leumi shares fell from 1,817 points to 1,091 points, a change of 39.96%, excluding an adjustment for the allocation of a dividend. During this period, the Bank's market value fell from NIS 26.8 billion to NIS 16.1 billion.

Since the end of December 2011 to 20 March 2012, the share price increased by 8.07%, and the market value reached NIS 17.4 billion.

The following table sets out details of changes in representative exchange rates and the CPI:

	December 31				
	2011	2010	2009	2008	2007
	NIS				
Exchange rate:					
U.S. dollar	**3.821**	3.549	3.775	3.802	3.846
Euro	**4.938**	4.738	5.442	5.297	5.659
Pound sterling	**5.892**	5.493	6.111	5.548	7.711
Swiss franc	**4.062**	3.788	3.667	3.565	3.420
Consumer Price Index:	(points)				
For November (the "known" index)	**104.0**	101.4	99.1	95.5	91.4
Index for December	**104.0**	101.8	99.1	95.4	91.9

The rates of exchange as of 20 March 2012 were as follows: $ 3.749, £ 5.944, € 4.951, Sw. Fr. 4.105.

Rates of change were as follows:

	December 31				
	2011	2010	2009	2008	2007
	in %				
Rate of change:					
U.S. dollar	**7.7**	(6.0)	(0.7)	(1.1)	(9.0)
Euro	**4.2**	(12.9)	2.7	(6.4)	1.7
Pound sterling	**7.3**	(10.1)	10.2	(28.0)	(7.0)
Swiss franc	**7.2**	3.3	2.9	4.2	(1.3)
Consumer price index:					
For November (the "known" index)	**2.6**	2.3	3.8	4.5	2.8
Index for December	**2.2**	2.7	3.9	3.8	3.4

General Environment and the Effect of External Factors on Activities

Part of the information in this Section is "forward-looking information". For the meaning of this term see the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" in this chapter, page 61.

Legislation and regulation in the area of pension counseling

In August 2008, the Bank received a pension counseling license, which included certain restrictions. With effect from April 2009, the Bank is entitled to provide pension counseling services regarding pension products to the entire population.

Since the first quarter of 2012, pension counseling services in Leumi have been provided through 13 designated counseling centers located throughout Israel, manned by teams of specialist pension counselors.

The over provision of pension counseling services including the range of pension products to the entire population requires complex operational and business preparations, in which the Bank has invested and continues to invest considerable resources.

As a rule, the absence of computerized interfaces between the Bank and the institutional bodies (clearing houses) complicates the monitoring of the implementation of the recommendations in counseling and makes such monitoring difficult. This issue becomes especially significant with regard to counseling provided to salaried employees, and to counseling with respect to insurance products.

With regard to counseling to salaried employees – the absence of interfaces between the Bank and the institutional bodies, and the absence of interfaces between the Bank and the employers and their salary departments, both regarding information and regarding the clearing of funds for the employees after the provision of counseling, seriously damages the implementation of the counseling process for salaried employees.

With regard to insurance counseling – the absence of computerized interfaces between institutional bodies and the distributors of insurance products, and the fact that the Ministry of Finance has not dealt on its website ("BituachNet") with standardized values which would allow for the products to be examined and identified, makes it difficult to construct a model to support decisions, and therefore prevents the provision of insurance counseling. In addition, in the absence of standardized values, as stated, and in the absence of interfaces with the institutional bodies, it is not possible to monitor the implementation of the counseling recommendations *vis-à-vis* the institutional bodies. Additionally, no regulations have yet been enacted to regulate payment of distribution commissions for counseling regarding insurance products. In the work-plan of the Capital Market, Insurance and Savings Division, as presented on 30 November, 2010, there is a reference to distribution commissions to which the Bank is entitled for counseling in insurance products.

Law for Increasing Enforcement in the Capital Market (Legislative Amendments), 2010

On 17 August 2011, the Law for Increasing the Enforcement in the Capital Market was published, including provisions regarding an amendment to the Supervision of Financial Services Law (Counseling, Marketing and Pension Clearing System) ("**the Pension Counseling Law**") which deals mainly with the expansion of supervision and investigation authorities of the Supervisor of the Capital Market, Insurance and Savings in the Finance Ministry ("the Supervisor") and the expansion of monetary sanctions that the Supervisor is entitled to impose in respect of a breach of the Pension Counseling Law in cases of a continuing breach and a repeated breach.

Pension Clearinghouse

Supervision of Financial Services Law, (Engagement in Pension Counseling and Pension Marketing) (Amendment no. 3), 2011

On 10 March 2011, the Supervision of Financial Services Law, (Engagement in Pension Counseling and Pension Marketing) (Amendment no. 3), 2011 was published, which is intended to regulate the methods of operation and management of a central pension clearing system, the way the Supervisor monitors it and the regulations relating to the provision of an operating license.

The law provides regulations relating to the establishment of a system for the transfer of data and monetary clearing in the savings and pension field in order to improve and enhance the working procedures connected with the transfer of data and monies.

On 12 July 2011, the Supervisor of the Capital Market, Insurance and Savings in the Finance Ministry ("the Supervisor") announced his decision to issue a tender to grant a license to operate a central pension clearing system ("the system"), to gradually activate the various services stipulated in the law, including providing information to savers and clearing money. This is according to the authority of the Supervisor by virtue of section 31b(d) of the Supervision of Pension Services (Counseling, Marketing and Pension Clearing System), 2005 ("the Counseling Law").

In the context of this announcement, the Supervisor clarified that he intends to oblige the institutional entities to join up to the system and that he intends to compel license-holders, as defined in the Counseling Law, to join up to the system gradually, as far as it will be necessary for guaranteeing the proper activity of the savings and pension market in Israel.

On 15 August 2011, an advertisement was published for the early classification for establishing and operating a central pension clearing system as a first stage in the tender.

On 1 December 2011, a draft of the Supervision Regulations of Financial Services (Consulting, Marketing and Pension Clearing System) (Data Protection in a Pension Clearing System), 2011 was published, with the aim of providing regulations and rules in connection with data protection, identification of customers and users, data security, obligations applicable to users and the method for generating output from the pension clearing system.

On 22 March 2012, the Commissioner published a circular entitled "Obligation to Use a Central Pension Clearing System", which detailed the actions that must be taken by the institutional entities and license holders, via the system. The circular requires that a license-holder that performs transactions via the system and institutional entities, must make all the necessary preparations for joining the system It was further provided in the circular that users of the system will bear the cost of connecting to the system, and maintaining the connection, and they will be charged a user fee, in accordance with the Supervisor's regulations and rules of the system which have been approved by the Supervisor.

Together with publication of the above circular, on 22 March 2012, the Supervisor issued a notice of publication of tender documents for establishing and operating a pension clearinghouse system, which were given to a number of bidders who complied with the minimum conditions of the tender, during the earlier review process conducted by the Supervisor.

Computerized graphic signature circular

On 10 August 2011, the Supervisor of Capital Markets, Insurance and Savings in the Ministry of Finance published a "computerized graphic signature circular" which was intended to improve the method of transferring documents from a license holder to an institutional body, to shorten the time for transferring the documents and to improve the service for the customer. The circular enables a license holder to make use of a computerized graphic signature for a customer signing documents as part of making a transaction, under the conditions set forth in the circular regarding the method of computerized graphic signature and regarding the method for locking documents which have been signed by a computerized graphic signature.

The circular further provides that an institutional body will accept documents signed with a computerized graphic signature as a part of executing a transaction. The effective date of the circular is 1 October 2011.

On 7 December 2011, a draft of an amendment of a computerized graphic signature circular was published with regard to the employers' signature by the license-holders. Pursuant to the draft, it was proposed to establish that a license-holder will obtain the signature of an employer with regard to a transaction entered into on behalf of its employees in a separate document which the employee must sign.

Draft Order for the Prohibition of Money Laundering (Identification, Reporting and Record-Keeping Obligations of Insurers, Managing Companies, Agents and Consultants, for the Prevention of Money Laundering and the Financing of Terrorism), 2011

On 3 July 2011, the Capital Markets, Insurance and Savings Division in the Ministry of Finance published the Draft Order for the Prohibition of Money Laundering (Identification, Reporting and Record-Keeping Obligations of Insurers, Managing Companies, Agents and Consultants, for the Prevention of Money Laundering and the Financing of Terrorism), 2011.

The draft order consolidates and combines under one framework the provisions of the Order for the Prohibition of Money Laundering (Identification, Reporting and Record-Keeping Obligations of Insurers and Insurance Agents), 2001 and the Order for the Prohibition of Money Laundering (Identification, Reporting and Record-Keeping Obligations of Provident Funds and a Managing Company of a Provident Fund), 2001. In addition, the draft order imposes on pension counselors the obligations of identifying, reporting, recording and preserving data relating to the opening of an account in a provident fund, entering a life assurance contract and executing transaction pursuant thereto.

Program to Increase Competition in the Pension Savings Market

On 27 March 2011, the Supervisor of the Capital Market, Insurance and Savings in the Ministry of Finance published a draft memorandum and a draft of regulations and circulars, as part of the program to increase competition in the pension savings market published in November 2010, pursuant to which the regulatory measures in the area of pension saving was presented, with the objectives of the program being to increase competition by the minimization of differences between the various savings products (provident funds, pension funds, managers insurance) and to increase transparency of institutional entities vis-à-vis savers.

The measures proposed in the program relate to the connection between institutional entities and customers, to the connection between distributors and customers and to the connection between institutional entities and distributors. The expected changes are presented in the program only in general terms and they have been planned to go out as a draft during 2011 and be applied by 2014.

Memorandum of Supervision of Financial Services Law (Counseling, Marketing and Pension Clearing System) (Amended), 2011

It is proposed to change the arrangement stipulated in the law, whereby a pension counselor which is a banking corporation is not permitted to engage with an employer, or with an employers' organization for the purpose of providing pension counseling services to an employee of that employer or to an employee of one who is a member of the employers' organization, by granting authority to the Supervisor of the Capital Market, Insurance and Savings to determine provisions for the purpose of the engagement of a pension counselor with an employer and employers' organization. It is further proposed to strengthen the protection of employees regarding pension counseling, and prevent a situation in which the employer forces the identity of the pension counselor on his employee, and enables a customer to choose the license holder who recommends him pension saving and prohibits the conditioning of service with service by the license holder. In addition, it is proposed to apply to the license-holder the debts to which the insurer is subject regarding the submission of reports and notices to the Supervisor of the Capital Market, Insurance and Savings.

Draft Supervision Regulations on Financial Services (Provident Funds) (Management Fees), 2011

This involves the application of a consistent model for limiting management fees in pension savings products from the class of provident funds and managers insurance, which will be gradually updated and the determination of the maximum rates of management fees for pension savings products from the class of pension funds.

Proposed Law for the Supervision of Financial Services (Provident Funds) (Amendment – Discount from Management Fees and Disclosure Obligation)

A private bill relating to the provision of consistent conditions in which a managing company will be entitled to grant its members a discount on management fees and compel a license-holder to give prior written disclosure of the extent of the distribution commission to which the license-holder will be entitled in respect of that customer.

Draft Supervision Regulations on Financial Services (Provident Funds) (Distribution Commission), 2011

This involves the application of a consistent distribution commission model in all the pension savings products (except training funds) that will apply to both regular deposits and the accrual. It is proposed to determine that an insurer will also pay a distribution commission in respect of pension products which are under its management and in respect of which pension counseling has been provided to a customer.

Draft circular regarding management fees in pension savings instruments

This is intended to increase transparency regarding the rate of management fees collected in the context of pension savings and the determination of a prohibition on raising management fees that have been agreed with the client for at least two years.

Engagement of Institutional Body with License Holder Circular

On 13 July 2011, the Supervisor of the Capital Market, Insurance and Savings Division in the Ministry of Finance published the Engagement of Institutional Body with License Holder Circular, whose purpose is to regulate the treatment of deposits paid to an institutional body through a license holder.

The purpose of the circular is to reconcile the working procedures provided for dealing with insurance fees paid to an insurer through an insurance agent for any commitment between a license holder and an institutional body. Accordingly, the specification of the circular of general principles with regard to the receipt and transfer of deposits of various types, from policyholders, members and license holders to institutional bodies, including regulations for managing a trust account by a license holder.

In relation to a pension counselor which is a banking corporation ("the banking corporation"), the circular includes a special arrangement enabling the banking corporation to transfer deposits of pension insurance to a separate bank account before it is transferred to the institutional body ("suspense account") under the conditions stipulated in the circular.

Pursuant to the instructions of the circular, the banking corporation is prohibited from making any use of the deposits transfer to it, except to transfer it to the institutional body and for the policy holder for whom they were transferred to the license holder, and the banking corporation is prohibited from collecting deposits from policy holders in the various payment arrangements other than those agreed with the institutional body.

The circular applies to commitments that will be in force from 1 January 2012.

Circular regarding Power of Attorney to License Holder

On 22 March 2012, the Commissioner of the Capital Market, Insurance and Savings Division in the Ministry of Finance published a circular regarding the power of attorney to a license holder "" for the purpose of establishing a consistent structure for the power of attorney form, through which a customer will empower the license holder to obtain information from institutional bodies or to forward requests, in the context of pension counseling, or pension marketing.

The circular clarifies that its purpose is, amongst other things, to prepare those engaged in the pension insurance sector, to provide information and to take actions through uniform computerized forms, including a pension clearinghouse system.

The circular details regulations limiting the validity of the power of attorney, or the wording of the power of attorney and the rules regarding the use of the powers of attorney.

The circular will become effective on 1 January 2013.

Draft Supervision Regulations on Financial Services (Insurance) (Brokerage Fees) 2011

On 25 October 2011, a second draft of the Supervision Regulations on Financial Services (Insurance) (Brokerage Fees), 2011 was published. Pursuant to the draft regulations, it was proposed, *inter alia*, to determine that brokerage fees will not be paid for a certain insurance product (including, a pension product) to more than one license holder for the same period, unless it involves the joint treatment of those license holders and is according to an agreement concluded with him in the sharing of agents' fees between them. In addition, the regulations allow the continuation of paying agents' fees to an insurance agent who has attached a policy holder for the first time to an insurance product (including a pension product), after another license holder has been appointed in his stead for a period not exceeding three years from the date on which the policy holder joined that insurance product for the first time.

Agreement for Provision of Services Circular - Second Update

On 29 December 2011, the Capital Market, Insurance and Savings Division in the Ministry of Finance issued an "Agreement for Provision of Services Circular - Second Update", pursuant to which regulations were provided in connection with the extension of the transitional provisions, enabling communication between a banking corporation and a managing company on condition of compliance with the conditions set forth in the circular, through 31 December 2013.

Prohibition on the Granting of Benefit to a Pension Counselor

On 14 March 2011, the Capital Market, Insurance and Savings Division in the Ministry of Finance issued a "Prohibition on the Granting of Benefit to a Pension Counselor" circular, which provides directives and rules in connection with prohibition on the granting of benefit to a pension counselor, the participation of a pension counselor in activity organized by an institutional entity and the receipt of marketing material or advertising products from an institutional entity.

The Adapted Monetary Savings Model

A draft of the Supervision Regulations of Financial Services (Provident Funds) (Establishment of Default Paths), 2012 and a draft of the Adaptation of the Investment Path to the Features of the Member circular, which is expected to obtain the approval of the Knesset Finance Committee were published on 4 January 2012. The drafts provide directives with regard to the adaptation of investment paths in provident funds to features of the member, which are intended to be gradually introduced.

Uniform Structure Circular for Transferring Information and Data in the Pension Savings Market, Appendices: C, D, E, F.

On 2 February 2012, further to regulations established in a circular 2011-9-1 relating to "Uniform Structure Circular for Transferring Information and Data in the Pension Savings Market", an updated draft of Appendix C (mobility interface), a draft of Appendix D and Appendix E (joining interface) and interface of events and a draft of Appendix F (interface of and input of monies) to the abovementioned circular were published.

Consortium Arrangements for the Granting of Credit

On 28 February 2011, the managers of the banks and insurance companies were given notification by the Antitrust Commissioner, regarding the conditions that if fulfilled, the Antitrust Authority does not intend to enforce the provisions of the Antitrust Law, 1988 ("the Law"), regarding association between the banks and insurance companies and between them and themselves ("banks and institutional entities") in a credit consortium.

The notice of the Commissioner replaces the earlier notice regarding conditions on this matter dated 8 March 2007, whose effectiveness was extended on 4 January 2009 ("the previous conditions").

A summary of the conditions for forming a consortium for the provision of credit is as follows:

1. The formation of the credit consortium must be with the written consent of the customer on a separate form;

2. The customer is given the possibility of negotiating over the terms of the provision of credit with whomever of the member parties in the consortium, including through another person on its behalf;

3. The formation of a consortium in which both Bank Hapoalim B.M. and Bank Leumi Le'Israel B.M. are members will be permitted only if the aggregate amount of the credit that the two banks are required to grant exceeds NIS 300 million (except for the case of a consortium arrangement whose purpose is the repayment of a debt deriving from credit provided by the aforesaid two banks before 18 August 2002 to the same person).

4. No information that is not required for the purpose of forming the specific consortium in respect of which the contacts are maintained may be transferred. Any transfer of information as aforesaid will be made in a way that minimizes any chance of impairment to competition between the parties.

5. The parties will prepare documentation that must include all of the data as outlined in the Commissioner's notice, both with regard to contacts made and/or information transferred between the parties on matters relating to the formation of a credit consortium, and with regard to a credit consortium that actually exists and with regard to contacts that did exist but have not actually resulted in a credit consortium. The documentation must be retained with each bank and/or institutional entity and transferred to the Authority within 30 days of the end of each calendar year, and on demand within 14 days of the demand.

The said validity of the Commissioner's notice is for two years, unless another notice is issued before the end of the effective period.

Companies Tax

On 14 July 2009, the Knesset approved the Improved Economic Efficiency Law (Statutory Amendments for Implementation of the Economic Plan for 2009-2010), 2009, which, *inter alia*, gradually reduces the company tax rates from 25% in 2010 to 18% for the year 2016 and thereafter. The company tax in Israel was 25% in 2010 and 24% in 2011. A body of persons is liable to tax on a real capital gain at company tax rates, commencing the year of sale.

On 5 December 2011, the Change in the Tax Burden Law (Legislative Amendments), 2011 (hereinafter – the Law) was passed in the Knesset. Pursuant to the Law, *inter alia,* commencing 2012, the outline plan of reducing company tax rates was canceled. The company tax rate was increased to 25% with effect from 2012 and the tax rates on inflation-adjusted capital gains and the tax rate on inflation-adjusted betterment were also raised.

For further details, see chapter "Description of Taxation Position" on page 273.

Value Added Tax

On 27 June 2006, the Value Added Tax Order (Tax Rate for Non-Profit Organizations and Financial Institutions) (Temporary Provisions) 2006 was published in the Israel Government Gazette. The Order fixed the rates for salary tax and profit tax that are applicable to financial institutions at 15.5%. The amendment came into force on 1 July 2006.

On 1 July 2009, the Value Added Tax Order (Tax Rate for Non-Profit Organizations and Financial Institutions) (Temporary Provisions) 2009 was published in the Israel Government Gazette. The Order raised the rates for salary tax and profit tax that are applicable to financial institutions, as from 1 July 2009 continuing through 31 December 2009, from 15.5% to 16.5%.

On 31 December 2009, the Value Added Tax Order (Tax Rate for Non-Profit Organizations and Financial Institutions) (Temporary Order) (Amendment) 2009, was published in the Israel Government Gazette, reducing the rates for salary tax and profit tax that are applicable to financial institutions, as from 1 January 2010 continuing through 31 December 2010, from 16.5% to 16.0%.

On 24 February 2011, the Value Added Tax Order (Tax Rate for Non-Profit Organizations and Financial Institutions) (Temporary Order) (Amendment) 2011, was published in the Israel Government Gazette (*Reshumot*), providing that the rates for salary tax and profit tax that are applicable to financial institutions as from 1 January 2011 continuing through 31 December 2012 would be 16%.

For further details see page 273.

Legislation affecting the Banking System

Banking Law (Legislative Amendments), 2012

On 19 March 2012, the Banking Law (Legislative Amendments), 2012 was published in the Israel Government Gazette (*Reshumot*). The law completes the arrangements, which were added to the Banking Law (Licensing) and the Banking Ordinance, as part of Amendment 13 to the Banking Law (Licensing), 2004 (as a result of the recommendations of the Marani Committee) and which were intended, *inter alia*, to enable the State to realize the balance of its holdings in banks which were in the Shares Arrangement. The law includes amendments to the Banking Law (Licensing), the Banking Ordinance and Section 37 of the Securities Law.

The main objective of the proposed law is further adaptation of the Banking Law (Licensing) and of the Banking Ordinance to the required supervision framework for the case of a banking corporation, all the holders of the means of control of which are not obliged in a permit pursuant to section 34(b) of the said law (hereinafter a banking corporation without a control core), and the law is focused mainly on the method of proposing and electing the directors, as aforesaid, balancing the right of the holders of the means of control to propose candidates for a term of office as directors and exercise their choice, with the desire to prevent actual control in the banking corporation without the receipt of the Bank of Israel permit.

- Pursuant to the law, a statutory committee will be set up for the appointment of directors in the banking corporation and for the proposal of candidates for the office of director in a banking corporation without a controlling core in a new composition as set forth below, instead of the existing committee. This committee would appoint directors in each banking corporation in which the number of the members of the board of directors falls to below the number prescribed by the board of directors as an appropriate number of directors in that banking corporation, and also in any banking corporation in which the composition of the board did not meet all of the legal requirements, and after the general meeting of that banking corporation had not succeeded in appointing directors as necessary, as aforesaid after two attempts. In a banking corporation without a controlling core, a notice will propose at every general meeting a number of candidates for the office of director equal to the number of vacant positions on the board, and a further 75% of the number of vacant positions rounded up.

- In a banking corporation without a controlling core, only the following will be entitled to propose to the general meeting candidates for election as director: the committee which proposes candidates as the number of vacant positions on the board of that banking corporation and a further 75% of the number of vacant positions rounded down, and whoever holds more than 2½ % of a certain class of the means of control in the corporation, and a body of holders which will appointment two or three holders, each one of which holds more than 1% and not more than 2½ %, and together not less than 2½ % and not more than 5% of a certain class of the means of control (hereinafter – body of holders), which will entitles to collaborate only for this purpose. A holder of more than 2½ % of a certain class of the means of control will be entitled to propose one candidate for the office of director, and as long as the director appointed on his proposal serves, he will not be entitled to propose a further candidate (except for a proposal of a candidate who replaces a serving director who was appointed at his proposal), unless he has received a permit from the Governor after consultation in the License Committee. The aforesaid will also apply with regard to a body of holders, including each member of the body of holders.

- The composition of the Statutory Committee will be as follows: the chairman of the committee will be a retired Supreme Court or District Court judge, who will be appointed at the proposal of the Minister of Justice after consultation with the President of the Supreme Court, two members will be people from the field of economics (in respect of whom conditions of eligibility will be demanded similar to those applicable to a director in a government corporation) or members (or former members) of senior academic staff in higher education institutions who will be proposed by the chairman of the committee after consultation with the chairman of the Securities Authority, and two members will be directors serving on the board of the relevant bank as external directors (as the term "external director" is defined in the Companies Law or in the Bank of Israel's Proper Conduct of Banking Business Directives), who will be proposed by the other members of the committee, in consultation with the Supervisor of Banks. A member of a committee who is an external director in a banking corporation will be appointed as aforesaid for terms of office of two years and as long as he serves as external director in that banking corporation, and he will be able to be re-appointed, providing that he does not serve on the committee continually for a period exceeding three years.

- A transitional provision prescribes that until the date on which the abovementioned statutory committee is appointed, the committee's authorities will be granted temporarily to a committee whose members will be the Chairman of the Public Committee according to the Bank Shares in the Arrangement Law (Temporary Provisions), 1993 (hereinafter – the Bank Shares in the Arrangement Law), which will be the Chairman of the Committee, two members to be appointed by the Chairman of the Committee out of the other members on the Public Committee pursuant to the Bank Shares in the Arrangement Law, and two directors serving as external directors in the banking corporation that the committee has discussed in this matter (according to the definition of the term "external director") in the Companies Law or in the Proper Conduct of Banking Business Directives of the Bank of Israel), who the Chairman of the Committee and the members of the temporary committee that has been appointed as aforesaid will appoint, in consultation with the Supervisor of Banks. Parallel to the abovementioned transitional provision, the definition of the term "banking corporation without a controlling core" in the Banking Law (Licensing) has been amended such that it will also include a banking corporation which is subject to the provisions of the Bank Shares in the Arrangement Law, and in respect of which the Shares Committee pursuant to the Law in the Arrangement does not actually serve.

- In a banking corporation without a controlling core, a candidate for the office of director is be subject to provisions similar to those applicable to an external director pursuant to the Companies Law, for the purpose of the prohibition of interest, with some changes (*inter alia*, the appointment and term of office of a director who has an interest, by way of the holding of the means of control at a rate exceeding ¼ % in a banking corporation or a shareholder who is entitled to propose candidates to the office of director in a corporation as aforesaid, as set forth above, is prohibited; the appointment and term of office of a director who has an interest for an office-holder in a banking corporation is prohibited); the candidate for the office of director proposed by the committee will be obliged to comply with additional restrictions and reservations for office which are applicable to the members of the committee, and in addition, they will be obliged to hold professional qualification or have accounting and financial expertise as required from a external director pursuant to the Companies Law.

- A shareholder holding more than 1% of a certain class of the means of control in a banking corporation without a controlling core is obliged to report to the banking corporation and to the Supervisor of Banks on his holdings, and the banking corporation will be obliged to report to the public on each shareholder holding more than 2½% of certain class of the means of control in a banking corporation. The duty to report to the public will also apply with regard to a shareholder holding more than 1% and up to 2½ % of a certain class of the means of control in a banking corporation, if the aforesaid shareholder agreed to publish to the public as aforesaid, and if he has not so agreed, he will not be entitled to join the body of holders for the purpose of proposing candidates to the office of directors to the general meeting, Notwithstanding the aforesaid, the Supervisor of Banks will have the authority to establish that the publication of the duty to the public will also be in respect of a holder of between 1% and 2½%, for reasons that will be set forth.

- The tests that Supervisor of Banks uses when he considers the suitability of a candidate for a post in a banking corporation were expanded, particularly, the tests that he employs in examining candidates for the function of director. In addition, the provision requiring the receipt of early approval of the Supervisor of Banks for office as an officeholder in a banking corporation was expanded, such that it will also apply to the office of legal advisor of the banking corporation and the Supervisor of Banks was authorized to stipulate up to seven officeholders in each banking corporation to whom the provision requiring an approval procedure will apply.

- Provisions that will apply to banking corporations that are public companies (banking corporations with or without a controlling core) were established, notwithstanding any other legal provision in the law. *Inter alia*, it were established that, except for the appointment of a director for a short interim period in certain cases, the board of directors will not be entitled to appoint directors to the board or to propose candidates for the office of director to the Statutory Committee. (It is clarified that the board of directors of a banking corporation without a controlling core will not be entitled to appoint directors even for the said interim period); a provision further provides that for at least 21 days prior notice of the convening of a general meeting on the agenda of which is the appointment of directors; and other provisions on the matter of the appointment or discontinuance of office of directors at the meeting.

- Additional special provisions on the matter of the appointment and discontinuance of office of directors were provided, which will apply to a banking corporation without a controlling core, notwithstanding any other provision in the law. *Inter alia*, a provision stipulates that the vote on the appointment of directors will be only at the annual meeting or at a meeting that has been convened with the approval of the Supervisor; a provision limiting the period of office of a director who is not an external director to three years, and his cumulative period of office to nine years; and a provision stipulating that the number of directors to be replaced each year will not exceed half of the serving directors.

- In addition, according to the law, the Supervisor of Banks or an employee that has been empowered will be authorized to grant a permit for opening a branch of a bank (instead of the Governor), and to cancel the said permit, but for the purpose of the cancelation of a permit for a branch, authority is granted only to the Supervisor, and he cannot empower another Bank of Israel employee for this purpose.

- The law updates the maximum number of customers in its branches in Israel of a bank or a foreign bank to which the prohibitions and restrictions regarding ownership and management of the assets of provident funds and mutual funds will be updated from 1,000 to 5,000.

  In addition, the Supervisor of Banks was authorized to approve the appointment of an internal auditor in a banking corporation, who does not meet the requirements provided in Section 3(a)(5) of the Internal Audit Law. It is clarified that this mechanism also applies to a banking corporation that is a public company.

Antitrust Law (Amendment – Amendment No. 12), 2010, regarding a "concentration group"

On 18 July 2011, Amendment No. 12 to the Antitrust Law regarding concentration groups was passed.

The main points of the law's amendment are as follows:

Declaration of a concentration group - According to the amendment to the law, the Commissioner may determine that a limited group of persons conducting businesses (including companies) in whose hands there is a concentration of more than half of the total supply of assets or of the total provision or purchase of services constitute a concentration group, when among the members of the group or in the industry in which they operate, conditions exist for minimal competition or that the competition between them is minimal (along with additional conditions that must be fulfilled for the declaration of the group as a concentration group).

According to this condition, in contrast to the current legal situation, the Commissioner is entitled to declare a concentration group in cases where there is no actual impairment to competition, but there are "conditions for minimal competition".

The amendment to the law provides that indications of minimal compensation can be considered, *inter alia*, a barrier to entry together with barriers to transfer and cross-holdings.

Regulation authority vis-à-vis a concentration group – After declaration of a concentration group, the Commissioner is granted authority to order a wide range of measures that are intended to preclude harm or concern about substantial harm to the public or to competition or substantially to enhance competition or to create conditions for a significant increase in competition.

In contrast to the previous legal situation, prior to the amendment according to which the Commissioner had authority only to order transactions that were intended to prevent impairment to competition, the amendment to the law grants the Commissioner authority also to order measures which are intended to significantly increase competition or create conditions for a significant increase in competition between members of the group or in the industry in which they operate, including to order their removal or the limitation of barriers to entry or transition to the industry, to order the discontinuance of a certain activity of a member of the group and to prohibit the transfer or publication of data between members of the group.

The amendment to the law provides special regulations for the areas of banking and insurance, with regard to the banking and insurance sectors. It is provided that:

The Commissioner should consult with the Governor of the Bank of Israel and Supervisor of Banks, prior to the declaration of a concentration group in the area of banking, and inform them of his intention to give an order for a concentration group that has been declared, which is intended to prevent damage to the public or competition in business.

The Governor of the Bank of Israel and the Supervisor of Banks have the right of veto to prevent the giving of an order (to a concentration group that has been declared) as aforesaid, if either of them are of the opinion that the giving of the order will jeopardize the stability of the banking corporation or the banking system. The veto right is established until 1 January 2014, and thereafter, it can be extended for a period of two years each time at the request of the Minister of Finance, with the approval of the Knesset Finance Committee. The publication of the veto right to the public should be at the same time as the decision of the Governor or the Supervisor on this matter. The explanations for their decision should be published six months thereafter, unless it has been agreed between the Commissioner and the Governor or the Supervisor to defer publication (only when there is agreement between them that timely publication could destabilize the banking system or a relevant banking corporation). Similar orders were also established in relation to the insurance sector.

Banking Law (Licensing) (Amendment No. 18), 2011

On 3 August 2011, Amendment No. 18 of the Banking Law (Licensing) regarding the clearing of debit card transactions was passed, the main points of which are as follows:

A clearing agent who has cleared 20% or more of the number of debit card transactions cleared in Israel, or of the total proceeds paid to suppliers in Israel in a previous year will be considered a "large-scale operator" and the Supervisor of Banks will be entitled to instruct such a clearing agent to clear debit card transactions issued by another issuer.

An issuer that issues 10% or more of the number of debit cards in Israel or an issuer which, through debit cards that it issued, carried out in a previous year at least 10% of the amount of transactions in Israel through debit cards issued in Israel, will be considered a "large-scale issuer" which will not refuse, without good reason, to enter into a commitment with a clearing agent for interchange clearance of debit card transactions that it issued. This section will apply nine months after the date of the law coming into effect.

The law also regulates other areas, for example, the debiting of entities that deal with clearance, the obtaining of a license from the Governor of the Bank of Israel, and the agreement of the Supervisor of Banks to supervise the area of credit cards.

In addition, it is provided that, with regard to the possibility of a business receiving discounting services, a clearing agent cannot prevent a business from entering into a commitment with a discounting company.

Order of the Bank of Israel (Data on the Transactions in Foreign Currency Derivatives and Short-Term Debt Instruments), 2011

On 14 April 2011, the Bank of Israel published a draft order, whereby, effective 1 July 2011, imposing the obligation of reporting, *inter alia*, the transactions set forth below:

- In respect of shekel-foreign currency swap transactions and future transactions in foreign currency in amounts of US$ 10 million and more which residents of Israel and foreign residents have executed in one day, the reporting obligation will fall on the details of the said transactions and on the holdings of the residents of Israel and the foreign residents in these assets and in shekel-dollar transactions.
- In respect of transactions in T-Bills and in short-term Government bonds of NIS 10 million and more which foreign residents have executed in one day - the reporting obligation will fall on the details of the said transactions and on the holdings of the foreign residents in these assets.

The reporting obligation, as stated above, applies both to the aforesaid transaction-makers and the financial intermediaries that have executed a transaction, as aforesaid, whether for themselves or for their customer.

Securities Order (Amendment to First Addendum to the Law), 2011

On 30 June 2011, Securities Order (Amended First Addendum to the Law), 2011 was published, pursuant to which the first addendum to the Securities Law and the definition of the "accredited investor" was expanded.

The order came into force on 1 August 2011. Pursuant to the amendment, the following was added to the first amendment to the Securities Law as accredited investors – an individual investor who is an "eligible investor" as defined in the Counseling Law, who is purchasing for himself and a corporation whose shareholders' equity is NIS 50 million (Before the order, the requirement was for a shareholders' equity of NIS 250 million.).

The order also provides that written confirmation must be obtained before every date of acquisition in which the conditions set forth in the first addendum to the Securities Law are fulfilled and that it is aware of the significance of its coming within the definition of an investor included in the addendum and concurs therewith.

Order for the Prohibition of Money Laundering (Identification, Reporting and Record-Keeping Obligations of Insurers, Managing Companies, Agents and Consultants, for the Prevention of Money Laundering and the Financing of Terrorism), 2011

On 6 November 2011, the Knesset Constitution, Law and Justice Committee approved an amendment to the Order for the Prohibition of Money Laundering (Identification, Reporting and Record-Keeping Obligations of Banking Corporations for the Prevention of Money Laundering and the Financing of Terrorism), 2001.

The amendment provides that on opening an account in a closed system, various provisions relating, inter alia, to the verification of details and the requirement of documents, declaration and identification of beneficiaries will not apply.

An account in a closed system is an account of an individual which serves to maintain and manage monetary deposits or of shares in a banking corporation where the source of finance or shares is an account of an individual which is a deposit holder or holder in another banking corporation or the Postal Bank (hereinafter – the source bank), providing the monies or shares managed therein are transferred back to the source account.

Proposed Law for the Regulation of Engaging in Investment Counseling, Investment Marketing and Investment Portfolio Management (Amendment – Provision of Investment Counseling), 2011

The proposed Counseling Law (Amendment – Provision of Investment Consultancy) was presented to the Knesset on 30 March 2011 as a private bill.

According to the proposed legislation, training funds will be excluded from the definition of financial assets;

A distinction will be made between investment consultancy / marketing pursuant to which advice may be given to a certain customer depending on his needs and personal data, and general investment consultancy/marketing pursuant to which consistent and non-specific advice, to a large number of people (sometimes, an unknown number) that is not adapted to a customer's personal needs and data.

Obligations regarding general investment counseling/marketing will be stipulated, including the disclosure of any conflict of interests of the provider/marketer of the counseling and of any material matters for general investment counseling/marketing, etc. It is proposed, *inter alia*, to allow the Minister of Finance, in consultation with the Authority and with the approval of the Knesset Finance Committee, to provide regulations regarding the conditions of professional eligibility for anyone engaging in the provision of general investment counseling/marketing and regarding a registry of those who engage therein.

According to the proposed law, obligations applying to the license holder in the provision of investment counseling / marketing will apply to him even if the outcome of the service is a recommendation to the customer in connection to the assets that are not securities or financial assets.

This involves applying the Counseling Law to Banking Products as deposits, savings plans, etc.

It is proposed that incorrect information must not be included the provision of counseling and/or marketing, including reference to the provision of these services or their advertising, and that no misleading detail will appear in a report, notice or document submitted pursuant to the Counseling Law.

In addition, it is proposed to add violations for which a penal sanction can be imposed and violations for which the Authority is authorized to impose on the violator a monetary sanction (both on an individual and on a corporation), for the purpose of the provision of general investment counseling / marketing, and in connection with incorrect information and misleading details.

Proposed Banking Law (Service to the Customer) (Amended – Prohibition on the Collection of a Charge for Managing an Account for Investment in Securities), 2011

On 1 August 2011, a private bill was placed before the Knesset, proposing the provision of a regulation whereby the Governor would not include in the commission charge-list any commission that would allow a banking corporation to collect from its customers a commission for managing an account for investment in securities

Proposed Banking Law (Service to the Customer) (Amendment – Prevention of Double Payment in respect of Management of Current Account), 2012

On 23 January 2012, a private bill was proposed in the Knesset to cancel the committees collected for basic services on current accounts, i.e., the prohibition of collection from a customer, as defined in the proposed law, in respect of 13 transactions listed in the Banking Rules (Service to the Customer) (Commissions), 2008 (hereinafter – the Banking Rules), as basic transactions for current management of a current account. The clause is intended to retain the principle whereby a banking corporation should not collect double payment from a customer in respect of the provision of its services, and that the cost of the basic banking services should be apparent to the customer for comparison purposes.

Proposed Law for Restrictions on the Issuers of Debit Cards (Legislative Amendments – Encouragement of Competition and Preserving the Rights of Customers), 2011

On 31 October 2011, a private bill to amend the Banking Law (Licensing), 1981 and the Banking Law (Service to the Customer), 1981 was placed before the Knesset. The bill proposes that a banking corporation will not be able to hold more than 26% of the means of control in an issuer of debit cards, and will prevent credit card companies making use of or transferring to a third party data and information relating to the debit card holders, received by them from various parties, except for the purpose of debiting the account of the cardholder.

Proposed Law for the Amendment of Securities Regulations (Details of the Prospectus and Draft Prospectus – Structure and Form), 2011

The Israel Securities Authority has proposed an amendment to the Securities Regulations (Details of the Prospectus and Draft Prospectus – Structure and Form), 2011. Among other things, it is proposed to cancel Regulation 5(b) which enables banking corporations and insurers to issue bonds, which are rated as an investment, the proceeds of which are placed in a deposit, guaranteeing repayment in the said corporation via prospectuses of designated companies. The significance of the cancelation is that public issues of bonds by a banking corporation or insurer will require them to publish prospectuses.

Proposed Law for the Amendment of Securities Regulations (Method of Offer of Securities to the Public), 2011

In the proposed amendment, the Israel Securities Authority requests the gradual reduction of the maximum rate of early commitment out of a total issue to only 30% (instead of 80% or more at present). It is further proposed to limit the list of investors entitled to purchase securities by early commitment (those listed in the First Addendum to the Securities Law, 1968) to mutual fund managers for funds under their management, managing companies for provident funds under their management, insurers for investments standing against yield-contingent liabilities and corporations operating outside of Israel whose characteristics are similar to the abovementioned entities.

Proposal for Legislative Amendments in the Area of Underwriting

The Israel Securities Authority has published a legislative outline prospectus for the comments of the public to amend the legislation relating to underwriting. Pursuant thereto, it is proposed that in every prospectus, including a shelf prospectus, there will be at least one underwriter who will take responsibility for the prospectus (whether it has entered into an insurance contract with the offeror company or not). The underwriter will be required to sign the drafts of the prospectus submitted to the ISA and the shelf offer reports submitted and to indicate in the prospectus, whether he has carried out the appropriate due diligence. It will be obligatory to publish the draft prospectus which is submitted for review to the authority in order to receive a permit. The actions that will be considered as underwriting will be expanded and the conditions of eligibility required from an underwriter will be tightened. An underwriter will not be able to be a subsidiary of the issuer and, as a distributor, it will not be able to act as an entity registered in the Registry of Underwriters.

Proposed Restrictive Practices Law (Amendment No. 14) (Monetary Sanction), 2011

On 13 December 2011, the proposed Restrictive Practices Law (Amendment No. 14) (Monetary Sanction), 2011 was published in the Government Gazette, regarding the addition of a mechanism for monetary sanction to the Restrictive Practices Law.

The proposed law was approved in its first reading and discussed in the Knesset Economics Committee in preparation for its second and third readings.

According to the proposed law, the Antitrust Commissioner will be entitled to impose a monetary sanction of up to NIS 24 million on any entity that breaches any of the principal provisions of the Restrictive Practices Law, 1988.

According to the proposed law, before imposing the monetary sanction, the entity breaching the law must be furnished with a written notice of intent to charge and the offender will be given the right to review the information relating to the breach and the right to argue its case. Thereafter, the Commissioner will decide whether to impose a monetary sanction on the offender, and will furnish the entity with a notice of the fact together with his reasons for so doing. The proposed law further provides that on the demand for payment, the offender is entitled to submit an appeal to the Restrictive Practices Court and that the imposition of the monetary sanction will be published in a public forum.

Furthermore, pursuant to the proposal, the monetary sanction will not derogate from a person's criminal liability in respect of a breach of any of the provisions of the law that constitute an offence. However, if a person is served with an indictment due to a breach, he will not be charged with a monetary sanction in respect thereof.

The proposed law prohibits the making of arrangements to indemnify and insure breaches by potential offenders with regard a monetary sanction pursuant to which it may be imposed.

Proposed Protection of Privacy Law (Amendment No. 12) (Enforcement Authorities), 2011

On 16 November 2011, the proposed Protection of Privacy Law (Amendment No. 12) (Enforcement Authorities), 2011 was published. The proposed law was passed in its first reading on 28 November 2011, and its aim, as it appears from the explanatory notes, is to improve the supervisory and enforcement abilities for securing the existence of the provisions of the Protection of Privacy Law, 1981.

For this purpose, the proposed law expands the authorities accorded the Registrar of Databases and grants him supervision, administrative arbitration and enforcement authorities.

In all matters related to supervisory authorities, the proposed law provides that the Commissioner for Data Protection will be entitled to demand any person to identify himself, to furnish him with any information or document, to present (or furnish a copy) before the Commissioner any computer material and to enter a place which he has reasonable grounds for assuming that it contains a database or that use is being made of such a database.

With regard to administrative arbitration authorities, the Commissioner is accorded authorities to request a search and seizure order or a penetration into computer material order, and to carry them out himself or through a supervisor. Furthermore, the proposed law provides that the authorities accorded a policeman pursuant to the Criminal Law Procedure Ordinance (Arrest and Search) (New Version), 1969 will be accorded a supervisor, and the authorities accorded an officer will be accorded the Commissioner and a State employee that he has authorized for this purpose.

With regard to enforcement authorities, the proposed law provides that, if the Commissioner or an investigator has reasonable grounds for suspecting that an offence has been committed pursuant to the chapters set forth in the proposed law, they will be entitled to investigate any person connected to the offence or anyone who may have information relating to the offence. Furthermore, the proposed law adds a chapter to the Protection of Privacy Law, 1981, regarding the administrative means of enforcement, and, *inter alia*, prescribes provisions relating to the Commissioner's authority to impose monetary sanctions, provisions relating to an administrative warning which the Commissioner's is authorized to give a person that he has reasonable grounds for assuming that he has breached a provision of the proposed law, and provisions relating to the Commissioner's authority to furnish the offender with a notice, according to which it is possible for the latter to furnish the Commissioner with an undertaking to refrain from committing the breach.

Over and above the provisions set forth above relating to supervision, administrative arbitration and enforcement, the proposed law also provides a list of offences including interference with the Commissioner in the course of fulfilling his duty, a breach with intent to deceive, non-transmittal of a notice with the intention to deceive, etc.

Pledge Law Memorandum 2010

On 3 January 2010, the Justice Ministry distributed a draft memorandum to the Pledge Law that was prepared in the Ministry. The memorandum is intended to represent a comprehensive arrangement of the laws of pledges. The memorandum, which is based on legislative arrangements in countries such as Canada, New Zealand, Australia, is intended to generate a revolution in the field of pledges from several aspects. The declared object of those who are framing the law is that it will include the credit market, while expanding the possibilities of asset-holders to leverage their assets and remove blocks to leverage. The proposed memorandum is revolutionary in many respects and the main issues are likely to have many implications for banks, including, *inter alia*:

An option of the debtor to create additional liens on a mortgaged asset, without the consent of the holder of the lien; the option of the debtor to sell the mortgaged asset without the consent of the holder of the lien, applying the lien on an alternate of the asset (for example, if the alternate is cash deposited in some bank by the debtor, the lien in favor of the original creditor applies to him).

An option for an individual to create a lien on future assets (Till now, this was only conferred on corporations.).

An option of assigning a contractual right to another, notwithstanding that the agreement prohibits assignment and compels the registration of the assignment, whether it involves assignment via the lien or assignment via the seller.

The memorandum creates a mechanism of lien on securities registered with a bank or a member of the stock exchange, in favor of third parties, without the need to obtain the consent of the bank or stock exchange member relating to the matter.

The memorandum provides orders of priority among creditors, which vary in certain aspects from those currently in effect.

The memorandum law is still in the stage of being examined by the Ministry of Justice prior to the start of the legislative process.

Companies Law Memorandum (Amendment – Recovery of Companies), 2010

In 2010, the Ministry of Justice initiated a proposed amendment to the Companies Law regarding the recovery of companies. If the amendment to the law is passed, it will have a significant impact on the treatment of companies in difficulties and their recovery process, and the realization of securities that have been given by these companies and on the level of protection, in general, on secured creditors. The amendment includes the following:

The relief for companies to receive a stay of proceedings order and to receive it for a period exceeding the current maximum of nine months

The option to appoint an officer in the company with various authorities, such as the authority to carry out investigations, examine the company's liens, delay their realization and convert them.

The traditional protections of the holders of the liens are reduced. (It is permitted to sell and mortgage mortgaged assets against appropriate protection the rules of which are unclear.)

The Legal Division is conducting discussions within the framework of the Union of Banks with the Constitution and Law Committee, which will begin the preparation of the law for its second and third readings in the coming months.

Prohibition of the Unfair Use of Information on Securities (Legislative Amendments) Law Memorandum

On 24 October 2010, the Israel Securities Authority issued a draft for comments by the public on the law memorandum.

The object of the law is the prevention of preemptive steps by other financial officers and their employees who, by virtue of their position, have, at their disposal, information on the execution of transactions in securities carried out by their customers. Preemption means the execution of a transaction in securities in the light of foreknowledge of an expected transaction of another in the same security. A second purpose is to create a uniform arrangement in relation to restrictions on holding and making transactions in securities, which are currently stipulated in the Investment Consultancy Arrangement, in Investment Marketing and in Investment Portfolio Management Law (hereinafter: "the Consultancy Law"), and in the Joint Trust Investment Law (hereinafter: "the Joint Investment Law"), from the perception that there is no point in distinguishing between the parties under the supervision of the Israel Securities Authority on this matter.

According to the proposed amendment, a financial intermediary, effecting a transaction in a security, in the knowledge that the transaction is intended to be made in the same security or in a security related thereto or by his client or by the fund under his management or under his ownership, and the transferor of information on the aforesaid transaction, will be considered as executing a prohibited preemptive transaction, subject to five years' imprisonment or a fine of some NIS 1 million for an individual or some NIS 5 million for a corporation. A recipient of the information will also be considered as executing and making advance transactions to a lesser degree.

Amendments are also proposed with regard to restrictions on the holding of securities and making transactions in securities, which apply to various entities under the supervision of the Securities Authority.

It is also proposed to provide in the law an obligation for corporations that are financial intermediaries that employ other financial intermediaries, to determine procedures that will guarantee the retention of the proposed prohibitions within the context of the proposed law and appoint a responsible official to guarantee the enforcement of these prohibitions. Within this framework, it was proposed that the Securities Authority will be qualified to determine guidelines for the procedures that the corporations will be obliged to determine.

Proposed Regulation on Investment Intermediaries Law, 2010

On 22 August 2010, the Israel Securities Authority promulgated, for comments by the public, a draft of the law, whose aim is to regulate the engaging in intermediation in all matters relating to investments. According to the proposed format, together with the regulation of activity, a supervisory council will be established, which will also have members representing the financial intermediaries, and will be supervised by the Authority.

The law stipulates basic obligations and rules of behavior regarding all investment intermediaries (except for pension counselors who are not mentioned in the law and who are under the supervision of the Ministry of Finance), and, in addition, there will be detailed regulation in secondary legislation, adapted to each type of business, which will also refer to the subject of those incentives which are permitted.

As far as banking corporations are concerned, the Supervisor of Banks will have certain authorities in relation to directives applying to banking corporations in connection with engaging in brokerage, nostro trading or custody.

Almog Committee Report regarding Custodial Services in Israel

On 3 August 2010, a joint committee of the supervision authorities in Israel published a report on the topic of custodial services in Israel, including a number of recommendations to regulate the area of custody and its supervision, which today is partially regulated under Israeli law.

The committee determined that the lack of comprehensive, clear and consistent regulation of custodial activity in primarily and secondary legislation increases legal risk and credit risks, and therefore, regulation is essential, and not just to strengthen public confidence in the capital market in Israel, but also to improve competition in the Israeli market compared to regulated markets abroad, and it will encourage foreign investors. In this context, the committee determined that it is possible to find entities in the domestic market supplying custodial services at international standards.

The committee reviewed the existing arrangement in Israel and it was found that the principal arrangement existing today on custodial activity is Proper Conduct of Banking Business Regulation 461 which applied exclusively to banks.

On 29 December 2011, the committee published its final recommendations, and in them, adopted a comprehensive, clear and consistent arrangement of custodial activity which will be implemented by three financial supervisors in Israel (the Securities Authority, the Capital Markets Division in the Ministry of Finance and the Banking Supervision Department), and will, in the future, consider clear and concrete legal enforcement tools. The committee formulated arrangement principles, comprising a list of proposed and recommended standards that will apply to custodial services, which is attached to the committee's report.

According to the directive of the Supervisor of Banks dated 13 February 2012, the banking corporations are required to implement the committee's recommendations with effect from 1 January 2003.

Foreign Account Tax Compliance Act– FATCA In March 2010, the Internal Revenue Code in the United States (the U.S. Income Tax Law) was amended such that it brings into effect a reporting regime which aims to compel foreign financial institutions (FFI), to transfer information regarding accounts held by U.S. customers. Thus, the law considerably expands the disclosure and reporting requirements imposed on FFI in relation to U.S. accounts. In February 2012, proposals for regulations were published by the United States Internal Revenue Service ("IRS"), which provide operative directives for implementing the law. According to the IRS, final regulations are expected to be published by the end of summer of 2012.

Pursuant to the law and proposed regulations, an FFI is obliged to enter into an agreement with the IRS, whereby it will undertake, inter alia, to locate American accounts, to report on them to the IRS and to deduct tax from customers who refuse to furnish the required information and documents.

An FFI who does not sign an agreement with the IRS will be charged a deduction of tax in respect of income from American sources.

In order to be prepared for the implementation of the law in Leumi Group, the Bank has set up a steering committee which is studying and monitoring developments in the law and regulations. In its direction, the Bank is taking steps to implement working procedures and to develop a system for complying with the FATCA requirements, in accordance with what is presently known regarding the IRS requirements. To date, the Bank has carried out a demarcation of the project, an examination of the Group companies relevant to FATCA and an impact analysis with regard to the FATCA requirements. It has also taken steps to analyze the impact of the aforesaid in the relevant subsidiaries.

In recent years, working procedures for dealing with American customers have been prescribed in the Bank and in the subsidiaries. In September 2011, a letter was sent to managers regarding the Bank's policies with regard to the FATCA, reiterating the Bank policy of not advising customer on taxation matters, particularly American tax, and not assisting them in hiding their identity. In December 2011, a comprehensive procedure was issued regulating the area of identifying, locating and handling American customers, which complements the procedures previously issued.

Proposed Company Law (Amendment of Creditors' Arrangement under the Supervision of the Court)

The private bill, popularly known as "the Haircut Bill" was passed in its preliminary reading in the Knesset plenum on 25 January 2012.

According to the bill, any debt arrangement between a company and its creditors, pursuant to which the creditor forfeits 10% of the debt or converts it to other securities, must be made under court supervision, pursuant to Section 350 of the Company Law.

Amendment to Proper Conduct of Banking Management Directive No. 301 regarding Board of Directors

In December 2010, the Banking Supervision Department circulated an amendment to Proper Conduct of Banking Management Directive No. 301, which includes rules and regulations relating to the efficient functioning of the board of directors, its authorities, composition types of committees and their functioning, with most of the amendments to the directive coming into force on 1 January 2012. The changes in the amended directive are based on the recommendations of the Basel Commission, the existing practice of the supervisory authorities in Israel and regulation revisions on the subject in Israel and abroad.

The amendments include:

- Additional cases were determined in which the appointment of a person as an officer in a banking corporation would require advance notice to the Supervisor of Banks, as follows: (1) the extension of the term of office or a re-appointment to the same position; (2) the appointment to another position as an officer; (3) the appointment of a director as the chairman of the board of directors; (4) after three years in office of a director (renewal of approval).
- In connection with the deliberations of the board of directors regarding the execution and disposal of permanent investments (including investment in a controlled corporation) according to criteria as determined by the board of directors, it is provided that the aforesaid criteria will be determined in a way that will prevent the involvement of the board of directors in the day-to-day management of the banking corporation.
- It is provided that in discussions on the credit policy of a banking corporation, the board of directors will refer, *inter alia*, to the following topics: business goals and target markets for providing credit; geographic exposure, exposure to currency, to the redemption dates and concentrations of collateral, pricing policy and debt arrangements relating to problem debts.
- It is provided that the level of authorities for the provision of credit will be determined by the board of directors, such that it will limit its involvement in the day-to-day management of the banking corporation.
- It is provided that once a year, the board of directors will hold discussions behind closed doors without the management of the banking corporation, where the board will discuss various topics connected to the system of relationships between the management and the board.
- It is provided that a substantial part of the resolutions passed in the committees of the board of directors will be required to receive retroactive ratification in the plenum of the board, unless approval not to do was given by the Supervisor. In addition, it is provided that the plenum of the board of directors will be required to convene an additional discussion on the aforesaid resolution, if one of the directors demands this.
- It is provided that at least one-third of the members of the board of directors in a banking corporation will be external directors (compared with one quarter at present). In addition, it is provided that equal conditions will be applied to all of the external directors, whether they were appointed pursuant to the Companies Law or whether they were appointed pursuant to Regulation 301, with some of the requirements being more stringent with directors in a banking corporation compared to the requirements for external directors in public companies (so, for example, it is provided that, with regard to external directors in a banking corporation, they will be also considered as having an interest preventing appointment when the holder of more than five percent of a certain class of the means of control in a banking corporation has an interest).
- It is provided that a director in a banking corporation (including the chairman of the board) will not serve (except in exceptional circumstances) at the same time as being a director in entities operating in the capital market (unless the said corporation is a member of a the same banking group). In addition, it is provided that a director in a banking corporation (including the chairman of the board) will not serve (except in exceptional circumstances) at the same time as being a director in a subsidiary of the banking corporation.

- It is provided that the number of members in each of the committees of the board of directors will not exceed half of the members of the board.
- It is provided that a remuneration committee will be set up in every banking corporation, to discuss and recommend remuneration policy and remuneration procedures of the banking corporation to the board of directors.
- It is provided that a risk management committee will set up in every banking corporation, to discuss the policy for exposure to the various risks and supervise the actions of the senior managers in managing those risks.
- It is provided that the audit committee is the one that will examine the annual and quarterly statements to the public of the banking corporation, discuss and recommend their approval to the plenum, and not to a balance sheet committee. Nevertheless, it is provided that a banking corporation will be entitled to discuss the approval of the financial statements in a committee other than the audit committee until 1 January 2013, providing that at least half of its members are also members of the audit committee, including the chairman of the audit committee.

Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report

The Director's Report includes, as mentioned above, in addition to data relating to the past, information that relates to the future, which is defined in the Securities Law, 1969, ("the Law") as "forward-looking information". Forward-looking information relates to a future event or matter, the realization of which is not certain and is not within the exclusive control of the Bank.

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

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

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

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

The above does not detract from the reporting duties of the Bank under the law.

Accounting Policy on Critical Subjects

General

The preparation of consolidated financial statements, in accordance with generally accepted accounting principles and the directives of the Supervisor of Banks, requires Management to make estimates and assessments that affect the reported amounts of assets and liabilities and the amounts of income and expenses.

The actual results relating to these items may differ from the estimates and/or the assumptions.

The estimates and assessments are generally based on economic forecasts, assessments regarding the various markets and considered decisions based on past experience which Management believes to be reasonable at the time of signature of the Financial Statements.

The principle accounting policies applied in the Leumi Group are set out in detail in Note 1 to the Financial Statements.

Set out below is a brief description of the major critical accounting subjects which involve Management's estimates and assessments and which have been discussed by the Board of Directors, Management and the joint auditors:

Allowances for credit losses and classification of problem debts

Directives for the measurement and disclosure of impaired debts, credit risk and allowance for credit losses

With effect from 1 January 2011, the directive regarding "Measurement and Disclosure of Impaired Debts, Credit Risk and Allowance for Credit Losses" came into effect. The directive adapts the reporting principles applicable to banking corporations in Israel on this subject to those applicable to banks in the United States and is based on, *inter alia*, accounting standards generally accepted in the United States and the directives of the United States Securities Exchange Commission relating to banks.

The five central subjects that have been regulated in the directive are as follows:

a. A change in the definition of a problem debt. Three main types of problem debt are specified in the directive, creating a scale of problem severity in a debt.

   1. Impaired debt – a debt that the Bank expects that it will not be able to collect all of the amounts due to it according to the debt agreement.

   2. Inferior debt – a debt which is not sufficiently protected by collateral or by the payment ability of the debtor and that there is a clear possibility that the bank will suffer a loss in respect thereof, if the weaknesses are not remedied.

   3. Debt under special mention – a debt that has potential weaknesses in respect of which the special attention of the management is required.

b. A change in the allowances for credit losses – a distinction is made between an allowance on an individual basis and an allowance on a collective basis, and rules have been drawn up for the calculation of these allowances.

   1. Individual allowance – an allowance which is required to cover expected credit losses in respect of debts that were examined on an individual basis and have been identified as impaired.

   2. Collective allowance – a collective allowance in respect of all the credit not classified as impaired. This allowance cancels the additional and general allowance relating to problem debts, and other instances such as: non receipt of financial statements, sectoral deviation, and other

departures from the accepted normal banking procedures, in the event that the regulations were in accordance with Proper Conduct of Banking Business Regulation No. 315 of the Supervisor of Banks. In any event, in 2011, the Bank was obliged to continue calculating the additional allowance, for the purpose of comparing it with the collective allowance, while, the balance sheet was required to state the higher of the two.

c. Accounting write-off of debts

   1. It is provided that any debt which is not collectible should be written off.

   2. Any debt where the allowance in respect thereof has been made on the basis of a collective allowance, after more than 150 days in arrears, should be written off.
   3. When the debt is recoverable, the individual allowance should be written off two years after recording the allowance.

d. Interest income – It is provided that no interest income that has not been collected will be recorded to debts that have been classified as impaired.

e. Disclosure – The directive expands the disclosure that is provided in reports to the public regarding the quality of the credit and the allowances for credit losses, and also expands the disclosure regarding the methods and assumptions used to measure the allowances for credit losses,

For further details on the abovementioned directive, see Note 1(o) to the financial statements.

Individual allowance

Within the context of the Bank's credit policy, principles have been determined for the granting of credit and the administration and supervision of the Bank's credit portfolio, with the aim of improving its quality and reducing the risk inherent in its management. The Bank examines the credit portfolio on an ongoing basis and in accordance with procedures, for the purpose of identifying, as early as possible, those borrowers whose risk level and exposure have risen and who require special management attention and close monitoring, in light of the characteristics of the risk or as a result of the economic/market conditions that are likely to impact on the borrowers' condition, so as to improve their position. An assessment of the extent of the problem is made while exercising business judgment by the business entities dealing with the borrower, by the credit risk management units in the Corporate Division and the Commercial Division, as well as an objective evaluation of the difficulties that have been identified, in order to determine their risk level. In the Banking Division, customers with an obligo of more than NIS 500 thousand are individually identified and the remainder is dealt with in the context of a collective allowance.

As part of the measures used by the Bank to manage credit risk, there is a methodology for identifying and classifying problem debts, and the Bank is implementing it in all its lines of business. The methodology includes a structured quarterly work process in the context of which a thorough review of the credit portfolio is carried out on the basis of a number of criteria that give advance warning of a debt becoming problematic, as part of process of dealing with customer defined as sensitive. In addition, a quarterly credit review process takes place in the Corporate Division , which deals with the larger customers of the Bank, as well as in the Commercial Banking Division, which deals with medium-sized business corporations, an examination is made of those borrowers whose risk rating is higher than that requiring inclusion in the customer population defines as sensitive. *Inter alia,* the methodology requires systematic examination of the appropriateness of the allowance for credit losses in respect of the debts regarding the collection of which the Bank has doubts, while establishing basic criteria in accordance with the Bank of Israel regulations for measuring impaired debts for the manner in which the allowances for credit losses are to be calculated. An examination of the appropriateness of the allowance is made every quarter, for all lines of business, for customers classified as "impaired". The calculation is made in accordance with the characteristics of the debt, the evaluation future cash flows based on the customer's business situation and ability to continue to operate, the business environment in which the customer operates and the degree to which the customer meets its obligations, in combination with past experience and a realistic examination of the collateral and the ability to realize same, and all this, in the value of the capital of the discounted receipt and the discounted fair value of the realization of the collateral, in the judgment of the Bank's

Management. The credit risk management units in the Business and Corporate Division and the corporate credit branch in the Banking Division approve the examination of the appropriateness of the allowance. In addition, an examination is made of the ability to service the debt of customers classified by other debt indicators (debt under special mention and substandard debt).

The process described above for classifying debts and estimating potential losses in the credit portfolio is based on a draft of Proper Conduct of Banking Business Directive No. 314,"Problem Debts Regulation: Disclosure, Assessment, Classification and Treatment of Problem Debts, Rules for Allowance for Credit Losses" involves a high degree of uncertainty and subjective assessments, with regard to the classification of a loan as problematic and to the factors on which the calculations of allowances are based. The assumptions and estimates may have a material effect on the amount of provisions for credit losses.

A discussion is held each quarter by the Bank's doubtful debts committee, headed by the Chief Executive Officer, regarding the allowances required for the quarter and recommendations for the classification of problem loans. Proposals for the quarterly allowances required for customers in excess of NIS 2 million are presented for discussion. In addition, the Financial Statements Review Committee and the Board of Directors discuss the allowances for credit losses so as to approve their amount. Data on the debts and collateral of the major customers in respect of whom an allowance is required, as well as the amounts of allowance proposed by Management, are made available to the Directors as background material.

The control process concludes with the decisions regarding classification or the making of an allowance and the reporting thereof to the Accounting Division Balance Sheet Division and Profit and Loss Division of the Bank.

Individual allowances in respect of housing loans granted by Leumi Mortgage Bank and Leumi are mostly made as percentages of the debts according to the extent of arrears. These percentages have been determined in directives of the Supervisor of Banks.

The allowances of consolidated Israeli subsidiaries are made in accordance with the procedures in effect at the Bank and in accordance with the Bank of Israel directive, with regard to banking corporations.

The allowances of overseas consolidated subsidiaries are determined by their authorized bodies, in accordance with accepted practice in the countries in which they operate and the directives of the local regulatory authorities.

Derivatives

In accordance with the directives regarding financial reporting of the Supervisor of Banks, the Bank applies Financial Accounting Standards nos. 133, 138, 149 and 157, as amended, with regard to the treatment and presentation of derivatives. In accordance with these, the values of derivatives traded on an active market are determined according to market value.

Derivative instruments not traded on an active market are revalued according to generally accepted models. The models and the reasonability of their results are examined on an ongoing basis according to existing monitoring guidelines. The calculation of fair value is based on the yield of the underlying assets used for hedging these instruments, as well as additional parameters such as standard deviation, duration of term to maturity, the risk margins and the exchange rates.

In a few cases where the Bank does not have a mathematical model for revaluing a derivative, the fair value is determined on the basis of price quotations received from traders in such derivatives. Although these quotations are received from reliable brokers with whom the Bank has chosen to work, it is not certain that the price quoted reflects the price obtainable in an actual transaction in any amount, and especially transactions in large amounts. Derivatives whose fair value was determined on the basis of price quotations represent some 0.38% of total derivatives and some 0.01% of the Bank's assets as at 31 December 2011.

For further details on determining fair value as from 2011, see Note 1(L).

Securities

Securities, other than debentures held to maturity, are presented in the balance sheet at fair value. Shares in respect of which the fair value is not available are presented at cost.

The fair value of Israeli securities is based primarily on prices quoted on the Tel Aviv Stock Exchange, and of overseas securities, on prices received from external sources. Most of the portfolio is calculated on a monthly basis by a reputable international body which is engaged in the business of calculating the fair value of financial assets for their disclosure in the financial statements. This organization is not dependent on the issuing houses or the marketing bodies. The calculation is based mainly on the transaction prices in active markets, and the revaluation of similar transactions. The calculation reflects the price that a willing buyer in the market would pay for securities, based on current information available in the market. Due to the fact that only a small part of the securities is traded worldwide on a daily basis, the organization makes use of valuation models as described on page 114. Regarding the portfolio of CLO asset-backed securities, where there is no active market, fair value is determined by a cash-flow based model, generally accepted for revaluing these products. For securities that are Israeli corporate debentures which are not traded, the fair value is determined by an independent valuation based on the value determined by the "Mirvach Hogen" company. Accordingly, a lower value than the price according to "Mirvach Hogen" was determined in individual securities.

With regard to securities whose value is determined on the basis of quotations and those whose value is determined according to their stock exchange price (see also regarding derivative instruments), their fair value does not necessarily reflect the price that may be received on the actual sale of the security in large amounts.

For further details, see pages 113-114 of the Report.

For further details with regard to the determination of the fair value with effect from 2011, see Note 1(g).

Each reporting period, the Bank examines the necessity for recording a provision for impairment of securities that is not of a temporary nature. The examination is carried out when there are signs which indicate the possibility that the value of the securities has been impaired. The criteria for determination as to whether an impairment is not of a permanent nature are based on considerations and tests as follows:

- An intention and an ability to strengthen the security until the predicted recovery of the full amount of the cost.
- The assets and collateral backing the security.
- The ratio of the impairment to the total cost of the security.
- The length of time for which the fair value has been lower than cost.
- An assessment of repayment ability.
- An adverse change in the situation of the issuer or in the situation of the entire market.

The Bank’s policy is to recognize a decline in value as being non-temporary in nature at least with respect to declines in value of each security regarding which one or more of the following conditions are met:

1. A security that was sold by the date of the publication of the Report to the public.

2. A security that the Bank intends to sell, as of a time close to the date of the publication of the Report to the public, within a short time frame.

3. A debenture whose rating was significantly downgraded between the rating at the date of its purchase by the banking corporation and the rating at the date of the publication of the Report. Reduction of the rating below BBB- only is considered a significant downgrading for purposes of this item.

4. A debenture which, after its purchase, was classified as problem by the Bank.

5. A debenture regarding which there was a credit failure which was not corrected within a short period of time.

6. A security, the fair value of which has been lower than the value at which it was purchased, for a period of at least nine months prior to the end of the reported period, and is lower, by 35% or more, than the cost, and at the end of the reported period, as well as at a date prior to the publication of the report (regarding debentures – the adjusted cost). Exceptions are allowed in such cases, if the Bank has objective and solid evidence and a cautious analysis of all relevant factors, which establishes, with a high degree of certainty that the decline in value is of a temporary nature. The objective evidence and relevant factors include parameters such as: a rise in value after the date of the financial statement, a high credit rating (group A or above), analysis of stability in stress scenarios by an external professional body or by the Bank, its backing including direct government investment in the equity for the purpose of ensuring the strength of the issuing bank (hereinafter: "significant impairment").

   These principles conform to the guideline issued by the Supervisor of Banks. The definitions of "significant downgrading" and "significant impairment" have been determined by the Bank.

Obligations regarding Employee Rights

The amounts of the obligations for pension and long-service grants are calculated according to actuarial models, using a capitalization rate of 4% determined by the Supervisor of Banks, and taking into account the forecast real increase in pay on the basis of past experience, which varies according to the age of the employee. The rates of increase vary between 0.8% and 7.2%. Any 0.5% change in the rate of capitalization of the abovementioned obligations will cause an increase/decrease of some NIS 853 million in the total of the obligations, a change of 0.25% in salary levels will cause an increase/decrease of some NIS 171 million in total obligations and a change in life expectancy of 10.0% will result in an increase of some NIS 210 million in obligations.

The actuarial models include assumptions regarding life expectancy tables, disability rates, leaving rates, the rate of leaving with preferred conditions, the rate of utilization of pension rights, the rate of withdrawal of severance pay and provident fund monies, etc. Although the parameters have been determined with appropriate care and professional expertise, a change in any or some of the actuarial parameters and/or the capitalization rate and/or the rate of increase in pay will cause a change in the level of the Bank's obligations.

In 2011, the various actuarial parameters were reexamined in the framework of the Bank of Israel's directive below. No significant changes in the various actuarial parameters were revealed in the examination, and the effect on the total liabilities was not material.

In connection with the effect on leaving with preferred conditions, see page 86 below.

The actuarial changes resulting either from changes of actuarial parameters, or from the change in the yield of the reserves that are used to cover liabilities, are recorded in the profit and loss statement. In contrast, at the U.S. and British subsidiaries, these changes are charged to capital fund, in accordance with the accounting rules in those countries. For the purpose of the consolidated financial statements, the recording in the capital fund is cancelled and the amount is recorded in the profit and loss statement.

In February 2007, the Chief Actuary of the Capital Market, Insurance and Savings Department of the Finance Ministry published circulars to the pension funds and insurance companies, which applied to the financial statements as at 31 December 2006, under which pension and life insurance reserves were to be evaluated on the basis of the above mortality tables.

The Bank adopted these tables, after adjustment for previous experience with the Bank's pensioners.

The actuary's valuation of the employees' rights may be found on the Israel Securities Authority's website, the address being: www.magna.isa.gov.il.

Directives and interpretations regarding the strengthening of internal control on financial reporting of employee rights

On 27 March 2011, the directives of the Supervisor of Banks regarding the strengthening of internal control over financial reporting of employee rights were published. The directives provide a number of interpretations relating to the assessment of a liability in respect of employee rights and directives regarding internal control over the financial reporting process regarding employee rights, with a demand to recruit a qualified actuary, the identification and classification of liabilities in respect of employee rights, the existence of internal control for reliance on the actuary's assessment and validation and certain disclosure requirements.

The directive provides, *inter alia,* that a banking corporation that anticipates paying its employees benefits in excess of the contractual conditions when they leave, should take into account the number of employees who are expected to leave and the benefits the Bank expects to pay in excess of contractual conditions, in case of an early retirement of employees. As a result of the aforesaid directive, the expected number of employees who will take an early retirement was restated in the actuarial models on which the liabilities for pension payments and jubilee grants which the Bank's calculations are based upon, and the benefits in excess if the contractual conditions were taken into account.

The Bank implemented the aforesaid directive for the first time in the financial statements in the second quarter of 2011. As of 30 June 2011, each reporting period was restated and the opening balances were amended accordingly. The cumulative effect of the application of the directive on the retained earnings as of 30 June 2011 amounted NIS 549 million, gross, and NIS 390 million, net. The aforesaid effect provisions was presented as a restatement of retained earnings as of 31 December 2008, and from that date, the effects on the statement of profit and loss of each period were recorded, by the restatement of salary expenses, provision for taxes and net profit.
For more details see Note 1s.2 in the financial statements below.

Obligations in respect of Legal Claims

Among the Bank's other obligations, there are provisions for various legal claims against the Bank, including applications for class actions. The provisions were determined in a conservative manner in accordance with Management's assessments, based on legal opinions.

A quarterly discussion is held in the Bank's Allowance Committee, headed by the President and CEO, and in the Financial Statements Review Committee of the Board of Directors in respect of provisions for claims above a certain amount that have been filed against the Bank.

To assess the risks in legal proceedings filed against the Bank, the Bank's Management relies on the opinions of the outside counsel representing the Bank in these claims.

These opinions were given by the outside counsel in accordance with their most considered opinion on the basis of the facts presented to them by the Bank and on the basis of the known legal position (laws and case law) as at the date of the assessment, and which are often open to possible conflicting interpretations and claims.

The assessment of chances in relation to the approval of class actions involves even more difficulty, since this is a field, the legal doctrine relating to which, even on important matters of principle, is still being formed and not yet entirely settled. There are also claims in respect of which, due to the stage of the proceedings, counsel is unable to estimate their inherent risk, even under the above-mentioned limitations.

In light of the above, it is possible that the actual results of claims may differ from the provisions made.

Buildings and Equipment

The Bank's buildings and equipment are presented in the financial statements at cost, less accumulated depreciation and a provision for a decrease in value.

Buildings offered for sale are presented at the lower of their cost or realization value. The realization value is determined by assessors. Changes in the valuation of the asset may affect the amount of the provision for decrease in value.

Depreciation is calculated on the basis of the cost, in accordance with the estimated use period, according to the straight line method. Direct costs relating to the development of computer programs for own use (as defined in International Accounting Standard No. 38 – "Intangible Assets") are capitalized as investments in equipment after the conclusion of the initial planning stage of the project and are depreciated from the date of their operation according to an assessment of the period of their use.

From time to time the management of the Bank examines the need for provisions for a decrease in value of the assets owned by the Bank. The test for a decrease in value of the assets is made by comparing the book value of the asset with its recoverable value. Recoverable value is the higher of the realization price of the asset and its usage value (which is the present value of an estimate of the forecasted future cash flows from the use of the asset).

Income Tax

The Bank has implemented Accounting Standard No. 19, "Taxes on Income" (the "Standard"). The Standard determines rules for recognition, measurement, presentation and disclosure with regard to taxes on income and deferred taxes in the financial statements. The Standard provides, *inter alia*, that a deferred tax liability must be recognized in respect of all taxable temporary provisions, and that a deferred tax asset must be recognized in respect of all temporary differences that can be deducted, losses for tax purposes and tax benefits that have not yet been utilized, if it is anticipated that there will be taxable income against which it will be possible to utilize them, except for a limited number of exceptions.

In certain matters relating to the accounting treatment of income tax, including with regard to recognizing a deferred tax asset in respect of losses to be carried forward and temporary differences, there are additional limitations in the directives of the Supervisor of Banks which apply to the Bank.

The main subjects in respect of which deferred taxes were not recorded are as follows:

- The amounts of adjustments for changes in the purchasing power of the shekel relating mainly to structures according to the rules determined by the Israeli Accounting Standards Board in Standard 19. See Note 26G.
- Investments in investee companies that the Bank intends to keep and not realize.
- A receivable tax benefit in respect of temporary provisions where the possibility of realizing the benefit in the foreseeable future is in doubt.

The deferred taxes are calculated pursuant to the tax rates expected to apply at the time of utilization or realization of the benefit, based on the tax rates legislated or whose legislation is virtually completed by the date of the balance sheet.

Future implementation of International Financial Reporting Standards – IFRS

In July 2006, the Israeli Accounting Standards Board published Standard 29, "Adoption of International Financial Reporting Standards" (the "Standard"). The Standard determined that entities subject to the Securities Law, 1968 would prepare their financial statements in accordance with the Standard.

This does not apply to banking corporations and credit card companies, the financial statements of which are prepared in accordance with the directives and guidelines of the Supervisor of Banks.

In June 2009, the Supervisor of Banks published a circular on the subject of "Reporting of Banking Corporations and Credit Card Companies in Israel in accordance with International Financial Reporting Standards (IFRS)", which determines the expected manner of adoption of IFRS by banking corporations and credit card companies.

Pursuant to the circular, the target date for reporting of banking corporations and credit card companies according to IFRS standards is, as follows:

1. Subjects that are not a core part of the banking business – beginning 1 January 2011.

2. Subjects that are a core part of the banking business – beginning 1 January 2013. However, the Supervisor of Banks has yet to make a final decision. The final decision will be made, taking into account the timetable laid down in the United States, and progress made in the convergence process between the International and American Standard Boards.

The standards adopted by the Supervisor of Banks and their incidence with effect from 1 January 2011 are as follows:

Reporting standard	Topic	Exposure level
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors – The objective of the standard is to determine the criteria for selecting and changing accounting policy and the related treatment and disclosure.	No significant effect
IAS 21	The Effects of Changes in Foreign Exchange Rates – The objective of the standard is to prescribe how companies must include foreign currency transactions and foreign operations in the financial statements and how to translate financial statements into a presentation currency.	No effect in 2011
IAS 33	Earnings Per Share - The objective of the standard is to prescribe principles for determining and presenting earnings per share amounts to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity.	No significant effect
IFRS 2	Share-based Payment – The objective of the standard is to determine the financial reporting that companies entering into share-based payment must follow, particularly in transactions in which employees are granted options.	No significant effect
IAS 29	Financial Reporting in Hyperinflationary Economies – The objective of the standard is to establish specific standards for entities reporting in the currency of a hyperinflationary economy.	No significant effect
IAS 34	Interim Financial Reporting – The objective of this standard is to prescribe who has the duty of publishing of an interim financial report	No significant effect
IFRS 3	Business Combinations – The objective of the standard is to improve the reliable relevance and comparability of the information that reporting companies provide in the financial statements with regard to a business combination and its impacts.	No significant effect
IAS 27	Consolidated and Separate Financial Statements – The standard determines the conditions for the preparation of consolidated statements and the way they are presented.	No significant effect
IAS 28	Investments in Associates – This standard prescribes the accounting treatment of investments in associated companies and set out the conditions for implementing the procedures of the equity method.	No significant effect
IAS 36	Impairment of Assets – the objective is to establish procedures that a company must apply in order to ensure that its assets are not stated at an amount that exceeds their recoverable amount, and directives regarding recognition of a loss from the aforesaid impairment.	No significant effect
IAS 17	Leases – The objective of this standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.	No significant effect
IAS 16	Property, Plant and Equipment – The objective of this standard is to prescribe the accounting treatment for property, plant and equipment, so that users can obtain information regarding the fixed assets in the company.	No significant effect
IAS 40	Investment Property – The objective of this standard is to prescribe the accounting treatment of investment property and the related disclosure requirements.	No significant effect

Reporting standard	Topic	Exposure level
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations – The objective of this standard is to prescribe the accounting treatment of assets held for sale and the presentation and disclosure of discontinued operations. The aforesaid assets should be presented according to the lower of the book value and the fair value net of selling costs.	No significant effect
IAS 10	Events After the Reporting Period – The objective of this standard is to determine when a company must make an adjustment in its financial statements in respect of events after the balance sheet date and the required disclosures. If the "going concern" assumption is not appropriate, the company should not prepare its financial statements on a "going concern" basis.	No significant effect
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance – This standard implements the accounting treatment of government grants and assistance and the related disclosure.	No significant effect
IAS 31	Interests in Joint Ventures – prescribes the accounting treatment of interests in joint ventures and the reporting of assets, liabilities, income and expenses of a joint venture in the financial statements.	No significant effect
IAS 38	Intangible Assets – The objective of the standard is to prescribe the accounting treatment for intangible assets that are dealt with specifically in another standard. The standard requires an entity to recognize an intangible asset, if and only if, curtained defined criteria are met.	No significant effect

For additional details on accounting policies and implementation of the standards, see Note 1 to the Financial Statements.

Procedure for Approval of the Financial Statements

The Bank's Board of Directors is the entity ultimately responsible for supervision within the Bank and for the approval of the Bank's financial statements. All of the members of the Board of Directors possess accounting and financial expertise.

The Board of Directors has established a Financial Statements Review Committee, composed of members of the Board, the function of which is to discuss the financial statements and recommend their approval to the Board of Directors.

Before the financial statements are submitted to the Financial Statements Review Committee for discussion, the Bank's financial statements are discussed by the Disclosure Committee. The Disclosure Committee is a management committee comprised of all the members of the Bank's Management, and a member of the committee acts as Secretary of Bank and of the Group. The Chief Internal Auditor and additional senior managers of the Bank participate in the discussions of the Committee. The Disclosure Committee checks, *inter alia*, that the information in the financial statements is accurate, complete and presented fairly. (The Disclosure Committee was set up as part of the implementation of the Bank Supervision Department directive, which is based on Section 302 of the SOX Law. See "Controls and Procedures with regard to Disclosure in the Financial Statements" on page 291 of the Report.)

Prior to the discussion of the financial statements by the full Board of Directors, discussions are held by the Financial Statements Review Committee, with the participation of the President and Chief Executive Officer, the Deputy Chief Executive Officer, the Chief Accounting Officer, the Chief Internal Auditor and others.

The background material sent to the members of the Financial Statements Review Committee for discussion includes the minutes of discussions in the Disclosure Committee and its decisions, the draft Board of Directors' Report, the draft of the Financial Statements, information regarding the Bank's exposure to legal claims and a description of the new legal claims and background material for discussion on the appropriateness of the classification of problem customers and the provisions. The members of the committee also receive details of new disclosure requirements (if any) applicable to the Bank.

As part of the deliberations, the committee discusses the appropriateness of the provisions and the classification of the Bank's problem debts, after the Chief Executive Officer has presented to the committee the extent of the provisions and the classification for problem debts and the changes and the trends in this area, and after the senior managers have presented the extent of the provisions and classifications for which they are responsible and have detailed the main factors of change in these areas. The subject of the legal claims and of the Bank's exposure in this regard is presented by the Bank's Chief Legal Advisor. The subject of decline in value of the securities is presented by a senior manager from the Capital Market Division. The Chief Accountant presents to the Committee the main and material matters in the Directors' Report and Financial Statements, the changes in critical accounting policies, if any, and the main matters discussed by the Disclosure Committee, and the Committee also discusses these matters.

The Financial Statements Review Committee submits its recommendations regarding the financial statements to the Board of Directors. The committee's recommendations relate, *inter alia*, (in accordance with the provisions of the Companies Regulations (Directives and Conditions Regarding the Process for Approving the Financial Statements), 2010) ("**the Companies Regulations**") to assessments and estimates made in connection with the statements; internal controls related to financial reporting, completeness and fairness of disclosure in the statements; the accounting policy adopted and the accounting treatment applied on the Bank's material interests; valuations, including assumptions and estimates on which they are based, which support the data in the financial statements.

Following the discussions of the Committee, there is discussion on the final draft of the Financial Statements in the full Board of Directors, attended by the President and Chief Executive Officer, the Chief Accounting Officer, the Chief Internal Auditor, and when the discussion concerns the approval of the annual financial statements, all the other members of the Bank's Management in addition. As background material for the discussion, the Directors receive the draft Financial Statements together with extensive accompanying background material, including in-depth comprehensive analyses of the Bank’s activities in its various areas of business.

In the context of this discussion, the Bank’s President and Chief Executive Officer reviews the results of Leumi Group's operations and the Chief Accountant presents and analyzes the results of the Group's operations in Israel and abroad, including a description of risk exposure and compliance with the limits established with regard to such risks. Thereafter, the full Board of Directors discusses and accordingly approves the financial statements.

All the discussions of the Board of Directors, the Financial Statements Review Committee and the Committee for Disclosure regarding the financial statements are attended by representatives of the Bank’s joint auditors, who are available to the participants to answer questions and provide clarifications. The financial statements are approved by the Board of Directors following their presentation to the joint auditors to the Financial Statements Review Committee and the Audit Committee of the Board of Directors of any material weaknesses that may have arisen during the audit processes that they carried out, and after the Board is presented with the representations of the President and Chief Executive Officer and of the Chief Accountant regarding evaluation of the Bank's disclosure controls and procedures for the financial statements.

The composition of the Financial Statement Review Committee is as stipulated by the Companies Law Regulations. The committee includes seven directors, including, pursuant to the Companies Law, one external director serving in the Bank, who chairs the committee. A further three committee members are external directors as stipulated by the Banking Supervision Department, and all the aforesaid external directors (pursuant to both Companies Law and the Banking Supervision Department Regulations) are independent directors. In addition, all committee members have financial and accounting expertise.

Disclosure Policy

Pursuant to Bank of Israel directives, the reporting requirements in Pillar 3 of the Basel II directives oblige the Bank to determine a formal disclosure policy. The policy is to refer to the banking corporation's approach to determining what disclosure is made, including the internal controls on the process.

Leumi has determined its disclosure policy, which has been approved by the Board of Directors.

The disclosure policy is based on the Directives for Reporting to the Public of the Supervisor of Banks and the provisional directives of the Israel Securities Authority, which have been adopted by the Supervisor of Banks.

In accordance with the said disclosure policy, Leumi aims to provide all material information necessary to understand its statements, which will be reported clearly and in detail.

Information given in the Directors' Report is prepared in accordance with directives for Reporting to the Public, particularly with regard to "Temporary Order concerning the Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report". In accordance with the directive, the directors' report is to include information in the Bank's business, the operating segments in which it operates, the general environment in which it operates and its effect on the Bank, the control structure of the Bank and its organizational structure, legal proceedings, material agreements, and detailed information on other matters.

With regard to information which can be quantified monetarily, quantitative data is given, and with regard to other information, qualitative data is given.

The general principle according to which information is given in the report is the principle of materiality. The Bank's business and its activities are examined according to their scope and nature, and at the end of the examination, disclosure is made regarding matters of material monetary size in relation to the annual profit of the Bank, its assets or its capital. In addition, disclosure is made of matters of public interest or of special sensitivity, such as matters connected with the structure of the Bank, its management, legislation affecting the bank and so on.

For the purposes of complying with this policy, every material subject is brought for discussion to the Disclosure Committee, (see above chapter of the Procedure for Approval of the Financial Statements), which decides, in all dubious cases, whether to make the necessary disclosure. Minutes of the Disclosure Committee are sent for perusal by the members of the Financial Statements Review Committee of the Board of Directors.

See also page 291, "Controls and Procedures regarding Disclosure in the Financial Statements".

D. Description of the Group's Businesses According to Segments and Areas of Activity

Development of Income, Expenses and the Tax Provision[1]

The net profit of the Leumi Group in 2011 amounted to NIS 1,891 million, compared with a profit of NIS 2,334 million in 2010 – a decrease of 19.0%. The operating profit in 2011 amounted to NIS 1,889 million, compared with a profit of NIS 2,151 million in 2010, a decrease of 12.2%.

The following table presents the principal changes in the Group's net profit in 2011:

	2011	2010	Change
	NIS millions		%
Net profit	**1,891**	2,334	(19.0)
Net operating profit	**1,889**	2,151	(12.2)

The decrease in the net profit in 2011 compared with 2010 is explained mainly by the following factors*:

1. An increase in expenses in respect of credit losses amounting to NIS 150 million, before the effect of taxes.

2. A decrease in operating and other income amounting to NIS 375 million, before the effect of taxes.

3. An increase in operating and other expenses (including salary) amounting to NIS 396 million, before the effect of taxes.

4. A decrease in the Group's share in the profits of companies included on equity basis amounting to NIS 272 million, net.

5. A decrease in extraordinary income amounting to NIS 181 million, net, as a result of the sale of Paz in 2010.

* Before minority interests.

On the other hand, the following factors partially offset the above decrease:

1. An increase in net interest income before expenses in respect of credit losses amounting to NIS 117 million, before the effect of taxes.

2. A decrease of 22 percentage points in the effective rate of tax as explained on page 87 in the item, provision for tax. The decrease in the tax provision amounted to NIS 821 million.

The Group concluded the fourth quarter of the year with a net profit of NIS 618 million, compared with a net profit of NIS 496 million in the fourth quarter of 2010, an increase of 24.6%.

[1] The Financial Statements are prepared in reported values. The known Consumer Price Index rose by 2.6% in 2011. The shekel depreciated in nominal terms by 7.7% against the U.S. dollar, while the euro depreciated by 4.2%. The representative rate of exchange of the U.S. dollar on 31 December 2011 was NIS 3.821.

For further details see Note 1.E to the Financial Statements.

Following are the main factors contributing to the increase of NIS 122 million in net profit in the fourth quarter compared with the corresponding quarter last year:

1. Income from taxation amounting to NIS 246 million as a result of a change in deferred taxes.

2. A decrease in operating and other expenses amounting to NIS 173 million, before the effect of taxes.

On the other hand, the following factors partly offset the abovementioned increase:

1. A decrease in net interest income before expenses in respect of credit losses amounting to NIS 173 million, before the effect of taxes.

2. An increase in expenses in respect of credit losses amounting to NIS 173 million, before the effect of taxes.

3. A decrease in operating and other income amounting to NIS 175 million, before the effect of taxes.

4. A decrease in the Group's share in the profits of companies included on equity basis amounting to NIS 158 million, net.

For further details, see page 89 below and Exhibit H to the Management Review.

Net interest income before expenses in respect of credit losses of the Leumi Group amounted to NIS 7,550 million in 2011, compared with NIS 7,433 million in 2010 – an increase of 1.6%. Net interest income before expenses in respect of credit losses of the Bank amounted to NIS 5,322 million in 2011, compared with NIS 5,826 million in 2010 – a decrease of 8.7%.

The change in the Group's net interest income before expenses in respect of credit losses derives mainly from:

	2011	2010	Change	Change
	NIS millions			%
Current activities	**7,493**	6,564	929	14.2
Collection of interest in respect of credit losses (1)	**29**	565	(536)	-
Net effect of non-accrual loans	**(349)**	(189)	(160)	84.4
Exchange rate difference in respect of financing shares credited to operating income or to capital reserve	**(38)**	20	(58)	-
Profits from available-for-sale debentures, net	**265**	262	(3)	(1.1)
Realized and unrealized profits from adjustments to fair value of debentures held for trading, net	**78**	147	(69)	(46.9)
Financing income (costs) in connection with the hedging of investments abroad (2)	**(132)**	130	(262)	-
Adjustments of derivative instruments to fair value	**58**	(119)	177	-
Effect of the known CPI	**146**	53	93	+
Total (1)	**7,550**	7,433	117	1.6

(1) From the first quarter of 2011, collections have been first recorded as a reduction in the expenses in respect of credit losses, whereas in the past, they were first included in net interest income. In cancelling the effect of the abovementioned item, there was an increase of NIS 653 million (9.5%), compared with net interest income in 2010.

(2) The cost of hedging asymmetry in tax liabilities in respect of exchange rate differentials on investments abroad compared with exchange rate differentials on sources of funds; the compensation for this cost is shown under taxes. See the effect also in the section on Taxes.

The following are additional details regarding the change in net interest income:

1. The total interest margin, including derivatives, decreased by 22 percentage points. The total effect of the price was negative and reduced net interest income by NIS 120 million, mainly in the foreign currency segment.
2. On the other hand, the increase in the volume of activity of 7.9% contributed to an increase of some NIS 729 million, mainly in the unlinked shekel segment where the volume of activity increased by 14.4%

For further details, see Exhibit C to the Management Review and Note 20 to the Financial Statements.
For a breakdown by segment of the changes in net interest income before expenses in respect of credit losses, see Note 28A to the Financial Statements, and Exhibit C to the Management Review.
For details regarding changes in net interest income by quarter, see page 89 below in Development of Main Items in Income from Financing Operations.

The following table shows the development of net interest income according to principal operating segments:

Segment	**2011**	2010	Change
	NIS millions		%
Households	**2,621**	2,217	18.2
Small businesses	**946**	906	4.4
Corporate banking	**1,759**	2,068	(14.9)
Commercial banking	**1,533**	1,470	4.3
Private banking	**441**	407	8.4
Financial management – capital markets	**236**	355	(33.5)
Other	**14**	10	40.0
Total	**7,550**	7,433	1.6

The following table presents the apportionment of activities by linkage sector, and their contribution to net interest income before expenses in respect of credit losses:

	2011			2010			Changes in net interest income	
	Scope of activity in %	Contribution to income* %	Contribution to income* NIS millions	Scope of activity in %	Contribution to income* %	Contribution to income* NIS millions	NIS millions Quantitative effect	Price effect
Israeli Currency:								
Unlinked	**45**	**64**	**4,831**	43	55	4,051	608	172
CPI-linked	**12**	**8**	**583**	12	1	96	95	392
Foreign currency, including foreign currency linked	**43**	**14**	**1,024**	45	23	1,682	26	(684)
	100		**6,438**	100		5,829	729	(120)
Options and other derivatives**		**2**	**154**		1	86		
Financing commissions		**5**	**399**		5	384		
Other financing income (expenses), net		**7**	**559**		15	1,134		
Total		**100**	**7,550**		100	7,433		

* Including financing income/expenses from activity in derivatives.

** The above profits cover the losses in the various linkage sectors.

The decrease in profit in the foreign currency sector stems from a devaluation of the shekel in relation to most currencies which affected expenditure resulting from an excess of financial liabilities in this sector.

The ratio of net interest income before expenses in respect of credit losses to the average balance of the income-earning balance sheet assets was 2.38% in 2011, compared with 2.43% in 2010.

Total Interest Margin (excluding transactions in derivative instruments) was 1.36% in 2011, compared with 2.58% in 2010 (of the Bank – 1.10% in 2011, compared with 2.46% in 2010). The interest margin, including transactions in derivative instruments, was 1.00% in 2011, compared with 1.22% in 2010 (of the Bank 0.78% in 2011, compared with 1.02% in 2010).

The interest margin in 2011 was adversely affected, *inter alia*, by the following factors:

1. Pursuant to the Supervisor of Banks' Regulations, with effect from 2011, the interest margin on credit to the public is calculated on average balances before expense for credit losses compared with previous years when the average balance was calculated on the net credit balance.

2. The change in Bank of Israel interest rates improved the interest margin excluding derivatives, mainly in the unlinked shekel segment.

3. The decrease in the overall interest margin was affected, *inter alia*, by exchange rate differentials including in respect of the hedging of foreign investments and by an increase in the rate of activity in derivatives out of the total assets.

4. Competitive factors in the system also contributed to the part of the increase in the interest margin from the abovementioned factors.

For further details on rates of income and expenses according to the different sectors, see Exhibit C to the Management Review.

Financing Commissions amounted to NIS 399 million in 2011 compared with NIS 384 million in 2010, an increase of 3.9%. These commissions include mainly income from off-balance sheet activity, such as guarantees for the granting of credit, guarantees for apartment purchasers and other guarantees, as well as commissions from foreign trade activity.

Other interest income and expenses include mainly profits/losses from the sale of debentures and the adjustment of debentures held for trading to fair value or market value; income from commission for early repayment of credit; collection of interest in respect of doubtful debts from previous years and a reduction in provisions for interest. The net income in respect of these activities amounted to NIS 559 million in 2011, compared with income amounting to NIS 1,134 million in 2010.

The following table shows the principal changes in other interest income and expenses:

	2011	2010	Change
	NIS millions		%
Profit from the sale of available-for-sale debentures	**315**	271	16.2
Losses from sale and impairment of available-for-sale debentures	**(50)**	(9)	-
Profit from the sale of and adjustments to market value of debentures held for trading	**78**	147	(46.9)
Collection of interest in cash (1)	**13**	565	(97.6)
Commissions for early repayment of credit	**161**	147	9.5
Other	**42**	13	+
Total	**559**	1,134	(50.7)

For further details, see Note 20 to the Financial Statements.

(1) From the first quarter of 2011, collections have been first recorded as a reduction in the expenses in respect of credit losses, whereas in the past, they were first included in net interest income.

Expenses in respect of credit losses in the Leumi Group in 2011 amounted to NIS 734 million, compared with NIS 584 in 2010 – an increase of NIS 150 million, and a rate of 25.7%. Expenses in respect of credit losses in the Bank in 2011 amounted to NIS 600 million, compared with NIS 340 million in 2010 – an increase of NIS 260 million.

The increase of expenses in respect of credit losses in 2011 derives partly from a change in the directive in respect of impaired debts, which led to an increase in the collective allowance, requiring an allowance in respect of any increment in balance-sheet and off balance sheet credit, and from the effect of a fall in the market value of collateral. On the other hand, the recording of the collection, first as a collection of the principal, and not as the collection of interest in financing income, partially offset the expenses in respect of credit losses.

With regard to the changes in the new directives regarding expenses in respect of credit losses and impaired debts, see page 62 above.

The effect of the change in the initial transition to the method of calculating the aforesaid allowances as of 31 December 2010 will be included in retained profits in capital. The impact amounted to NIS 1,319 million, gross, and NIS 721 million, net after tax.

The overall rate of expense for credit losses in 2011 was 0.30% of total credit to the public (in annual terms), compared to 0.26% and 0.74% in 2010 and 2009, respectively. The overall rate of expense for credit losses in relation to the overall credit risk (balance sheet and off-balance sheet) was 0.20%, 0.17% and 0.48%, respectively. The rate of expense for individual credit losses constituted 0.16% of all credit to the public, compared to 0.32% and 0.76% in 2010 and 2009, respectively. The decrease in the rate of expense for individual credit losses stems from the fact that part of the credit loss expenses, which were previously recorded as a specific expense, are now registered as a collective allowance due to the change in the directives of the Supervisor of Banks in 2011.

As mentioned above, with effect from 1 January 2011, the directives of the Supervisor of Banks regarding the measurement and disclosure of impaired debts, credit risk and allowance for credit losses, apply. The aforesaid directives adopt the generally accepted regulations of the authorities in the United States. As a part of the abovementioned regulation, the general and additional allowance was canceled and in its stead, a collective allowance in respect of credit risk was made. The collective allowance as at 31 December 2011 amounts to NIS 2,570 million, representing 0.72% of the total overall credit risk, compared with NIS 2,396 million as at 1 January 2011, representing 0.70% of the total overall credit risk. The total addition to the collective allowance amounts to NIS 1,800 million compared with the additional and general provision amounting to NIS 770 million as at 31 December 2010. The addition to the collective allowance as at 1 January 2011 was recorded to the debit of capital and the change in 2011 was carried to the profit and loss statement.

The following table shows the development of expenses in respect of credit losses according to principal operating segments:

	Year ended 31 December 2011		Year ended 31 December 2010	
	NIS millions	Percentages*	NIS millions	Percentages*
Households	**69**	**0.1**	169	0.2
Private banking	**(31)**	**(0.3)**	8	0.1
Small businesses	**89**	**0.4**	147	0.8
Corporate banking	**312**	**0.4**	(71)	(0.1)
Commercial banking	**218**	**0.4**	341	(0.7)
Financial management and other	**77**	**7.4**	(10)	(2.0)
Total	**734**	**0.3**	584	0.26

* Percentage of total credit at year end.

The following table shows the breakdown of the expense in respect of credit losses by principal sectors of the economy, including collective allowance:

	2011
	NIS millions
Agriculture	**(39)**
Industry	**64**
Construction and real-estate	**436**
Trade	**100**
Hotels, accommodation and food	**(80)**
Transport and storage	**20**
Communications and computer services	**(19)**
Financial services	**250**
Other business services	**(11)**
Private individuals – housing loans	**(9)**
Private individuals – other	**10**
Others	**12**
Total	**734**

The following table shows the provision for doubtful debts by principal sectors of the economy*:

	2010
	NIS millions
Industry	(31)
Construction and real-estate	418
Trade	268
Hotels, accommodation and food	(34)
Transport and storage	(53)
Communications and computer services	(54)
Financial services	(23)
Other business services	42
Private individuals – housing loans	(46)
Private individuals – other	224
Others	10
Total	721

* In 2010, provisions for doubtful debts according to the previous method.

The following is a summary of the expenses in respect of credit losses *:

	For the year ended 31 December 2011	**For the three months ended 31 December 2011**
	NIS millions	
Individual allowance during the period	**1,133**	**416**
Reduction in individual allowance	**(751)**	**(238)**
Net increase carried to the profit and loss statement	**382**	**178**
Increase in respect of collective allowance carried to profit and loss statement	**352**	**207**
Total increase in expense in respect of credit losses	**734**	**385**

	For the year ended 31 December 2010	For the three months ended 31 December 2010
	NIS millions	
Specific allowance during the period	2,318	846
Reduction in allowance	(1,581)	(591)
Collection of debts previously written off	(23)	(7)
Net increase carried to the profit and loss statement	714	248
Decrease in respect of supplementary allowance carried to profit and loss statement	(130)	(36)
Total allowance for doubtful debts	584	212

* 2010 provisions for doubtful debts according to the previous method.

The following table shows the breakdown of expenses in respect of credit losses in the Group (the Bank and consolidated companies) that were recorded in the statement of profit and loss:

	For the year ended 31 December		
	2011	2010*	Change
	NIS millions		%
The Bank	**600**	340	76.5
Arab Israel Bank	**6**	24	-
Leumi Mortgage Bank	**(16)**	(42)	+
Leumi Card	**15**	31	(51.6)
Bank Leumi USA	**49**	124	(60.5)
Bank Leumi (UK)	**36**	22	63.6
Leumi Romania	**41**	72	(43.1)
Leumi Leasing and Investments	**3**	15	-
Others	**-**	(2)	+
Total	**734**	584	25.7

* 2010 provisions for doubtful debts according to the previous method.

The following table shows the net expenses in respect of credit losses as a percentage of the balance of credit to the public at the Bank's responsibility:

	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002
	%									
The banking system in Israel	(*)	0.41	0.73	0.71	0.21	0.52	0.69	0.88	1.13	1.36
Leumi Group	**0.30**	0.26	0.74	1.01	0.20	0.51	0.79	0.87	1.09	1.09

(*) Data for the banking system are not known on the date of publication of this Report.

Non-performing assets (*), impaired debts accruing interest income, problem commercial credit risk and unimpaired debts in arrears of 90 days or more:

(*) Impaired debts that do not accrue interest income

All of the balances shown in this table are presented pursuant to the new directives for the measurement and disclosure of impaired debts, credit risk and provision for credit losses. All of the balances are before allowance for credit losses.

	31 December 2011	31 December 2010
	Reported amounts	
On a consolidated basis	NIS millions	
1. Non-performing assets:		
Impaired credit to the public not accruing interest income*		
Reviewed on an individual basis	**6,634**	8,876
Reviewed on a group basis	**6**	6
Impaired bonds not accruing interest income	**-**	-
Impaired debts not accruing interest income	**25**	19
Total impaired bonds not accumulating interest income	**6,665**	8,901
Assets received in respect of credit repaid	**75**	81
Total non-performing assets	**6,740**	8,982
2. Impaired debts in the restructuring of problem debts accruing interest income	**156**	65
3. Problem commercial credit risk (1):		
Problem balance sheet credit risk in respect of the public	**10,443**	12,734
Problem commercial off-balance sheet credit risk in respect of the public (2)	**1,524**	1,800
Total problem commercial credit risk in respect of the public	**11,967**	14,534
Balance sheet credit risk in respect of others	**324**	443
Off-balance sheet credit risk in respect of others	**-**	-
Total problem commercial credit risk in respect of others	**324**	443
Total problem commercial credit risk	**12,291**	14,977
4. Unimpaired debts in arrears of 90 days or more	**1,556**	1,109
Of which: Housing loans for which provision has been made according to the extent of arrears	**655**	788
Housing loans for which provision has not been made according to the extent of arrears (3)	**263**	258
Unimpaired bonds in arrears of 90 days or more	**-**	-
Others	**638**	63

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

* It should be noted that the new method of accrual does not include CPI/foreign currency linkage differentials on the principal.

(1) Balance sheet credit (credit, bonds, other debts recognized in the balance sheet and assets in respect of derivative instruments) and off-balance sheet credit risk that is impaired, inferior or under special supervision, except for balance sheet and off-balance sheet credit risk in respect of private individuals.
(2) As calculated for the purpose of restrictions on the indebtedness of a borrower or group of borrowers, except in respect of guarantees given by a borrower to secure the indebtedness of a third party, before the effect of deductible collateral.
(3) Housing loans, the minimum allowance in respect of which is calculated according to the extent of the arrears which are in arrears of between 3 to 6 months, and other housing loans that are not impaired, which are in arrears of 90 days or more and the minimum allowance for which is not calculated according to the extent of arrears.

Below are a number of indices for reviewing credit risk according to the new directives:

	31 December 2011	31 December 2010
	%	
Balance of impaired credit to the public not accruing interest income as a percentage of the balance of credit to the public	**2.7**	3.9
Balance of credit to the public which is not impaired in arrears of 90 days or more as a percentage of the balance of credit to the public	**0.6**	0.5
Balance of the allowance for credit losses in respect of credit to the public as a percentage of the balance of credit to the public	**1.6**	2.4
Balance of the allowance for credit losses in respect of credit to the public as a percentage of the balance of impaired credit to the public not accruing interest income	**59.7**	60.5
Problem commercial credit risk in respect of the public as a percentage of total credit risk in respect of the public	**3.3**	4.2
Expenses in respect of credit losses as a percentage of the average balance of credit to the public	**0.3**	0.3
Net write-offs in respect of credit to the public as a percentage of the average balance of credit to the public	**0.9**	*
Net write-offs in respect of credit to the public as a percentage of the balance of the provision for credit losses in respect of credit to the public	**52.2**	*

* The above ratios cannot be calculated because of the initial implementation of new directives.

Summary of the effect of the initial implementation of the new directives on the retained earnings as at 31 December 2010:

The table below shows the effect of the initial implementation of the new directives for the measurement and disclosure of impaired debts, credit risk and allowance for credit losses, if they have been implemented for the first time on 31 December 2010.

	31 December 2010
	Reported amounts
	NIS millions
Balance of undistributed profits as of 31 December 2010 included in the Financial Statements	**15,437**
Cumulative effect, net of tax, from initial application of the new directives at 31 December 2010	**(721)**
Of which: Change in allowance for credit losses	**(1,319)**
Related tax effect	**598**
Balance of retained earnings as of 31 December 2010 according to the new directives	**14,716**

Net Interest Income of the Leumi Group after expenses in respect of credit losses, amounted to NIS 6,816 million in 2011, compared with NIS 6,849 million in 2010 – a decrease of 0.5%. The decrease derives from a rise in expenses from credit losses. Net interest income after expenses in respect of credit losses amounted to NIS 4,722 million in 2011, compared with NIS 5,486 million in 2010 – a decrease of 13.9%.

Total Operating and Other Income of the Leumi Group in 2011 amounted to NIS 3,736 million compared with NIS 4,111 million in 2010 – a decrease of 9.1%. (In the Bank, NIS 2,631 in 2011, compared to NIS 2,612 million in 2010, an increase of 0.7%).

The following table shows the principal changes in operating and other income:

	2011	2010	**Change**	Change
	NIS millions			%
Operating commissions (1)	**3,702**	3,739	(37)	(1.0)
Profits (losses) from investments in shares (2	**(12)**	216	(228)	-
Other income (3)	**46**	156	(110)	(70.5)
Total operating and other income	**3,736**	4,111	(375)	(9.1)

Below are additional details regarding each of the above-mentioned items:

1. Operating commissions (decrease of NIS 37 million)

a. An increase in income from the handling of credit and the drawing up of contracts, amounting to NIS 31 million (9.2%);

b. An increase in income from credit cards, amounting to NIS 38 million (4.6%);

c. A decrease in income from activity in securities, amounting to NIS 79 million (9.1%);

d. A decrease in income from account management amounting to NIS 10 million (1.2%).

e. A decrease in income from conversion differentials amounting to NIS 6 million (2.0%).

The Bank provides pension counseling in a partial format, and receives distribution commissions in respect of provident funds (including pension funds) related to the counseling.

2. Profits from investments in shares and funds (decrease of NIS 228 million):

a. Net losses amounting to NIS 226 million from the sale of available-for-sale shares and from an impairment of a nature other than temporary, compared with profits amounting to NIS 41 million in the corresponding period the previous year. In the third quarter of 2011, Leumi Group recorded impairment amounting to NIS 239 million in respect of investments in shares of Partner Communication Ltd.

b. Profits from realization and adjustment to fair value of securities held for trading amounting to NIS 140 million, primarily attributable to the collection of a debt from Lehman Brothers.

c. Income from dividends from available-for-sale shares and shares held for trading amounted to NIS 74 million in 2011, compared with NIS 174 million in 2010. The decrease derives mainly from a decrease in dividends from Partner amounting to NIS 97 million.

3. Other income (decrease of NIS 110 million)

The reduction in other income in 2011 derives mainly from gains in the employees' severance pay fund, which amounted to NIS 70 million recorded last year. This year, no gains were recorded.

The following table shows details of other income:

	2011	2010	Change	Change
	NIS millions		%	NIS millions
Profits from the severance pay fund	**-**	70	-	(70)
Other income	**46**	86	(46.5)	(40)
Total	**46**	156	(70.5)	(110)

With regard to legal claims and the discussions with the Antitrust Commissioner on topics relating to credit cards, see Note 18.K to the Financial Statements.
With regard to the Antitrust Commissioner's announcement concerning the coordination of commission rates, see Note 18. M.

The ratio of operating and other income to total income (i.e. net interest income before expenses in respect of credit losses, and operating and other income) was 33.1%, compared with 35.6% in 2010.

Operating and other income covered 44.8% of operating and other expenses, and, after neutralizing special salary expenses as detailed below, 47.4%, compared with cover of 51.7% and 53.3%, respectively, in 2010.

For further details, see Notes 21-23 to the Financial Statements.

Total operating and other expenses of the Leumi Group in 2011 amounted to NIS 8,347 million, compared with NIS 7,951 million in 2010 – an increase of 5.0%. After canceling the effect of special salary expenses as set forth below, there was an increase of 2.1% (at the Bank – NIS 6,198 million in 2011, compared with NIS 5,807 million in 2010 – an increase of 6.7% and a rise of 3.2% after canceling the effect of special salary expenses).

a. Salary expenses amounted to NIS 5,067 million in 2011, compared with NIS 4,676 million in 2010, an increase of 8.4%. The increase in salary expenses derives mainly from the losses that were in the severance pay fund and the provident fund in 2011, which are also used as a reserve for covering pension obligations to employees, compared with the profits in the corresponding period last year, the effect of which was NIS 455 million, compared with NIS 208 million in the corresponding period last year. After canceling the effect of the special salary expenses as specified below, the increase in salary amounted to 3.6%.

The following table shows details relating to special salary expenses:

	2011	2010
	NIS millions	
Supplementing provisions for severance pay and pension*	**455**	208
Recording (cancellation) of benefit in respect of sale of shares to employees	**13**	(22)
Actuarial adjustments in respect of long-service bonuses	**-**	51
Total special salary expenses	**468**	237

* The offset is limited to the extent of the expense and the positive surplus is recorded in other income.

Below are additional details of components of salary expenses:

1. The calculation of the Bank's actuarial liability for pensions and long-service bonuses in the financial statements is made on the basis of the discount rate stipulated by the Supervisor of Banks of 4%, assuming a real increase in salaries based on past experience, and varying according to the employee's age. The rates of increase range from 0.8%-7.2%.

2. In 2011, the various actuarial parameters serving as calculation indicators were re-examined. There were no material changes as a result of the aforesaid examination.

3. The Bank implemented the regulations of the Banking Supervision Department regarding the strengthening of internal control over financial reporting concerning the rights of employees for the first time in the financial statements for the second quarter of 2011. As of 30 June 2011, all of the reporting periods were restated and the opening balances amended accordingly. The cumulative effect of implementing the regulation on the balance of retained earnings in the shareholders' equity as of 30 June 2011 amounted to NIS 549 million, gross, and NIS 390 million, net. The change in the aforesaid provisions was recorded as a restatement of the balance of retained earnings at 31 December 2008, and from that date, the impact for profit and loss of each period was recorded by the restatement of the salary expenses, provision for taxes and the net profit. For details, see Note 1s.2 to the financial statements below.

4. For details regarding costs related to the privatization of the Bank, see the above table.

For further details, see Note 15 to the Financial Statements.

Salary and related expenses (excluding special expenses) constituted some 58.0% of total operating expenses in 2011, compared with 57.0% in 2010.

b. Operating and other expenses, excluding salary expenses, amounted to NIS 3,280 million in 2011, compared with NIS 3,275 million in 2010, with no material change. After canceling the effect of the goodwill in 2010 in respect of the investment in Romania, expenses increased by 2.6%.

Other important changes were as follows:

1. An increase in the expenses of maintenance of buildings and equipment amounting to NIS 40 million (4.2%).

2. An increase in expenses in respect of professional services including legal expenses amounting to NIS 53 million (16.4%), mainly as a result of the implementation of the " Advancing Together" project in the Banking Division, a project to improve the operating model of Leumi's retail activity, and in respect of expenses of purchasing Banque Safdié in Switzerland.

3. An increase in marketing and advertising amounting to NIS 23 million (8.8%).

4. An increase in depreciation expenses amounting to NIS 73 million (11.4%). Of this, NIS 23 million is the effect of the initial application of international accounting standards.

5. A decrease in goodwill amortization expenses amounting to NIS 78 million stemming from the amortization of goodwill in 2010 in respect of the investment in Romania**.**

Group computer expenses shown in Note 25 to the Financial Statements do not include the Bank's computer expenses, which are included in all other expenses, since the computer center is a unit within the Bank. Computer expenses include mainly expenses in subsidiaries that purchase computer services and/or are outsourcing costs.

For further details see Notes 24 and 25 to the Financial Statements.

Operating and other expenses in 2011 constitute 74.0% of total income, compared with 68.9% in 2010 and 58.5% in 2009. After canceling the effect of the special salary expenses set forth above, the operating expenses constitute 69.8% of total income, compared with 66.8% in 2010. In addition, the recording of collections in respect of credit losses as the collection of principal instead of interest income had an impact of some 3 percentage points on the abovementioned change.

Total operating and other expenses constitute 2.28% of total assets, compared with 2.42% in 2010, and, after neutralizing special salary expenses of 2.13% and 2.26%, respectively.

Operating profit before taxes of the Leumi Group in 2011 amounted to NIS 2,205 million, compared with NIS 3,009 million in 2010 – a decrease of NIS 804 million or 26.7% (in the Bank – a profit of NIS 1,155 million in 2011, compared with a profit of NIS 2,291 million in 2010, a decrease of NIS 1,136 million, or 49.6%). After canceling the effect of special salary expenses, the decrease was NIS 573 million or 17.7%, while, in the Bank, the decrease was NIS 922 million.

Provision for taxes on operating profit of the Leumi Group in 2011 amounted to NIS 418 million in 2011, compared with NIS 1,239 million in 2010. The statutory tax rate for financial institutions in Israel in 2011 was 34.5%, compared with 35.3% in 2010.

The actual tax provision for 2011 is 19.0%, compared with 41.2% in 2010.

The rate of provision for taxes was affected in 2011 by the following factors:

- The cancelation of the outline reduction plan in the rate of company tax, and an increase in the rate of company tax to 25%, had an impact on the increase in the balance of deferred taxes amounting to NIS 326 million.

- The effect of positive exchange rate differentials in respect of investments abroad in 2011, compared to negative exchange rate differentials in 2010 led to a reduction in tax amounting to NIS 106 million, compared to an increase in tax amounting to NIS 114 million in 2010.

For further details on the provision for taxes, see Note 26 to the Financial Statements.

Operating profit after taxes of the Leumi Group in 2011 amounted to NIS 1,787 million, compared with a profit of NIS 1,770 million in 2010, an increase of 1.0%.

The Group's share in operating profits (losses) after taxes of companies included on equity basis in 2011 amounted to a profit of NIS 148 million, compared with a profit of NIS 420 million in 2010, a decrease of NIS 272 million.

The majority of the profit under this item derives from the contribution of the following companies:

1. The Israel Corporation Ltd.: a profit of NIS 97 million in 2011, compared with a profit of NIS 350 million in 2010.
2. Associate companies of Leumi Partners: a profit of NIS 60 million in 2011, compared with NIS 38 million in 2010. For further details, see page 180 of the Report.

Net operating profit before attribution to non-controlling interests in 2011 amounted to a profit of NIS 1,935 million, compared with a profit of NIS 2,190 million in 2010.

Net operating profit attributed to non-controlling interests in 2011 amounted to a profit of NIS 46 million, compared with a profit of NIS 39 million in 2010.

Net operating profit attributable to shareholders of the Leumi Group banking corporation in 2011 amounted to a profit of NIS 1,889 million, compared with a profit of NIS 2,151 million in 2010, a decrease of 12.2%. After canceling the effect of special salary expenses as explained above, there was a decrease of NIS 106 million or 4.6%.

Profit from extraordinary activity after taxes before attribution to non-controlling interests amounted in 2011 to a profit of NIS 2 million, compared to NIS 183 million in 2010. The profit in 2010 was mainly attributable to the sale of the holding in Paz Oil Company Ltd.

Basic net profit from ordinary activity per share attributable to shareholders of the banking corporation amounted to NIS 1.28 in 2011, compared with NIS 1.46 in 2010.

Net profit attributable to shareholders of the banking corporation amounted to NIS 1,891 million in 2011, compared with NIS 2,334 million in 2010, a decrease of 19.0%.

Basic net profit per share attributable to shareholders of the banking corporation amounted to NIS 1.28 in 2011, compared with NIS 1.58 in 2010.

The following table shows the return on average shareholders' equity for the period:

	2011	2010
	%	
Net profit	**8.3**	10.3
Net operating profit	**8.3**	9.5

The following table shows the return on average shareholders' equity (excluding minority interests) on a quarterly basis (in annual terms):

	2011				2010			
	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
	%							
Net profit	**11.2**	2.7	10.3	10.1	8.8	10.9	12.9	10.4
Net operating profit	**11.2**	2.7	10.3	10.1	8.8	10.9	9.4	10.3

Development of the profit over the last eight quarters

A. The following table is a condensed statement of operating profit and loss after taxes for the last eight quarters:

	2011					2010				
	4th quarter	3rd Quarter	2nd Quarter	1st Quarter	Total for year	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year
	NIS millions									
Net interest income	**1,968**	1,692	1,952	1,938	7,550	2,141	1,846	1,639	1,807	7,433
Income (expenses) in respect of credit losses **	**(385)**	(378)	(73)	102	(734)	(212)	(46)	(196)	(130)	(584)
Operating and other income	**915**	832	966	1,023	3,736	1,090	983	1,039	999	4,111
Operating and other expenses *	**(2,122)**	(2,062)	(2,078)	(2,085)	(8,347)	(2,295)	(1,805)	(1,944)	(1,907)	(7,951)
Operating profit before taxes *	**376**	84	767	978	2,205	724	978	538	769	3,009
Provision for taxes*	**246**	(32)	(259)	(373)	(418)	(376)	(415)	(136)	(312)	(1,239)
Operating profit after taxes *	**622**	52	508	605	1,787	348	563	402	457	1,770
Group's share in operating profits (losses) after taxes of companies included on equity basis after the effect of taxes	**3**	115	72	(42)	148	161	57	117	85	420
Net operating profit attributable to non-controlling interests	**(7)**	(11)	(18)	(10)	(46)	(10)	(14)	(12)	(3)	(39)
Net operating profit attributable to shareholders in the banking corporation *	**618**	156	562	553	1,889	499	606	507	539	2,151

* 2010 and first quarter of 2011 - restated – see Note 1s.2 below.
** 2010 - provisions for doubtful debts according to the previous method.

B. The following table shows the development of the principal items in net interest income, before expenses in respect of credit losses:

	2011					2010				
	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year
	NIS millions									
Current activity	**1,953**	1,815	1,890	1,835	7,493	1,800	1,633	1,493	1,638	6,564
Collection of interest in respect credit losses *	**5**	5	(23)	42	29	179	91	151	144	565
Effect of non-interest bearing debts	**(79)**	(100)	(104)	(66)	(349)	(52)	(57)	(24)	(56)	(189)
Exchange rate differentials in respect of financing shares recorded in capital reserve and operating income	**(11)**	(56)	12	17	(38)	10	19	(14)	5	20
Profits (losses) from the sale of available-for-sale debentures, net	**68**	55	65	77	265	88	78	31	65	262
Realized and unrealized profits from adjustments to fair value of debentures for trading	**31**	70	29	(52)	78	(63)	29	111	70	147
Financing income in connection with hedging of overseas investments	**(30)**	(122)	17	3	(132)	72	51	(33)	40	130
Adjustments to fair value of derivative instruments	**35**	(8)	(2)	33	58	83	(22)	(96)	(84)	(119)
Effect of the known CPI	**(4)**	33	68	49	146	24	24	20	(15)	53
Total	**1,968**	1,692	1,951	1,939	7,550	2,141	1,846	1,639	1,807	7,433

* From 1 January 2011, most of the collections are charged to expenses in respect of credit losses in the profit and loss statement.

C. The following table shows the quarterly development of allowances for credit losses:

	2011					2010				
	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year
	NIS millions									
Individual allowance	**178**	241	24	(61)	382	248	63	244	159	714
Group allowance (2010 additional allowance)	**207**	137	49	(41)	352	(36)	(17)	(48)	(29)	(130)
Total	**385**	378	73	(102)	734	212	46	196	130	584
Percentage of allowance out of total credit to the public (on an annual basis)	**0.64%**	0.64%	0.13%	(0.18%)	0.30%	0.38%	0.09%	0.37%	0.25%	0.26%

D. The following table shows the quarterly development of operating and other income:

	2011					2010				
	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year
	NIS millions									
Operating commissions	**901**	901	918	982	3,702	986	919	924	910	3,739
Profits (losses) from investments in shares	**(5)**	(75)	38	30	(12)	28	14	100	74	216
Other income	**19**	6	10	11	46	76	50	15	15	156
Total operating and other income	**915**	832	966	1,023	3,736	1,090	983	1,039	999	4,111

E. The following table shows the quarterly development of salary expenses:

	2011					2010				
	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year
	NIS millions									
Salary expenses, excluding special salary expenses	**1,254**	1,040	1,140	1,165	4,599	1,137	1,078	1,099	1,125	4,439
Special salary expenses	**(57)**	208	132	185	468	76	(24)	100	85	237
Of which:										
Supplementing the provisions for severance pay and pension offset by profits of the funds	**(57)**	211	116	185	455	89	(24)	74	70	208
Benefit (cancelation of benefit) in respect of sale of shares to employees	**-**	(3)	16	-	13	-	-	(22)	-	(22)
Actuarial changes in respect of long-service bonuses and pension *	**-**	-	-	-	**-**	(13)	-	48	-	35
Period of advance notice for holders of personal contracts	**-**			-	**-**		-		15	15
Total salary expenses *	**1,197**	1,248	1,272	1,350	**5,067**	1,213	1,054	1,199	1,210	4,676

* Restated. See Note 1s.2 below.

F. The following table shows the quarterly development of operating and other expenses and maintenance of buildings and equipment:

	2011					2010				
	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year	4th quarter	3rd quarter	2nd quarter	1st quarter	Total for year
	NIS millions									
Depreciation	**180**	173	191	167	711	165	160	157	156	638
Maintenance of buildings and equipment	**262**	249	241	241	993	254	241	234	224	953
Other expenses	**483**	392	374	327	1,576	663**	350	354	317	1,684
Total operating and other expenses*	**925**	814	806	735	3,280	1,082	751	745	697	3,275

* Excluding salary.
** Including special and non-recurring expenses/provisions amounting to some NIS 200 million.

Below are the principal changes in profit and loss by quarter:

1. **Net interest income before expenses in respect of credit losses:** (for quarterly details, see Table B above).

In the first quarter of the year:

- An increase in current operating income.
- A reduction in the collection of interest in respect of credit losses, as a result of changes in regulations for recording collections in respect of problem debts.
- An increase in profits from the sale of available-for-sale debentures and a decrease in the market value of debentures and unrealized gains from the adjustment to fair value of trading debentures compared to the corresponding period in 2010.
- A positive effect in respect of adjustments to fair value of derivative instruments (timing differences).
- A positive effect of the known index.

In the second quarter of the year:

- An increase in current operating income.
- An increase in the effect of non-income bearing debts, as a result of a change in the directives of the Bank of Israel. An increase in net profits from the sale of available-for-sale debentures and in realized and unrealized profits from adjustments to market value of debentures held for trading, compared to the corresponding quarter last year.
- A decrease in the negative effect of adjustments to fair value of derivative instruments.
- The positive effect of financing cost in connection with hedging investments abroad.
- An increase in the positive effect of the known index.

In the third quarter of the year:

- An increase in current operating income.
- A decrease in the collection of interest in respect of credit losses, and result of a change in Bank of Israel directives.
- An increase in the effect of non-income-bearing debts.
- The negative effect of exchange rate differentials in net interest income in respect of shares recorded in a capital reserve and in operating income.

- A reduction in profits from the sale of available-for-sale debentures and in realized and unrealized profits from adjustments to market value of debentures held for trading, compared to the corresponding quarter last year.
- The negative effect of financing cost in connection with hedging investments abroad.

In the fourth quarter of the year:

- An increase in current operating income.
- A reduction in profits from the net sale of available-for-sale debentures and in realized and unrealized profits from adjustments to market value of debentures held for trading.
- Decrease in net debt collection due to non-income bearing debts, as a result of a change in Bank of Israel regulations.
- The negative effect of funding costs in relation with hedging abroad.

2. **Expenses in respect of credit losses** (for quarterly details, see Table C above)

- In the first half of the year, there was a decrease in expenses in respect of credit losses compared to the average quarterly allowances of the four quarters in 2010, mainly as a result of an increase in collections following a change in the method of recording the collections and a reduction in individual allowances.
- On the other hand, in the quarters of the second half of the year, there was an increase in expenses in respect of credit losses, in the group allowance, following a change in sectoral risks.

3. **Operating and other income:** (for quarterly details see Table D above)

- In 2011, operating and other income fell relative to quarterly income in 2010, mainly as a result of sharp changes in the capital market, which affected a decrease in capital market activity and a fall in securities management fees, and recording of impairment in an investment in the shares of Partner.
- In other income, the decrease derives from the fact that there were no profits in respect of the severance pay and provident fund, compared with operating income of NIS 70 million, which were recorded last year, as a result of the profits of the funds.

4. **Salary expenses and related expenses:** (for quarterly details see Table E above)

- An increase in salary expenses as a result of losses in 2011 in provident and severance pay funds, which were also used as a fund to cover the pension obligation of the employees, compared to profits in 2010.
- The quarterly average of salary expenses in 2011 amounted to some NIS 1,267 million, compared with an average of NIS 1,169 million in 2010, and after deducting special salary expenses amounted to some NIS 1,150 million, compared with an average of NIS 1,110 million in 2010.

5. **Other operating expenses (excluding salary)**: (for quarterly details see Table F above)

- The quarterly average in 2011 for other operating expenses (excluding salary) stood at NIS 820 million, compared to NIS 819 million in 2010, an increase of 0.2%.
- The increase in expenses in the fourth quarter arises mainly as a result of expenses in respect of the purchase of Banque Safdié in Switzerland and expenses in respect of the "Advancing Together" Project.

6. **Provision for taxes:**

- In the first quarter of the year, the tax rate was 38.1%, compared with 40.6% in the corresponding quarter last year, mainly as a result of a decrease in negative exchange rate differentials in respect of investments in subsidiaries abroad that are not included in the tax base.

- In the second quarter of the year, the tax rate was 33.8%, compared with 25.3% in the corresponding quarter last year, mainly as a result of negative exchange rate differentials in respect of investments on foreign subsidiaries, compared to positive exchange rate differentials in the corresponding period last year.
- In the third quarter, the tax rate was 38.1%, compared with 42.4% in the corresponding quarter last year, which resulted mainly in positive exchange rate differentials, compared to negative exchange rate differentials in the corresponding quarter last year, as explained above.
- The change in tax expenses in the fourth quarter derives mainly from the cancelation of the outline plan to reduce the company tax rate and from a rise in the tax rate to 25%, and as a result of positive exchange rate differentials compared with negative exchange rate differentials in respect of investment in subsidiaries abroad which are not included in the tax base and an increase in disallowed expenses in respect of foreign companies.

For additional multi-quarter information, see Exhibit H to the Management Review.

Structure and Development of Assets and Liabilities

Total Assets of the Leumi Group on 31 December 2011 amounted to NIS 365.8 billion, compared with NIS 328.3 billion at the end of 2010, an increase of 11.4%. The Bank's total assets on 31 December 2011 amounted to NIS 322.7 billion, compared with NIS 289.9 billion at the end of 2010, an increase of 11.3%.

Out of the Group's total assets, the value of assets denominated in or linked to foreign currency was some NIS 95.7 billion, some 26.1% of total assets. In 2011, the shekel appreciated against the US dollar by 7.7% and appreciated against the euro by 4.2%.

The change in the exchange rate of the shekel in relation to foreign currencies in general contributed to an increase of some 1.7% in the total assets of the Group.

Total assets under the Group’s management – the total balance sheet as well as customers’ securities portfolios, and provident funds and supplementary training funds in relation to which operational management and custodial services are provided - amounted to some NIS 898 billion, compared with NIS 889 billion at the end of 2010 (about US$ 235 billion and US$ 251 billion respectively, the decrease resulting from a devaluation of the shekel), as detailed below.

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

	Consolidated			The Bank		
	31 December			31 December		
	2011	2010	Change	**2011**	2010	Change
	NIS millions		%	NIS millions		%
Total assets	**365,854**	328,322*	11.4	**322,720**	289,860*	11.3
Cash and deposits with banks	**53,044**	30,052	76.5	**93,879**	68,133	37.8
Securities	**47,936**	55,791	(14.1)	**41,253**	48,219	(14.4)
Credit to the public, net	**241,320**	223,981	7.7	**151,608**	143,421	5.7
Buildings and equipment	**3,653**	3,638	0.4	**3,154**	3,173	(0.6)
Deposits of the public	**279,404**	249,584	11.9	**257,530**	232,074	11.0
Deposits from banks	**5,056**	2,691	87.9	**9,589**	4,479	+
Debentures, notes and subordinated notes	**29,999**	26,939	11.4	**7,719**	7,683	0.5

* Restated, see Note 1s.2 below.

The increase in credit to the public amounting to some NIS 17 billion and in bank deposits amounting to NIS 23 billion was funded mainly by an increase in deposits of the public amounting to some NIS 30 billion, a net increase in capital notes amounting to NIS 3 billion and a reduction in investments in securities of some NIS 8 billion.

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

	Consolidated			The Bank		
	31 December			31 December		
	2011	2010	Change	**2011**	2010	Change
	NIS millions		%	NIS millions		%
Documentary credits	**2,055**	2,101	(2.2)	**1,376**	1,446	(4.8)
Credit guarantees	**7,280**	6,192	17.6	**6,199**	7,204	(14.0)
Guarantees to purchasers of apartments	**11,437**	11,348	0.8	**11,398**	11,194	1.8
Other guarantees and liabilities	**15,479**	14,327	8.0	**14,916**	15,123	(1.4)
Derivative instruments*	**416,117**	348,506	53.6	**403,205**	338,121	19.2
Options of all kinds	**130,733**	140,754	22.6	**129,339**	139,969	(7.6)

* Including forwards, financial swap contracts, swaps, futures and credit derivative transactions.
For further details, see Note 18a and 18**f** to the Financial Statements.

C. The following table sets out the development of balances of customers' off-balance sheet financial assets with the Leumi Group (1):

	Consolidated		
	2011	2010	Change
	NIS millions		%
Securities portfolios of customers	**462,318**	495,324	(6.7)
Of which: in the management of mutual funds (2) (3)	**52,648**	57,129	(7.8)
Provident funds (2) (3)	**45,902**	44,014	4.3
Supplementary training funds (2) (3)	**24,385**	21,064	15.8
Total	**532,605**	560,402	(5.0)

(1) Including a change in market value of securities and the value of securities of mutual and provident funds held in custody, in respect of which operational management and custodial services are provided.
(2) The Group in Israel does not have mutual funds, provident funds or supplementary training funds under its management.
(3) Assets of customers in relation to which the Group provides operational management services, including balances of the funds of customers who receive counseling at Leumi.

The decline in the value of the assets results from the fall in market values in Israel and abroad, which was partly offset by an increase in the level of activity.

Deposits of the Public

Deposits of the public with the Group amounted to NIS 279.4 billion at the end of 2011, compared with NIS 249.6 billion at the end of 2010, an increase of 11.9%.

The devaluation of the shekel against most foreign currencies contributed to a 2.6% increase in total deposits of the public.

Additionally, the Group raised funds from the public, through issues of debentures, notes and subordinated notes, the balance of which was some NIS 30.0 billion as at the end of 2011, compared with NIS 26.9 billion at the end of 2010. Deposits of the public, debentures and subordinated capital notes increased in 2011 by 11.9%, and together constitute 84.7% of total assets.

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

	31 December 2011				
	On demand	Short-term	Savings schemes	Earmarked deposits	Total
	%	%	%	%	NIS millions
Israeli currency:					
Unlinked	**46**	**55**	**1**	**40**	**145,719**
CPI-linked	**-**	**11**	**96**	**60**	**25,915**
Foreign currency:					
Including foreign currency linked	**54**	**34**	**3**	**-**	**107,594**
Non-monetary	**-**	**-**	**-**	**-**	**176**
Total, as a percentage	**100**	**100**	**100**	**100**	
Total in NIS millions	**63,134**	**212,680**	**3,582**	**8**	**279,404**

	31 December 2010				
	On demand	Short-term	Savings schemes	Earmarked deposits	Total
	%	%	%	%	NIS millions
Israeli currency:					
Unlinked	47	53	1	50	127,333
CPI-linked	-	12	96	50	25,999
Foreign currency:					
Including foreign currency linked	53	35	3	-	96,204
Non-monetary	-	-	-	-	48
Total, as a percentage	100	100	100	100	
Total in NIS millions	62,840	183,039	3,695	10	249,584

Developments in the various types of deposits were as follows:

- Unlinked shekel deposits of the public increased by NIS 18.4 billion (14.4%) compared with 31 December 2010, primarily as a result of the public's preferring to minimize exposure and risks, due to the crisis in the capital market.

- Deposits of the public denominated in or linked to foreign currency increased by NIS 11.4 billion (11.8%), compared with 31 December 2010, and after offsetting the effect of the changes in the exchange rate of the shekel, these deposits increased by 5.1%. Deposits of the public with the foreign subsidiaries increased in 2011 by some 27.0%, or about NIS 7.0 billion, of which NIS 2.7 billion is from the purchase of Banque Safdié, increase in activity, and as a result of a devaluation of the shekel against the foreign currencies in which the subsidiaries operate.

- CPI-linked shekel deposits decreased by NIS 84 million (0.3%) compared with 31 December 2010, mainly in demand deposits.

The Bank develops and sells financial investment products of the structured products type. There are various types of structured products including, on the one hand, assurance of the whole or part of the principal, and, on the other hand, the possibility of a yield higher than that provided by a risk-free investment. Waiving risk-free interest enables the purchase of financial derivatives based on various underlying assets, such as: options on interest rates, options on shares and share indices, options on exchange rates, credit derivatives and more, which constitute a component of the structured product. Structured deposits offered by the Group give full assurance of the principal, while the structured debentures often give only partial assurance. The terms of the structured products range from the short-term, sometimes even for one month, to long term up to 15 years.

The balance of structured deposits amounted to US$ 183 million (NIS 701 million) on 31 December 2011, compared with US$ 193 million (NIS 685 million) at the end of 2010.

The following table sets out the development of deposits of the public by principal operating segments:

	31 December 2011	31 December 2010	% change
Segment	NIS millions		
Households	**130,276**	118,266	10.2
Small businesses	**18,109**	16,579	9.2
Corporate banking	**28,179**	26,281	7.2
Commercial banking	**46,527**	36,421	27.7
Private banking	**39,999**	36,241	10.4
Financial management, capital markets and other*	**16,314**	15,796	3.3
Total	**279,404**	249,584	11.9

* Includes mainly deposits of institutional bodies.

Deposits from Governments amounted to some NIS 519 million at the end of 2011 - these deposits include deposits from government sources that were made available to the banks in former years mainly for restructuring debts of the kibbutzim, and also deposits for granting housing loans to eligible members of the public.

In 2011, there was a decline of some NIS 141 million in deposits from governments.

This item also includes deposits of foreign governments in overseas subsidiaries, which amounted to some NIS 123 million at the end of 2011, compared with NIS 117 million at the end of 2010.

Deposits with Banks and Deposits from Banks

A. Deposits with banks (central and commercial):

	31 December 2011		31 December 2010	
	With central banks	With commercial banks	With central banks	With commercial banks
	NIS millions			
Israeli currency:				
Unlinked	**36,131**	**791**	16,945	658
CPI-linked	**-**	**326**	-	373
Foreign currency including foreign currency-linked	**4,708**	**8,947**	2,755	7,335
Total deposits with banks	**40,839**	**10,064**	19,700	8,366

Total deposits with banks increased by 81.4%, - most of the increase was deposits in the Bank of Israel amounting to NIS 19 billion. Deposits with commercial banks increased by 20.3%, the result of adjusting the level of risk of a financial crisis abroad and a strengthening in the level of the Bank's liquidity, against a reduction in investments in securities.

B. Deposits from banks (commercial):

	31 December 2011	31 December 2010
	NIS millions	
Israeli Currency:		
Unlinked	**1,425**	980
CPI-linked	**213**	302
Foreign currency including foreign currency-linked	**3,418**	1,409
Total deposits from banks	**5,056**	2,691

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

On 31 December 2011, deposits of the Group with the Bank of Israel amounted to NIS 36.7 billion, against which there were no loans from the Bank of Israel.

For further details, see page 129.

As may be seen from these tables, the liquidity position of the Group is extremely high, and the Group has net deposits with banks amounting to NIS 45.8 billion.

Credit to the public, net

Credit to the public in the Leumi Group at the end of 2011 amounted to NIS 241.3 billion, compared with NIS 224.0 billion at the end of 2010, an increase of NIS 17.3 billion or 7.7% (in the Bank, an increase of 5.7%). Credit to the public constitutes 66.0% of total assets (compared with 68.2% at the end of 2010).

The devaluation of the shekel against most foreign currencies contributed to an increase of 1.5% in total credit to the public. After canceling the effect of the devaluation, there was an increase of 6.2% in total credit to the public.

As well as granting credit to the public, the Group invests in the securities of companies, including securities of holding companies of banks, amounting to NIS 8,034 million at the end of 2011, compared with NIS 11,657 million at the end of 2010. These investments also involve credit risk.

The following table sets out the quarterly development of credit to the public by linkage segment:

	2011				
	31 March	30 June	30 September	31 December	Total annual
Unlinked in NIS millions*	**123,061**	**127,617**	**130,148**	**133,031**	**133,031**
% increase (decrease)	**1.6**	**3.7**	**2.0**	**2.2**	**9.8**
CPI-linked in NIS millions	**51,262**	**51,819**	**52,169**	**52,423**	**52,423**
% increase (decrease)	**(0.7)**	**1.1**	**0.7**	**0.5**	**1.5**
Foreign currency including foreign currency-linked in NIS millions	**50,748**	**48,912**	**54,998**	**55,866**	**55,866**
% increase (decrease)	**(1.0)**	**(3.6)**	**12.4**	**1.6**	**9.0**
Total in NIS millions	**225,071**	**228,348**	**237,315**	**241,320**	**241,320**
% increase	**0.5**	**1.5**	**3.9**	**1.7**	**7.7**

* Including non-monetary items.

Total credit to the public by the Group in Israel amounted to some NIS 214 billion at the end of 2011, compared with NIS 200 billion at the end of 2010, an increase of 7.5%.

The following table sets out the mix of credit to the public by linkage sector:

	31 December 2011		31 December 2010		Change
	NIS millions	% of mix	NIS millions	% of mix	%
Unlinked*	**133,031**	**55**	121,110	54	9.8
CPI-linked	**52,423**	**22**	51,632	23	1.5
Foreign currency	**55,866**	**23**	51,239	23	9.0
Total	**241,320**	**100**	223,981	100	7.7

* Including non-monetary items.

Credit to the public in unlinked shekels increased by NIS 11,921 million, or 9.8%, and index-linked credit to the public increased by NIS 791 million, or 1.5%. The increase in foreign currency and foreign currency-linked credit to the public amounted to NIS 4,627 million, or 9.0%, and after neutralizing the effect of the changes in the exchange rate of the shekel, foreign currency credit to the public increased by 2.3%.

Total credit to the public that was offset deriving from deposits according to the extent of their collection amounted to NIS 6.9 billion in the Group. Some 81.6% of such credit is granted from government deposits according to the extent of their collection for financing the purchase of an apartment (housing loans).

The following table sets out the distribution of credit in foreign currency, including foreign currency-linked credit, by principal currency:

	31 December 2011	31 December 2010
	NIS millions	
US dollar	**38,825**	35,809
Euro	**6,778**	5,629
Other currencies	**10,263**	9,801
Total	**55,866**	51,239

The devaluation of the shekel against most foreign currencies contributed to an increase of some 6.7% in foreign currency and foreign-currency linked credit.

The following table sets out the development of indebtedness to the construction and real estate sector:

	31 December 2011	31 December 2010**	Change
	NIS millions		%
Balance sheet credit risk	**49,557**	46,668	6.2
Guarantees to apartment purchasers*	**4,966**	5,472	(9.2)
Other off-balance sheet risk	**25,216**	21,419	17.7
Total	**79,739**	73,559	8.4

* Weighted according to balance sheet value.
** Reclassified

Total credit risk of the construction and real estate sector in Israel (according to the report by sector of the economy in Exhibit E to the Management Review) increased by 6.6% in 2011. The credit risk of the construction and real estate sector in Israel constitutes some 22.1% of total credit risk in Israel. However, in accordance with the rules laid down by the Bank of Israel for calculating the rate of financing by sector of the economy, total indebtedness in the sector at the Bank amounts to some 24.50% of total indebtedness in Israel, and therefore there is a sectoral excess of credit, for the purpose of an additional allowance, of some 4.50%, compared with an excess of 24.1% at the end of 2010.

The following table sets out the development of credit to the public by principal operating segment:

Segment	**31 December 2011**	31 December 2010	Change
	NIS millions		%
Households (1)	**83,045**	76,341	8.8
Small businesses	**20,039**	19,018	5.4
Corporate banking	**77,571**	73,163	6.0
Commercial banking	**50,536**	47,226	7.0
Private banking	**9,074**	7,738	17.3
Financial management, capital markets and others	**1,055**	495	+
Total at end of period	**241,320**	223,981	7.7

Total business credit (commercial and corporate) amounted to NIS 128.1 billion and in 2011, increased by 6.4%. Total private credit (households, small businesses and private banking) amounted to NIS 112.2 billion and in 2011 increased by 8.8%.

(1) Credit to households also includes housing loans (mortgages). After canceling the effect of this credit, credit to households increased by 7.0%. (The rate of increase in credit in 2010 was 12.0%.) Housing loans amounted to NIS 55.9 billion at the end of 2011, and increased by 9.7%.

See Exhibit E to the Management Review for further details of the development of credit and credit risks by sector of the economy.

The following table sets out the quarterly development of credit to the public* according to principal operating segments:

	2011				2010			
End of period balances	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Households	**83,045**	81,579	79,720	77,826	76,341	73,136	71,156	68,248
Small businesses	**20,039**	19,604	19,371	19,153	19,018	17,614	17,544	17,590
Corporate banking	**77,571**	76,507	74,001	73,404	73,163	72,390	70,845	70,415
Commercial banking	**50,536**	50,108	46,376	46,116	47,226	46,302	45,259	44,210
Private banking	**9,074**	8,171	7,587	7,666	7,738	6,859	6,666	6,150
Financial management, capital markets and others	**1,055**	1,346	1,293	906	495	917	983	1,000
Total at end of period	**241,320**	237,315	228,348	225,071	223,981	217,218	212,453	207,613

* Of which housing loans of NIS 56,052 million and at the end of 2010, NIS 51,161 million.

Lien in favor of the Bank of Israel

On 21 May 2008, the Bank signed a debenture pursuant to which it granted a first degree floating lien in favor of the Bank of Israel on its rights to receive amounts and monetary shekel payments that are or will be payable to the Bank from time to time, from its customers who are corporations (established according to the laws of the State of Israel), which are not in arrears with their repayments to the Bank of loans received from the Bank, of which the average duration of the credit does not exceed three years, and were granted or will be granted to these customers by the Bank. The lien is in an amount equal to the level of amounts secured by the debenture, from time to time, up to an amount of NIS 1.1 billion.

This lien secures funds that are required for the Bank's operations for purpose of its activities with the CLS clearinghouse.

For further details, see page 129 of the Report.

Credit risk by economic sector

The following table sets out the development of overall credit risk to the public (1) by principal sector of the economy:

Sector of the economy	**31 December 2011** Overall credit risk to the public	Percentage of total	31 December 2010 Overall credit risk to the public	Percentage of total
	NIS millions	%	NIS millions	%
Agriculture	**2,217**	**0.6**	2,162	0.6
Industry	**49,483**	**13.8**	46,919	13.7
Construction and real estate (2)	**79,739**	**22.2**	73,559	21.4
Electricity and water	**1,750**	**0.5**	2,109	0.6
Trade	**31,117**	**8.7**	25,923	7.6
Hotels, accommodation and food services	**5,001**	**1.4**	4,957	1.4
Transportation and storage	**6,732**	**1.9**	5,536	1.6
Communications and computer services	**8,486**	**2.4**	7,177	2.1
Financial services	**37,226**	**10.4**	48,650	14.2
Other business services	**12,540**	**3.5**	9,219	2.7
Public and community services	**8,233**	**2.3**	8,624	2.5
Private individuals - housing loans	**59,270**	**16.5**	54,772	16.0
Private individuals – other	**56,837**	**15.8**	53,481	15.6
Total	**358,631**	**100.0**	343,088	100.0

(1) Including off-balance sheet credit risk and investments of the public in debentures, and other assets in respect of derivative instruments. Data as at 31 December 2011 are before an allowance for credit losses and data as at 31 December 2010 are after an allowance for credit losses.

(2) Including housing loans which have been extended to purchasing groups in the process of building amounting to NIS 932 million and off-balance sheet risk amounting to NIS 2,032 million, compared to NIS 853 million and NIS 1,625 million, respectively, as of 31 December 2010.

Below is a distribution of credit risk in the real estate and construction sector (1) by principal operating area:

	31 December 2011			31 December 2010		
	Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk	Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk
	NIS millions					
Construction for trade and services	**4,154**	**3,437**	**7,591**	4,078	2,630	6,708
Construction for industry	**851**	**356**	**1,207**	750	12	762
Construction for housing	**7,357**	**15,257**	**22,614**	7,876	15,543	23,419
Income generating assets	**23,894**	**2,889**	**26,783**	22,061	1,748	23,809
Other	**13,301**	**8,243**	**21,544**	11,902	6,959	18,861
Total construction and real estate sector	**49,557**	**30,182**	**79,739**	46,667	26,892	73,559

(1) Data as at 31 December 2011 are before an allowance for credit losses and data as at 31 December 2010 are after an allowance for credit losses.

See Exhibit E to the Management Review for further details as to the distribution of credit to the public by sector of the economy.
Part of the information set out below is "**forward-looking information**". For the meaning of this term, see the chapter "General Environment and Effect of External Factors on Activities" in the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report" on page 61 above.

Industry Sector:

The following discussion is by industry sub-sector:

Industry Sectors:

At the beginning of 2011, the industry sector saw a continuation of the trend from 2010, which was characterized by a growth in activity and exports.

The first half of 2011 was characterized by rising demand, mostly among export customers.

From the third quarter of 2010 and throughout the second half of 2011, a certain slowdown was observed in the activity of some of the customers of the exporters operating in the industry sector, reflected by a reduction in inventories and a contraction in production.

The aforesaid slowdown was mostly apparent among companies exporting to European markets, and was reflected in a certain decline in the companies' results.

In addition, the profitability of the companies was affected by the fluctuations in exchange rates and in commodity prices during the year.

2011 was mostly characterized by the relatively low exchange rates of the euro and the dollar against the shekel, resulting in some erosion in export proceeds. Nevertheless, in the last months of 2011, the trend was reversed with a devaluation of the shekel against the dollar and euro.

The prices of goods began to fall in the latter half of 2011. However, the effect of this decline on the companies' gross profitability (increase in their profitability) is likely to be reflected primarily at the beginning of 2012, with the entry into production of inventories purchased at the low prices.

On the other hand, the process of a slowdown in demand in Israel is likely to lead to erosion of profitability.

a. Metal

In Israel, the metals sector incorporates the basic metal area (construction steel rod manufacturing, construction steel net manufacturing, iron casting, etc.), and the area of finished metal products (metalwork, manufacturing complete constructions, etc.). Data for the sector indicate that turnover of the finished metal products segment is a primary component in the sector as a whole.

The metal market is heavily influenced by the prices of raw materials and the margins of most of the companies are derived from the time interval between the date of purchasing the inventory and the date of its sale. Raw material prices in 2011 were characterized by low volatility, although at slightly higher price levels than 2010 price levels. In addition, the volume of imports of raw materials continued the increasing trend which began almost two years ago.

In general, the sector remained stable in 2011, with the companies presenting a consistent increase in revenues and profitability, compared with 2010. This was a result of an increase in demand, with emphasis on the area of infrastructure.

Compared with the rest of the economy, the global economic slowdown had a negligible effect on the metal industry, because it is not export-biased. It should be noted that the slowdown in the sectors that use metal products in large amounts, for example, the building sector (and as is known, there is a fear of a credit squeeze in this area), is likely to lead to a slowdown in activity in this sector.

b. Hi-tech Companies

Macro-economic data for 2011 published so far indicate a continuation of the slowdown that began in the industry as a result of the global economic crisis. In addition, the data characterizing the customers of the sector also indicate an expected slowdown in the first quarters of 2012.
Since the main growth engine in the hi-tech industry is exports, the sector is greatly influenced by developments abroad: uncertainty, the financial crisis in Europe and its repercussions, the investment policy in infrastructures of various countries and growth in developing countries affect sector growth. Furthermore, the sector is exposed to the appreciation of the shekel against the dollar and against other currencies (the sector has benefited recently from the strengthening of the dollar against the shekel).

Against the backdrop of the above, there was a trend in previous years of diverting sector exports from western countries (the Eurozone and the United States) to countries in Asia, Africa and Latin America and turning them into a significant export destination for the hi-tech industry. The increase in demand in the developing countries reduces the dependency of Israeli exports to the US as a principal target.

Diamond sector

In the first half of 2011, the increasing trend in trade continued and a continuation of increasing prices, in both uncut diamonds and polished diamonds, a trend which began in the second half of 2009. However, in the second half of 2011, particularly in the fourth quarter, as a result of concerns over the global economic crisis and after two consecutive years of a positive trend in the diamonds sector, the trend in the industry changed, with trading volumes contracting, bringing with it a downward price correction for both uncut and polished diamonds. This pattern of relatively weak activity in the shadow of the crisis continues, even in the first few months of 2012, and no change is expected in this pattern in the near future.

In the Israeli diamond sector, whose main activities include: trade, marketing, sorting and preparation of diamonds for polishing, and smaller amounts of diamond-polishing, 2011 was characterized as a year with a significant increase in trade volumes, both in the export of polished diamonds (an increase of 23.5% compared with 2010) and the export of uncut diamonds (an increase of 14.9% compared with 2010). However, these growth rates were a result of a very successful first half-year experienced by the sector. This, as mentioned above, changed for the worse, and in the third and fourth quarters, there was a significant downturn in trade volumes, both in exports of polished diamonds (a decline of 13.3% from the fourth quarter of 2010) and in exports of uncut diamonds (a decline of 32% compared with the fourth quarter of 2010). This state of slowed activity continues to characterize the sector in Israel in the first few months of 2012.

Leumi Group is active in financing the diamond sector, mainly for purposes of financing working capital in Israel and the United States.

Residential real estate

The residential construction sector in Israel in the first half of 2011 was characterized by a continuation of an increase in the rates of sales and in prices. However, this trend changed later and in the second half of 2011 there was a slowdown in the rate of apartment sales. The slowdown in sales, alongside an increase in the volume of building starts (which is higher than the potential level of demand derived from the average annual increment in Israeli households) resulted in an increase in a number of months of supply until the third quarter of the year to a level pointing to the fact that pressures for price increases are decreasing, and conditions are being created that can lead to their decline. Towards the end of the year and the beginning of 2012, a certain change in this trend was noted against the background of an increase in sales.

Below are a number of characteristics that affected the sector in 2011:

1. An increase in the level of risk and of uncertainty in the market, which is the result of three main factors:

a. Global economic events, radiating throughout the Israeli economy (for example, a growth forecast for the economy for 2012 which was only recently revised downwards by the Bank of Israel) and from there to the Israeli real estate market.

b. An atmosphere of social protest, one of the targets of which was the housing market, and this is because of substantial price rises in the market in recent years, which has resulted in a situation where, for certain segments of the population, the purchase of a residential dwelling is less affordable compared with past periods.

c. Continued government/regulatory involvement, which is focused on the real estate sector and on the housing construction sub-sector, in particular. This involvement affects both demand - (restraint of demand by, for example, a limit on taking Prime-linked mortgages, raising rates of purchase tax for a second apartment, and the raising of Bank of Israel interest rates at the beginning of the year, a trend which was later reversed following the global slowdown); and supply - (encouragement of supply by, for example, the granting of a temporary exemption from betterment levy on the sale of an apartment for investment, encouragement for converting apartments from use as offices to zoning for housing, and a structural change in the Israel Lands Administration – National Housing Committee Law, a law passed in August 2011, in the wake of the social unrest, permitting the establishment of six planning committees throughout Israel, which will act alongside district committees, but which will operate only to approve public housing programs. The committees will work temporarily for 18 months and will take steps for the approval of 50,000 housing units per year.

2. There was an increase in the number of building starts, (particularly in the first half of 2011), and at the same time, an increase in the volume of unsold inventory in such a manner that the number of months of supply, which is an important indicator for apartment prices, increased rapidly by the third quarter of the year indicating that the residential housing market is no longer characterized by substantial excess demand. In the fourth quarter of the year, a certain change in this trend was noted and the number of months of supply began to fall slightly.

3. From the second half of the past year, there began a process of slowing the price acceleration of housing and it appears that reports have begun to be received from a number of locations around Israel of price decreases, though, so far, only of minimal percentages.

4. There was continued moderation in the phenomenon of purchasing groups, which started in 2010. This is a consequence of the tightening of terms of finance for purchasing groups resulting from an increased requirement by the Bank of Israel for retention of capital against credit to purchasing groups, raising shareholders' equity requirement for taking mortgages, and the obligation to pay VAT even on the land component.

5. A continued decrease in the purchase of apartments for investment, arising from increasing uncertainty in the market and from restrictions on purchasers in taking mortgages (causing them to be more expensive).

6. In 2011, there was a sharp slowdown in sales, with the presence of uncertainty with regard to the continuation of the trend in 2012, against the backdrop of the possibility of a slowdown in the economy and a continuation of a "cooling" of the real estate market for housing by the Government and the Bank of Israel and, on the other hand, the natural annual potential level of demand of Israeli households for housing. It should be noted that at the end of the year and at the beginning of 2012, sales began to recover.

Income-generating Property

Non-residential construction in Israel includes income-generating property, mainly office buildings, shopping, commercial and business centers, and other buildings used for industry and trade. The income-generating real estate market is by nature more volatile than the residential real estate market and, in recent years, shows a high correlation with the growth in the economy.

In the area of commerce, a strengthening trend can be noted, as evidenced in relatively high occupancy rates, the relative stability of rents collected, and rates of return on assets.

In 2011, there was an increase in the supply of new building for offices, which was affected by the continuation of the economic recovery and the growth in the economy in the first half of the year, causing entrepreneurs to divert activity from housing to the area of income-producing property.

A combination of a slowdown in the economy with an increase in supply of building plots is likely to result in stabilization, and even to a certain decline in rental prices, notwithstanding the time-lag.

Infrastructure Projects

National projects - In recent years, including 2011, the moderate increase in the execution of large-volume national infrastructure projects continued, primarily in PPP (Public Private Partnership) formats (which are based on collaboration between the private and public sectors). Large infrastructure projects are located mainly in the areas of transport, communication, water, energy and electricity (including private power stations based on gas and/or solar energy).

Contractors and infrastructure – Government investment, public investment and the investment of the business sector in infrastructure increased during 2011, *inter alia*, as a result of Public Road Works tenders, an increase in the volume of housing construction, a certain recovery in non-housing construction (office and commerce buildings) and public construction, which, as mentioned, led to a stabilization of the activity of performance contractors, and even to a shortfall in manpower in the sector. These trends have yet to be reflected in a significant improvement in the profitability of performance of infrastructure contractors.

Trade and Services

a. Trade

At the beginning of 2011, an end of the crisis characterizing 2009 was felt in most trading sectors. In the majority of the companies, sales volumes increased. This increase was also reflected in an increase in profitability due to changes in currency exchange rates, and a large proportion of the companies recorded an increase in financing expenses.

In the second half of the year, there was a significant change in the trend, and we witnessed erosion in the profitability of companies dealing in the area of trade, mainly in the electric and electronic product sector. It is apparent from the third-quarter financial statements of importers in the sector that, despite a certain increase in sales, this increase was not accompanied by an increase in profitability.

The erosion in profits was caused by an increase in financing expenses and a build-up of competition in the sector, as a result of the companies' concentrating on increasing market shares, as well as at the cost of reducing product prices and impairing profitability. This trend is reflected in the published financial statements for the third quarter.

In the sector for the import of wood, it can be seen that 2011 was characterized by a moderate growth in activity levels with continuing improvement in profitability.

b. Food chains

The sector comprises the two largest public chains (including their sub-chains) and the smaller chains.

The sector is characterized by increasing competition, reflected, *inter alia*, in the accelerated opening of commercial space and the conversion of branches to inexpensive "formats". The chains operate to increase their share in the market, mainly by opening additional branches, marketing customer clubs and expanding private brand products.

We would stress that the profitability of the chains was eroded during the past year, mainly due to the increase in rental expenses and an increase in the minimum wage. In addition, since the beginning of the third quarter of 2011, the rate of growth of the large chains has moderated, bearing in mind the economic slowdown and the social protest, which affected consumer behavior in general and food consumption in particular.

c. Hotels:

2011 ended with data similar to 2010, despite a lack of geo-political stability in our region which characterized most of the period, including disquiet in Arab countries and the economic situation in Europe. So far, these have not caused significant impairment to tourism to Israel.

In 2011, there was a slight fall in the number of incoming visitors to Israel, compared with 2010, which was a record year for tourism in Israel. During this period, about 3.4 million visitors arrived in Israel (include single-day tourist visits), a fall of 2.4% compared with the corresponding period in the previous year. This decline stems from the sharp fall recorded in the number of arrivals by land, almost completely set off by the increase in the number of visitors arriving by air. Nevertheless, the number of incoming tourists to Israel ("visitors" who stay overnight in Israel) stood at 2.8 million, similar to last year's figure.

The number of overnight stays in 2011 was 21.9 million, a similar figure to the corresponding period in the previous year. The average room occupancy on a national basis, which reached 66.0% during the period, was also similar to the occupancy rate in the corresponding period in 2010.

Despite the stability in the data for overnight stays, the tourist hotel turnover in 2011 amounted to NIS 8.8 billion – a decrease in real terms of 1.5% compared with 2010, arising from the appreciation in the shekel against the dollar. In this context, we note that 43% of the turnover derives from foreign tourists and the rest from locals.

d. Communications Services:

The sector is comprised of four principal sub-sectors: fixed line communications (domestic and international), cellular communications, multi-channel television and Internet access.

The key issues worthy of note in this sector in 2011 were:

- The communications industry has been particularly dynamic in the past two years. During this period, some of the largest transactions in the economy have been completed, with changes in ownership of nearly all of the companies operating in the sector.

  It appears that the market trend for convergence into four large communication groups is continuing. In 2011, with the approval of the regulatory body, transactions to purchase the large Internet service providers and international operators were completed by the cellular companies providing Internet services.

- The communications sector is distinguished by massive regulation and extensive involvement by regulatory bodies. In the past year, there have been a large number of steps made and decisions taken with the aim of making the industry more competitive; and their influence was already felt last year

and they are expected to continue to influence the market in the near future, for example: the removal of entry barriers to the cellular market through the reduction of connectivity fees, restricting exit penalties, granting licenses to two additional competitors (expected to operate in 2012) and awarding licenses to Mobile Virtual Network Operators (MVNO), one of which had already commenced operations at the end of the year, and a decision was taken to expand the "Idan+" broadcasting setup.
In October 2011, the Hayek Committee, appointed by the Ministry of Communications, published its conclusions, with the aim, *inter alia*, of examining ways of establishing a wholesale market in the area of communications infrastructure. The Ministry of Communications is taking steps to enable the IEC to enter the area of infrastructure as a wholesaler of nationally deployed broadband communications, thus intensifying competition in the Israeli broadband infrastructure sector.

- In the past two years, steps have commenced for significant investments in upgrading fixed-line communication infrastructure throughout the country.

The following is a description of the main sub-sectors:

1. **Fixed line communications** – Implementation of the policy of the Ministry of Communications to allocate licenses for the supply of VOB (Voice-over-Broadband) telephony to various companies continues to intensify competition in this area. According to various reports in 2011, the different companies operating in this field have continued to increase their market share in the area.

2. **Cellular communications** – The cellular segment represents a dominant component of the total activity in the communication sector. The opening up of cellular communication to competition and the significant reforms led by the regulator have, since the beginning of 2011, contributed to substantially intensify competition in this segment. In 2011, cellular companies reported a decrease in profitability and cash-generation ability, compared with previous years, mainly as result of the actions of the regulator. As outlined above, the Communications Ministry is acting to increase competition in this sector, and it appears that in 2012, the impairment of profitability for these companies will continue.

3. **Multi-channel television** – There are two companies operating in this sector, and they are engaged in lively competition. The companies continue to invest in content, in order to penetrate and preserve various sections of the market. In 2010-2011, the digital territorial television (DTT) network still did not have a significant impact on the companies operating in the sector. It should be noted that the activity of the regulator in this field through planning to expand the broadcasting setup within the DTT framework to 16 channels, instead of the current five, is expected to have repercussions for the companies' activity in this sub-sector.

4. **Internet access –** The provision of broadband internet access services may be divided into two parts: the provision of an infrastructure through traditional fixed line communications and the provision of access services through the service providers (almost all of which also currently provide international communications services). Three large companies operate in the sector, sharing the market relatively equally among them. The penetration rate in the sector is relatively high (more than 75% of Israeli households), and so rates of growth in the sector are not high. Most of the company merger processes in the sector were carried out in 2008, with ownership changes continuing to occur in 2010-2011. As noted above, the two largest companies operating in the field were purchased by the cellular companies.

   A further reform of the Communication Ministry to cancel the payment for the Internet telephony line is due to be examined, and could impact this segment.

Households and Private Consumption

Private consumption expenses rose in real terms in 2011 by 3.6 percent, and in terms of private consumption per capita, there was an increase of 1.7 percent. These figures indicate a slowdown from 2010, in which real consumer expenditure rose by 5.3 percent, with per capita private consumption 3.3 percent. Examination of the various components indicate that the slowdown in consumption in 2011 from its former level was wide-scale throughout all components, current and durable, except for housing components and equipment for households, which increased.

Credit cards

Data regarding the use of credit cards indicate a continuing positive trend, with figures of the Central Bureau of Statistics (at fixed prices, after canceling the effects of the seasons and holidays) for the fourth quarter of 2011 pointing to an increase of 4.8 percent in the volume of purchases in credit cards by private consumers, compared with the corresponding quarter in the previous year, but similar to the average for the whole of 2011. However, these figures represent a slowdown from the growth rate in the average volume of purchases by private consumers in 2010, which stood at 7.6%.

Mortgages - housing loans

The mortgage sector ended 2011 with a reduction of 8.9% in the provision of mortgages, compared to the corresponding period in the previous year. The reduction is attributable to a reduction in demand for mortgages. On the supply side, there was an increase of 12% in the number of building starts, resulting in an increase in the number of months of supply of apartments, from 7.3 months at the end of the previous year to 10.6 months at the end of the current year.

During 2011, the Supervisor of Banks issued a number of directives related to the housing loans market, as follows:

1. Housing loans at variable interest

On 3 May 2011, the Supervisor of Banks published a directive, pursuant to which a banking corporation may approve and extend a housing loan, if the ratio between the part of the housing loan at variable interest (i.e., loans, the interest on which is liable to vary over a period shorter than five years from the date of its approval) and total housing loan does not exceed 33.3%.

This directive will apply to loans for which approval was given in principle from 5 May 2011 and thereafter, and to loans the refinancing of which was approved by the bank since 5 May 2011 (except for refinancing where there was a reduction in the weighting of the variable interest component of the loan and its amount).

It was further provided that the banking corporation is entitled not to apply the restriction to certain types of housing loans as set forth below, if the ratio between the total of variable interest housing loans to the total of housing loans for which approval was given since 5 May 2011, extended each quarter, does not exceed 33.3%. The loans in question are as follows:

Housing loans in foreign currency to a foreign resident;

Bridging loans whose original repayment period is up to three years;

Loans for any purpose up to NIS 100,000

2. Collective allowance – Housing loans

On 1 May 2011, the Banking Supervision Department published a letter requiring the calculation of the collective allowance for credit losses in housing loans as defined in Proper Conduct of Banking Business Regulation 451 of the Bank of Israel. This was in light of the content of their letter according to which the rapid increase in housing loans, which had occurred in recent years, had not been reflected in allowances by extent of arrears.

In a letter of the Bank of Israel of 9 May 2011, it was determined that the initial effect of the calculation of the collective allowance as of 1 January 2011 will be included within the framework of the effect of the initial application of the new directives for the measurement and disclosure of impaired debts, credit risk and allowance for credit losses.

Below is additional data on total credit:

The following table sets out the distribution of credit to the public* and off-balance sheet credit risk according to the size of credit to a single borrower:

Credit ceiling in NIS thousands		31 December 2011			31 December 2010		
		Percentage of total number of borrowers	Percentage of total balance sheet credit	Percentage of total off-balance sheet credit	Percentage of total number of borrowers	Percentage of total balance sheet credit	Percentage of total off-balance sheet credit
From	To	%					
0	80	**83.3**	**6.0**	**18.4**	84.4	6.2	16.5
80	600	**14.1**	**17.6**	**11.1**	13.3	18.8	10.8
600	1,200	**1.6**	**9.3**	**2.7**	1.4	8.8	3.5
1,200	2,000	**0.4**	**4.5**	**1.9**	0.4	4.1	1.8
2,000	8,000	**0.4**	**8.8**	**5.4**	0.3	8.9	5.3
8,000	20,000	**0.1**	**7.2**	**5.7**	0.1	7.7	5.7
20,000	40,000	**0.05**	**7.2**	**6.6**	0.05	7.1	6.3
40,000	200,000	**0.04**	**17.0**	**19.4**	0.04	16.3	19.5
200,000	800,000	** **0.01**	**13.9**	**17.9**	** 0.01	14.1	18.3
Above 800,000		*** **0.00**	**8.5**	**10.9**	*** 0.00	8.0	12.3
Total		**100.0**	**100.0**	**100.0**	100.0	100.0	100.0

* In 2011, before deducting individual allowances in respect of credit losses and in 2010, after deducting specific provisions for doubtful debts.

** In 2011 – 143 borrowers and in 2010 – 139 borrowers

*** In 2011 – 25 borrowers and in 2010 - 23 borrowers.

See Note 4.F to the financial statements for further details about the distribution of credit by size.

Below are details of balances of credit to the public and off-balance sheet credit risk exceeding NIS 800 million per single borrower, based on a more detailed cross-section of credit areas by economic sector as of 31 December 2011:

1. Credit risk by size of credit to the borrower as of 31 December 2011:

Credit ceiling in NIS millions		Number of borrowers		Balance sheet credit		Off-balance sheet credit	
		Total	Of which, related parties	Total	Of which, related parties	Total	Of which, related parties
From	To				In NIS millions		
800	1,200	**14**	**1**	**7,592**	**708**	**5,529**	**147**
1,200	1,600	**5**	**-**	**4,527**	**-**	**2,011**	**-**
1,600	2,000	**3**	**-**	**2,535**	**-**	**2,559**	**-**
2,000	2,400	**1**	**-**	**1,640**	**-**	**566**	**-**
2,400	2,710	**2**	**-**	**5,009**	**-**	**293**	**-**
Total		**25**	**1**	**21,303**	**708**	**10,958**	**147**

Credit risk by size of credit to the borrower as of 31 December 2010:

		Number of borrowers		Balance sheet credit		Off-balance sheet credit	
Credit ceiling in NIS millions		Total	Of which, related parties	Total	Of which, related parties	Total	Of which, related parties
From	To				In NIS millions		
800	1,200	14	-	8,017	-	5,445	-
1,200	1,600	4	1	4,032	890	1,461	516
1,600	2,000	3	-	969	-	4,669	-
2,000	2,400	-	-	-	-	-	-
2,400	2,800	1	-	2,607	-	59	-
2,800	3,200	-	-	-	-	-	-
3,200	3,630	1	-	2,612	-	1,018	-
Total		23	1	18,237	890	12,652	516

2. Credit risk according to economic sectors as of 31 December 2011:

	Total number of borrowers	Balance sheet credit	Off-balance sheet credit
	Total	Total	Total
		In NIS millions	
Industry	**9**	**6,948**	**5,961**
Construction and real estate	**8**	**5,759**	**2,293**
Public and community services	**1**	**853**	**19**
Communications and computer services	**2**	**2,917**	**846**
Financial services	**3**	**3,686**	**356**
Electricity and water	**1**	**977**	**790**
Trade	**1**	**163**	**693**
Total	**25**	**21,303**	**10,958**

Credit risk according to economic sectors as of 31 December 2010:

	Total number of borrowers	Balance sheet credit	Off-balance sheet credit
	Total	Total	Total
		In NIS millions	
Industry	8	6,295	6,000
Construction and real estate	5	3,208	1,636
Public and community services	1	892	9
Communications and computer services	2	1,896	268
Financial services	6	5,496	4,268
Electricity and water	1	450	471
Total	23	18,237	12,652

All the related parties in the above tables are corporations in which the Bank holds less than 20% and which are not controlling shareholders of the Bank. There are no debts in the credit detailed in the above table in respect of which provisions have been made for doubtful debts.

3. **Credit to groups of borrowers whose indebtedness exceeds 15% of the Bank's capital (for capital adequacy purposes) is as follows:**

31 December 2011					
Groups of borrowers	Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk	Of which: derivative instruments	% of capital
	In NIS millions				
1	**6,488**	**1,936**	**8,424**	**164**	**20.4**
2	**6,319**	**761**	**7,080**	**121**	**17.2**

For further information on the subject of groups of borrowers, see page 237.

Problem debts

The risk of problem credit in accordance with the new regulations after individual allowances applicable from 1 January 2011 is as follows:

	31 December 2011			31 December 2010 – proforma		
	Balance sheet	Off-balance sheet	Total	Balance sheet	Off-balance sheet	Total
	In NIS millions					
Impaired debts	**5,118**	**819**	**5,937**	6,016	661	6,677
Substandard debts	**1,118**	**78**	**1,196**	969	50	1,019
Special mention debts	**3,570**	**473**	**4,043**	3,804	899	4,703
Total	**9,806**	**1,370**	**11,176**	10,789	1,610	12,399

Problem credit risk:

	31 December 2011	31 December 2010
	Problem credit risk	Problem credit risk
	In NIS millions	
Commercial problem credit risk	**12,291**	14,977
Retail problem credit risk	**1,440**	1,569
Total	**13,731**	16,546
Allowance for credit losses	**2,555**	4,147
Problem credit after allowance for credit losses	**11,176**	12,399

The following table sets out the development of problem credit by (1)(6)(7) by the classification stipulated in the directives of the Supervisor of Banks until 31 December 2010:

	31 December 2010
	NIS millions
Problem debts[1]	
Non-performing	1,364
Restructured [2]	906
To be restructured [3]	482
In temporary arrears	297
Special mention*	9,921
Total balance sheet credit to problem borrowers [1]	12,970
Off-balance sheet credit risk to problem borrowers [1] [5]	2,634
Debentures of problem borrowers (public)	465
Total overall credit risk of banks (debentures + deposits in banks)	6
Other assets in respect of derivative instruments of problem borrowers	48
Total overall credit risk in respect of problem borrowers [1]	16,123
Assets received in respect of repaid credit	81
*of which: debts for which there is a specific provision [4]	5,946
*of which: credit for housing for which there is an allowance according to the extent of the arrears	383

(1) Not including problem loans that are covered by collateral eligible for deduction for the purpose of restrictions on the indebtedness of a borrower and a group of borrowers (Proper Conduct of Banking Business Directive No. 313).
(2) Credit that was restructured during the course of the current year and also credit that was restructured in previous years with a waiver of income.
(3) Credit to borrowers in respect of whom a decision to restructure has been made by the banking corporation's management, but the restructuring has not yet been implemented.
(4) Apart from credit for housing in respect of which there is an allowance in accordance with the extent of the arrears.
(5) As calculated for the purposes of limits on the indebtedness of a single borrower and a group of borrowers, except in respect of guarantees given by a borrower to secure an obligation of a third party.
(6) Credit to problem borrowers as detailed in the disclosure format.
(7) Problem debts include credit classifications from the implementation of Proper Conduct of Banking Business Directive No. 325 "Management of Current Account Credit Lines". Pursuant to the above directive, and to clarifications of the Supervisor of Banks, the Bank is required to classify any excess over approved credit lines (where excesses are above NIS 1,000), if the Bank charges the customer excess interest. In this situation, the excess is to be classified as a non-accrual loan, and credit within the limit and the remainder of the customer's obligations must be classified as a special mention loan. The effect of the said directive has been to increase non-accrual loans by NIS 49 million, and special mention loans by NIS 1,163 million at the end of 2010.

Total problem debts under the old method as at 31 December 2010 amounted to NIS 16.1 billion, while according to the new regulation, problem debts amounted to NIS 12.4 billion. The decrease of NIS 3.7 billion derives mainly from a change in consideration of Proper Conduct of Banking Management Directive No. 325, as noted above, from a resultant cancelation of the classification of special mention debts, and from an improvement in the total problem debts.

The aggregate balance of the general allowance and the supplementary allowances for doubtful debts in respect of credit losses (according to risk characteristics defined by the Supervisor of Banks) at the Bank and its consolidated companies at the end of 2010 amounted to NIS 770 million (constituting some 0.23% of total credit risks).

See Note 4 to the Financial Statements and Exhibit E in the Management Review for further details on problem loans.

Credit to governments as at 31 December 2011 amounted to NIS 448 million, an increase of NIS 69 million (18.2%) compared with 31 December 2010.

Securities

The Group's investments in securities as at 31 December 2011 amounted to NIS 47,936 million, compared with NIS 55,791 million in 2010, a decrease of 14.1%,. The decrease in shares stems from the realization of debenture and deposit of most of the proceeds in the Bank of Israel and partly in foreign banks. The purpose of this decrease is, *inter alia*, to reduce the Bank's exposure to risks in the *nostro* portfolio.

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

Securities for trading are presented in the balance sheet at fair value and the difference between fair value and adjusted cost is charged to the statement of profit and loss.

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

Method of calculating fair value

The fair value of Israeli securities is based mainly on prices quoted on the Tel-Aviv Stock Exchange and for foreign securities on prices received from external sources. Most of the foreign security portfolio is calculated each month by a recognized international institution, which is engaged in calculating the fair value of financial assets for the purpose of disclosure of the value in financial statements. This institution is independent of both the issuing entities and the marketing entities. The calculation is based mainly on the prices of transactions on active markets and valuation of similar transactions. The calculation reflects the price a willing purchaser in the market will pay for securities on the basis of current information observed in the market (observable market inputs). Since only a small part of the securities are traded worldwide on a daily frequency, the institution makes use of two methods of evaluations:

a. Evaluation at asset-grouping level: most of the securities are valued by means of rates of return (capitalization) which relate to groupings of assets of similar characteristics (by country, sector, type of asset, rating, etc.), and primarily from the weight attached to information existing in the market, generally in relation to the relevant index.

b. Evaluation and quotation of specific securities: Other securities are evaluated on an individual basis (evaluation of the issuer and the specific security), on the basis of direct price quotations for a margin for the security or the specific issuer. A small part of the assets in this grouping are evaluated only on the basis of price quotations from very active markets (mainly government debentures that have active market makers).

The CLO portfolio, which constitutes some 1.4% of the securities portfolio, is valued independently based on a model. The model is used by leading banks worldwide. In order to make use of the model, the Bank employs aggregate data generally accepted for use in those institutions. The Bank validates the model and ensures, to a reasonable degree of certainty, the accuracy of the fair value. The validation includes, *inter alia*, an examination of the systemic-logical connection between the data and the evaluation, reference to factors material to the evaluation, and the validity of the data and the parameters on which the evaluation was based, as well as by comparisons with price indications obtained from the market and from the actual execution of transactions in those securities.

Unquoted debentures in Israel denominated in shekels are evaluated by a model, since there is no active market in these debentures. The Bank validates the model and ensures, to a reasonable degree of certainty, the accuracy of the fair value. The validation includes, *inter alia*, an examination of the systemic-logical connection between the data and the evaluation, with reference to factors material to the evaluation and the validity of the data and the parameters on which the evaluation was based. The model refers to results of the "Mirvach Hogen" model, which evaluates these assets for the purposes of financial statements of financial institutions. The total value of the assets based on the model is slightly lower than the value as evaluated by the "Mirvach Hogen" model.

The following table sets out the value of securities by method of calculation in NIS millions:

	31 December 2011 (1)	31 December 2010
Securities traded on an active market	**34,219**	32,678
Securities according to prices determined according to external models	**11,600**	20,421
Securities according to quotation from counterparty or to cost	**2,117**	2,692
Total	**47,936**	55,791

(1) 2011 data are calculated in accordance with FAS 157. For information on FAS 157, see Note 1(G) to the financial statements.

For further details of the accounting policy and the method of valuing the securities portfolio and the distinctions between a temporary impairment and that of a non-temporary nature, see the Section "Accounting Policy on Critical Subjects" and Note 3 to the financial statements.

The following table sets out the classification of the securities item in the consolidated balance sheet in accordance with the above rules:

	31 December 2011				
	Adjusted cost	Unrealized gains from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value	Balance sheet value
	NIS millions				
Debentures					
Available-for-sale	**36,524**	**227**	**(748)**	**36,003**	**36,003**
For trading	**9,369**	*** 78**	*** (66)**	**9,381**	**9,381**
	45,893	**305**	**(814)**	**45,384**	**45,384**
Shares and funds					
Available-for-sale	**1,876**	**341**	**(26)**	**2,191**	**2,191**
For trading	**363**	*** 4**	*** (6)**	**361**	**361**
	2,239	**345**	**(32)**	**2,552**	**2,552**
Total securities	**48,132**	**650**	**(846)**	**47,936**	**47,936**

	31 December 2010				
	Adjusted cost	Unrealized gains from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair value	Balance sheet value
	NIS millions				
Debentures					
Available-for-sale	44,271	418	(432)	44,257	44,257
For trading	8,367	90*	(59)*	8,398	8,398
	52,638	508	(491)	52,655	52,655
Shares and funds					
Available-for-sale	2,211	653	(5)	2,859	2,859
For trading	636	-	(359)*	277	277
	2,847	653	(364)	3,136	3,136
Total securities	55,485	1,161	(855)	55,791	55,791

* Carried to profit and loss.

As at 31 December 2011, some 79.7% of the Group's *nostro* portfolio was classified as available-for-sale securities and some 20.3% as the trading portfolio. This classification allows for flexibility in the management of the securities portfolio. Some 5.3% of the value of the securities represents investments in shares of companies that are not presented on equity basis, but according to cost or to the market value of the shares traded on the stock exchange.

The following table sets out details of the Group's activity in debentures:

	2011	2010
	NIS millions	
Debentures redeemed and/or sold (available-for-sale)	**35,051**	30,709
Purchases of debentures available-for-sale	**26,477**	30,082
Net profit from investments in debentures:		
Financing income on accrual basis*	**2,405**	(951)
Profit from sale and from decrease in value of available-for-sale debentures	**265**	262
Profit realized and/or unrealized from adjustments to fair value of debentures for trading	**78**	147

*The increase derives from positive exchange rate differentials due the depreciation of the shekel against most currencies, compared with negative exchange rate differentials in 2010.

The following table sets out details of the composition of investments in debentures by linkage basis:

	31 December 2011			31 December 2010		
	Government of Israel	Foreign governments	Other companies	Government of Israel	Foreign governments	Other companies
	NIS millions			NIS millions		
Israeli currency:						
Unlinked	**19,227**	**-**	**619**	22,691	-	523
CPI-linked	**7,124**	**-**	**861**	6,399	-	937
Foreign currency including foreign currency-linked	**1,577**	**3,858**	**12,118**	1,810	2,851	17,174
Total debentures*	**27,928**	**3,858**	**13,598**	31,170	2,851	18,634

* Of which NIS 1,605 million subordinated debentures.

In 2011, there was a decrease of some NIS 5.0 billion, about 27.0% in Group investments in corporate debentures, including banks and financial institutions, mainly in foreign currency debentures abroad. Some 70.0% of debentures are invested in government debentures, mainly of the Israeli government.

See Note 3 to the financial statements for further details.

Below is a table of details of investments in corporate debentures (not banks) only issued in Israel and abroad, by sector of the economy (available-for-sale and trading portfolio):

	31 December 2011	
	Issued in Israel	Issued abroad
Economy sector	NIS millions	
Agriculture	**-**	**-**
Industry	**71**	**313**
Construction and real estate	**41**	**92**
Electricity and water	**216**	**181**
Trade	**331**	**-**
Transportation and storage	**26**	**-**
Communications and computer services	**79**	**149**
Financial services	**610**	**5,776**
Business and other services	**16**	**34**
Public and community services	**24**	**75**
Total	**1,414**	**6,620**

The Available-for-Sale Portfolio

The following table shows the composition of the available-for-sale portfolio as at 31 December:

	2011		2010		Change	
	NIS millions					
	Abroad	In Israel	Abroad	In Israel	Abroad	In Israel
Debentures	**16,641**	**19,362**	19,616	24,641	(2,975)	(5,279)
Shares and funds	**724**	**1,467**	563	2,296	161	(829)
Total	**17,365**	**20,829**	20,179	26,937	(2,814)	(6,108)

a. In 2011, NIS 1,021 million was recorded to shareholders' equity in respect of the available-for-sale portfolio, due to a decline in value and exchange rate differentials in respect of debentures denominated in foreign currency, compared with an increase in value of NIS 235 million (before tax) in the corresponding period the previous year. The main increase in value derives from subordinated debentures of banks abroad.

b. In addition, NIS 265 million was recorded to profit and loss, in respect of net profits from the sale of debentures after setting off provisions defined as impairment of securities of a non-temporary nature, compared with profits of NIS 262 million in the corresponding period the previous year.

c. The following table shows a summary of the above results in respect of the available-for-sale portfolio (including financing income):

	2011	2010
	NIS millions	
Profits (losses) in respect of securities which were recorded to profit and loss	**2,100**	(546)
Of which: Exchange rate differentials	**1,107**	(1,866)
Adjustments to capital reserve of available-for sale securities	**(1,021)**	235

d. The following table shows net balances in shareholders' equity (net adjustments in respect of available-for-sale securities before tax):

	31 December 2011	30 September 2011	31 December 2010	Movement 4th Quarter	Movement Year 2011
	NIS millions				
Shares	**315**	261	648	**54**	**(333)**
Israel government debentures	**151**	141	115	**10**	**36**
Foreign government debentures	**(2)**	(1)	3	**(1)**	**(5)**
Other debentures *	**(670)**	(601)	(132)	**(69)**	**(538)**
Other credit instruments	**(118)**	(111)	63	**(7)**	**(181)**
Total	**(324)**	(311)	697	**(13)**	**(1,021)**
Related tax	**106**	97	(229)	**9**	**335**
Net total	**(218)**	(214)	468	**(4)**	**(686)**

* Of which as at 31 December 2011, NIS (281) million in subordinated notes of overseas banks.

The accumulated net balance of adjustments to fair value of securities held in the available-for-sale portfolio, as at 31 December 2011, amounted to a negative amount of NIS 218 million (after the effect of tax) compared with a positive amount of NIS 468 million at the end of 2010. These amounts represent net losses/profits which had not been realized at the dates of the Financial Statements.

In the value of the available-for-sale portfolio, since the end of 2011 until 29 February 2012, there has been an increase in capital reserves amounting to NIS 296 million before tax and NIS 171 million, net, as a result of an increase in the value of the securities.

e. Below is the impairment in available-for-sale securities charged to shareholders' equity as at 31 December 2011:

		Duration of impairment since commencement of the decline*				
		Up to 6 months	6-9 months	9-12 months	More than 12 months	Total amount
		NIS millions				
Rate of decline						
Up to 10%	Shares	**20**	**-**	**-**	**-**	**20**
	Asset-backed debentures	**2**	**1**	**8**	**24**	**35**
	Other debentures	**121**	**42**	**1**	**95**	**259**
	Total	**143**	**43**	**9**	**119**	**314**
10%- 20%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**12**	**4**	**4**	**1**	**21**
	Other debentures	**38**	**31**	**23**	**181**	**273**
	Total	**50**	**35**	**27**	**182**	**294**
20%-30%	Shares	**6**	**-**	**-**	**-**	**6**
	Asset-backed debentures	**12**	**-**	**-**	**6**	**18**
	Other debentures	**-**	**-**	**2**	**96**	**98**
	Total	**18**	**-**	**2**	**102**	**122**
30%-35%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**-**	**-**
	Other debentures	**-**	**-**	**-**	**43**	**43**
	Total	**-**	**-**	**-**	**43**	**43**
35%-40%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**-**	**-**
	Other debentures	**-**	**-**	**-**	**1**	**1**
	Total	**-**	**-**	**-**	**1**	**1**
Above 40%	Shares	**-**	**-**	**-**	**-**	**-**
	Asset-backed debentures	**-**	**-**	**-**	**-**	**-**
	Other debentures	**-**	**-**	**-**	**-**	**-**
	Total	**-**	**-**	**-**	**-**	**-**
Total amount	Shares	**26**	**-**	**-**	**-**	**26**
	Asset-backed debentures	**26**	**5**	**12**	**31**	**74**
	Other debentures	**159**	**73**	**26**	**416**	**674**
Overall total		**211**	**78**	**38**	**447**	**774**

For the treatment of the evaluation of securities and distinctions between an impairment of a temporary nature and that of a non-temporary nature, see page 65 above.

* The duration of the impairment from the commencement of the impairment means from the beginning of any impairment whatsoever of the security from the price of the adjusted cost.

The Trading Portfolio

The following table shows the composition of the trading portfolio as at 31 December:

	2011		2010		Change	
	NIS millions					
	Abroad	In Israel	Abroad	In Israel	Abroad	In Israel
Debentures	**793**	**8,588**	2,119	6,279	(1,326)	2,309
Shares and funds	**-**	**361**	99	178	(99)	183
Total	**793**	**8,949**	2,218	6,457	(1,425)	2,492

In respect of trading debentures, realized and unrealized profits amounting to NIS 78 million were recorded in the statement of profit and loss, compared with profits amounting to NIS 147 million in 2010, and in respect of shares and funds, realized and unrealized profits were recorded amounting to NIS 140 million, compared with profits of NIS 1 million in 2010.

In September 2008, following the collapse of the Lehman Brothers Investment Bank Group ("the Investment Bank"), a total of some US$ 100 million in respect of the sale of a security issued by a member company of the Investment Bank Group ("the Security") was not repaid to the Bank. On 17 August 2011, a verdict of the Bankruptcy Court in the United States, with the consent of the parties, was handed down to dismiss the legal proceedings being conducted against the Bank in the United States by the trustee of Lehman Brothers Inc. ("LBI"), as a response to the legal proceedings being taken by the Bank in Israel to exhaust its legal rights for the recovery of the monies due to the Bank.

The agreement of the trustee of LBI to dismiss the legal proceedings against the Bank and against another Israeli bank arose from the fact that the Bank agreed to remove the attachment order it imposed on monies in Israel. The Bank's agreement to remove the order results from a number of arrangements the Bank reached with companies in the Investment Bank Group, including: legal proceedings in Israel between the Bank and Lehman Brothers International (Europe) ("LBIE") had been completed; and proceedings in Israel against Lehman Brothers Holdings ("LBHI") and Lehman Brothers Securities N.V. will be closed.

The removal of the legal proceedings in Israel stemmed from the fact that the Bank reached an arrangement with the trustee over the assets of LBIE, whereby it would be permitted to exercise all of the attachment orders imposed on the rights of LBIE in Israel and to continue holding the security. The Bank exercised the aforesaid attachment orders and sold the security, for an aggregate total of NIS 210 million.

With respect to the said arrangements, the Bank recorded a gain of some NIS 143 million in the third quarter of 2011 (before tax).

Investments in Securities Issued Abroad

The Group's securities portfolio includes some NIS 18.2 billion (some US$ 4.8 billion) of securities issued abroad, all of which (except for some 1.0%) are investment grade securities, of which some 90% are rated 'A-' and above, of which some 35% are rated 'AAA'. The portfolio includes subordinated debentures of banks abroad with a fair value of NIS 1,605 million; about 9.0% of all investments in securities issued abroad. Of the said portfolio, some NIS 17.4 billion (some US$ 4.5 billion) is classified in the available-for-sale securities portfolio, and the balance is classified in the trading portfolio.

The following table shows the composition of investments in securities issued abroad:

	2011		2010	
	Available-for-sale portfolio	Trading portfolio	Available-for-sale portfolio	Trading portfolio
Balance sheet value	NIS millions			
Government debentures*	**5,089**	**251**	3,831	750
Debentures of banks and financial institutions	**7,854**	**366**	10,589	348
Asset-backed debentures	**2,444**	**120**	4,341	213
Other debentures	**1,254**	**56**	855	808
Shares and funds	**724**	**-**	563	99
Total	**17,365**	**793**	20,179	2,218

* Of which Government of Israel debentures issued abroad at 31 December 2011, NIS 1,414 million in the available portfolio and NIS 68 million in the trading portfolio, and at 31 December 2010, NIS 1,730 million in the available portfolio.

In the opinion of Bank Management, the impairment in the available-for-sale portfolio is mostly temporary in nature. The Bank intends, and is able, to continue to hold the investments until the expected return of the full cost of the assets or until maturity. Therefore, the impairment is recorded in shareholders' equity. The net decrease in value charged to shareholders' equity in respect of securities issued abroad, from the date of purchase until 31 December 2011, amounts to some NIS 604 million (some NIS 396 million after taxes). In 2011, the negative reserve increased by NIS 513 million, compared to a decrease of NIS 129 million in 2010. In 2011, in addition to the impairment which was recorded in shareholders' equity, an increase in value of some NIS 312 million was charged to the profit and loss account in respect of the trading portfolio. From the beginning of 2012, there was an improvement in the value of securities and the negative capital reserve contracted significantly. Until 29 February 2012, the increase in value of shares issued abroad amounted to NIS 387 million (some NIS 252 million after tax).

The following table shows the fair value at 31 December 2011 of debentures of banks and financial institutions abroad (excluding asset-backed securities):

	AAA to AA-	A+	A	A-	BBB+ to BBB-	BB+ to B-	Not rated	Total
	NIS millions							
United Kingdom	528	806	293	-	-	-	88	1,715
Austria (1)	-	-	20	-	-	-	-	20
Italy (1) (5)	-	-	359	-	-	-	-	359
Germany (1)	284	-	-	-	-	-	35	319
Denmark	-	-	88	-	-	-	-	88
Holland (1)	427	320	56	-	18	-	-	821
Luxembourg (1)	-	-	-	-	-	-	14	14
Spain (1) (5)	340	-	-	-	-	-	30	370
France (1)	375	189	-	-	-	-	20	584
Switzerland	8	-	-	-	-	-	85	93
Australia	567	-	-	-	-	-	-	567
Sweden	33	67	-	-	-	-	56	156
New Zealand	253	-	-	-	-	-	-	253
Norway	29	-	-	-	-	-	-	29
Canada (2)	19	-	-	-	-	-	-	19
South Korea	-	38	-	-	-	-	19	57
U.S.A. – by bank level (2)								
Citigroup Inc NY	-	614	-	-	-	-	-	614
Chase Manhattan Bank, N.A.	241	-	-	-	-	-	-	241
Bank of America (including Merrill Lynch)	4	-	523	-	-	-	-	527
Goldman, Sachs and Co.	206	154	-	-	-	-	-	360
Morgan Stanley	-	41	239	-	-	-	-	280
Wells Fargo Bank N.A.	283	-	-	-	-	-	-	283
United States – other (3)	39	-	62	-	-	-	350	451
Total (4)	3,636	2,229	1,640	-	18	-	697	8,220

(1) Eurozone countries amounting to NIS 2,487 million.
(2) North American countries (United States and Canada) amounting to NIS 2,775 million.
(3) This amount includes investments in six banks in the United States.
(4) Including subordinated debentures with a fair value as of 31 December 2011 of NIS 1,605 million (including available portfolio and trading portfolio).
(5) For further details in connection with credit exposure for countries abroad, see page 242.

The following table shows the fair value at 31 December 2010 of debentures of banks and financial institutions abroad (excluding asset-backed securities):

	AAA to AA-	A+	A	A-	BBB+ to BBB-	BB+ to B-	Not rated	Total
	NIS millions							
United Kingdom	745	85	183	313	316	79	-	1,721
Austria (1)	72	-	70	-	-	-	-	142
Italy (1)	306	15	-	-	-	-	-	321
Ireland (1)	-	-	-	15	-	-	-	15
Belgium (1)	-	-	365	-	-	-	-	365
Germany (1)	379	250	-	5	-	-	-	634
Holland (1)	344	211	33	128	-	-	-	716
Luxembourg (1)	-	33	47	-	-	-	-	80
Spain (1)	361	24	-	14	-	-	-	399
Portugal (1)	-	-	-	14	-	-	-	14
Finland (1)	28	-	28	-	-	-	-	56
France (1)	645	37	-	-	-	-	-	682
Switzerland	160	-	-	-	-	-	-	160
Australia	621	-	-	-	-	-	-	621
Sweden	56	-	63	-	-	-	-	119
New Zealand	250	-	-	-	-	-	-	250
Norway	27	31	-	-	-	-	-	58
Canada (2)	33	-	-	-	-	-	-	33
Other (3)	127	44	67	-	-	-	45	283
U.S.A. – by bank level (2)								
Citigroup Inc NY	-	106	-	787	-	-	-	893
HSBC Bank	10	-	-	311	-	-	-	321
Chase Manhattan Bank, N.A.	151	121	-	-	-	-	-	272
Bank of America	73	-	903	-	-	-	-	976
Goldman, Sachs and Co.	67	270	17	-	-	-	-	354
Morgan Stanley	-	-	323	-	-	-	-	323
Wells Fargo Bank N.A.	142	684	-	-	-	-	-	826
United States – other (2) (4)	119	22	43	78	-	-	41	303
Total (5)	4,716	1,933	2,142	1,665	316	79	86	10,937

(1) Eurozone countries amounting to NIS 3,424 million.
(2) North American countries (United States and Canada) amounting to NIS 4,301 million.
(3) This amount includes investments in 4 countries.
(4) This amount includes investments in 11 banks in the United States.
(5) Including subordinated debentures with a fair value as of 31 December 2010 of NIS 2,000 million (including available portfolio and trading portfolio).

1. Investments in foreign asset-backed securities

The Group's securities portfolio includes some NIS 2.6 billion (US$ 0.7 billion) of asset-backed securities (both mortgage-backed and non-mortgage-backed), all of which (save for 1%) are rated 'A-' and above, of which some 84% are rated 'AAA'. Of the said portfolio, some NIS 2.4 billion (US$ 0.6 billion) is classified in the available-for-sale portfolio.

The following table shows a summary of investments in asset-backed debentures in the available-for-sale portfolio:

	31 December 2011			
	Adjusted cost	Unrealized profits	Unrealized losses	Balance sheet value (fair value)
	NIS millions			
MBS - mortgage-backed securities	**1,722**	**23**	**(12)**	**1,733**
ABS asset-backed securities (other than mortgage-backed)	**770**	**3**	**(62)**	**711**
Of which: CLO	**720**	**1**	**(60)**	**661**
Other	**50**	**2**	**(2)**	**50**
Total	**2,492**	**26**	**(74)**	**2,444**

	31 December 2010			
	Adjusted cost	Unrealized profits	Unrealized losses	Balance sheet value (fair value)
	NIS millions			
MBS - mortgage-backed securities	3,414	62	(34)	3,442
ABS asset-backed securities (other than mortgage-backed)	815	114	(30)	899
Of which: CLO	686	102	(28)	760
SCDO	45	12	-	57
Other	84	-	(2)	82
Total	4,229	176	(64)	4,341

For the definition of asset-backed securities see Note 3 to the financial statements.

Securitization Exposures

Investment in asset-backed securities by exposure type (Table 9(f) – Basel II)

	31 December 2011	31 December 2010
	Accrued amount of exposure	
	NIS millions	
Mortgage-backed Securities (MBS):		
Pass-through securities:		
Securities guaranteed by US Government GNMA	**114**	1,734
Securities issued by FNMA and FHLMC	**259**	257
Other securities	**5**	7
Other mortgage-backed securities		
Securities issued by FHLMC, FNMA, or GNMA, or guaranteed by these entities	**1,017**	1,451
Other mortgage-backed securities	**448**	48
Total mortgage-backed securities (MBS)	**1,843**	3,497
Asset-backed securities (ABS):		
Credit card debtors	**40**	38
Lines of credit for any purpose secured by dwelling	**5**	5
Credit for purchase of vehicle	**-**	152
Other credit to private persons	**5**	6
Credit not to private persons	**4**	5
CLO debentures	**661**	760
SCDO debentures	**-**	57
Others	**6**	34
Total asset-backed (ABS)	**721**	1,057
Total asset-backed securities and mortgage backed securities	**2,564**	4,554

Investment in asset-backed securities by risk weighting* (Table 9(g) – Basel II)

	31 December 2011	31 December 2010	**31 December 2011**	31 December 2010
	Accrued amount of exposure		Capital requirement for securitization exposure	
	NIS millions		NIS millions	
20%	**1,001**	502	**18**	9
50%	**100**	110	**5**	5
100%	**21**	111	**2**	10
Deducted from equity	**29**	214	**-**	-
Total	**1,151**	937	**25**	24

* Not including GNMA, FNMA, FHLMC securities, which are presented as a U.S. Government obligation.

The available-for-sale securities portfolio of foreign asset-backed securities as at 31 December 2011 includes investments in mortgage-backed securities in the total amount of some NIS 1.7 billion. 75% of the mortgage-backed securities in the available-for-sale portfolio are guaranteed or directly issued by United States federal agencies, (FNMA, FHLMC,GNMA). The FNMA and FHLMC agencies have come under governmental protection under the U.S. Administration's rescue plan, and there is a government guarantee for GNMA debentures.

At 31 December 2011, the accumulated net increase in value charged to shareholders' equity resulting from the mortgage-backed securities portfolio was some NIS 11 million.

The projected term to maturity for all the mortgage-backed securities portfolio is some 3 years on average.

In addition to mortgage-backed securities, the Group's available-for-sale portfolio also includes other securities backed by assets other than mortgages (car financing credit and other types of credit), amounting to some NIS 711 million. All these debentures, save for 3%, are rated 'A-' and above. This portfolio includes CLOs amounting to some NIS 661 million. The projected term to maturity of the portfolio of securities backed by assets other than mortgages is some 3 years on average.

As mentioned above, total asset-backed securities of the CLO type amounted to NIS 661 million. In respect of these securities, an impairment of NIS 59 million was recorded in 2011 in shareholders' equity and in 2010 an increase in value of NIS 74 million. In addition, in 2011, a profit of NIS 114 million was recorded in respect of these securities.

The charge to profit and loss in respect of these two portfolios was made on the basis of the policy detailed in the section on Significant Accounting Policies in Note 1 to the Financial Statements and on page 113 of the Directors' Report above.

In the framework of the trading portfolio, there are investment in asset-backed securities amounting to NIS 10 million (in 2010 – NIS 158 million).

For the definition of asset-backed securities see Note 3 to the financial statements.

2. Investments in other (non asset-backed) foreign securities

The Group's securities portfolio as at 31 December 2011 includes some NIS 15.6 billion (US$ 4.1 billion) of non-asset-backed securities, which include mainly securities issued by banks and financial institutions, including subordinated debentures, the balance being securities issued by governments, principally the United States government. Of these securities, NIS 14.9 billion (US$ 3.9 billion) are classified in the available-for-sale portfolio, with the balance in the trading portfolio. Of the total securities, 86% are rated A- or higher.

For further details regarding exposure to overseas financial institutions, see page 240.

The Bank is of the view that the decline in prices of these securities is mostly of a temporary nature, and so, most of the impairment was charged to shareholders' equity. This is based on the criteria described in Note 1 under principal accounting policies and takes into consideration additional parameters such as the involvement and backing – including direct capital investment – of governments for insuring the strength of these and other banks in their countries, and market expectations regarding the risk of bank failures, as expressed in the prices of credit derivatives (CDS) as well as increase in value after the date of the financial statement, high credit rating (group A and above) and an analysis of the ability to withstand stress scenarios.

As at 31 December 2011, aggregate impairment charged to shareholders' equity in respect of non-asset-backed securities issued abroad in the available-for-sale portfolio amounted to NIS 555 million (NIS 364 million after tax).

Non-asset backed debentures issued abroad are for the most part debentures of banks.

The portfolio of bank debentures also includes some NIS 1,605 million in subordinated debentures. Debentures of this type held by the Group are debentures with no element of convertibility to shares and their final redemption date is less than ten years. With these debentures the issuer has, generally, the option of early repayment of the debenture (call). In the event that the issuer does not make an early call, the duration of the debenture is extended by a number of years (generally three to five), and the interest rate increases (step-up mechanism).

A significant part of the impairment in securities issued overseas was in subordinated debentures. Since the major element of impairment derives from the increased probability that the issuer will exercise his right not to make an early call, and thus he will extend the duration of the debentures, or from the fulfillment of regulatory provision that does not allow an early call, and after the Bank has carried out individual examinations to review the stability of each of the banks in this group, the Bank considers this impairment to be of a temporary nature.

The Bank intends and is able to continue holding these debentures until their expected final redemption or at least until restoration of their value. At any time, the Bank considers regulatory developments, in particular the new liquidity rules that are intended to represent an important pillar in Basel III regulations. Since it currently appears that these regulations, which will come into force in another few years, reduce the advisability in holding a portfolio of bank debentures, the Bank is reducing its portfolio of bank debentures as much as they are repaid or can be sold without loss.

	Fair value					
	31 December 2011	30 September 2011	30 June 2011	31 March 2011	31 December 2010	Difference in fair value for 2011
	NIS millions					
Total subordinated debentures of banks issued abroad	**1,534**	1,971	2,127	2,095	1,796	(281)
Of which: subordinated debenture which decreased by more than 35%	**-**	-	-	-	6	-

In addition to the available-for-sale portfolio, the securities portfolio also includes non-asset backed securities in the trading portfolio. This includes mainly securities of states, banks and financial institutions, and securities funds. All the securities in the trading portfolio are of investment grade, and some 94% are rated A and above. The value of the non-asset backed trading portfolio as of 31 December 2011 amounted to NIS 0.7 billion (US$ 0.2 billion). The difference between fair value and adjusted cost, if there is such a difference, is recorded in the profit and loss account.

3. Investments in corporate debentures issued in Israel

Investments in debentures issued in Israel amounted to NIS 28.0 billion on 31 December 2011, of which NIS 26.4 billion was in debentures issued by the Government of Israel, and NIS 0.9 billion was in debentures issued by companies and the remainder was issued by banks and financial institutions. On 31 December 2011, some 65% of the investments in corporate debentures amounting to some NIS 0.6 billion were included in the available-for-sale portfolio, and the balance was in the trading portfolio. At the end of 2011, the available-for-sale debenture portfolio included a positive capital reserve amounting to NIS 90 million.

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

The test for determining whether an impairment of a debenture in the available-for-sale portfolio is of a non-temporary nature is based primarily on the criteria set out in accounting policy on page 67 and in Note 1 to the financial statements.

4. Investments in shares and funds

Total investments in shares and funds amounted to some NIS 2,552 million on 31 December 2011, of which NIS 1,367 million was in listed shares and NIS 1,185 million was in non-listed shares. Of the total investment, NIS 2,191 million is classified as available-for-sale and NIS 361 million is classified in the trading portfolio.

Risk Management objectives and policy with regard to investment in shares - (Qualitative Disclosure – Table 13 - Basel II):

Investment policy:

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

Definition of the aim of the investment:

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

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

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

Accounting treatment of investments:

- Investments are recorded as investments in the available-for-sale securities portfolio. When the investment is in a company included on equity basis, it is recorded in "investments included on equity basis".
- With regard to the accounting method, see the Chapter on Accounting Policy and Note 1(I.)

The following table sets out the principal investments in shares and funds recorded in the securities item (1) (Table 13 (B) Basel II):

	The Bank's share on a consolidated basis in the paid-up capital giving the right to receive profits		Value of the investment in the consolidated balance sheet*		Capital adequacy requirement		Listed/not listed
	31 December 2011	31 December 2010	**31 December 2011**	31 December 2010	**31 December 2011**	31 December 2010	
	%		NIS millions				
Migdal Insurance and Financial Holdings Ltd.	**9.79**	9.80	**534**	744	**48**	67	listed
Africa Israel Properties Ltd.	**2.2**	2.2	**16**	35	**1**	3	listed
Super-Pharm (Israel) Ltd. (2)	**-**	18.0	**-**	182	**-**	16	not listed
Otzar Hityashvuth Hayehudim B.M.	**8.62**	8.62	**44**	85	**4**	8	listed
Partner Communications Ltd. (3)	**4.96**	4.96	**261**	553	**23**	50	listed
Electra Consumer Products (1970) Ltd.	**8.98**	9.0	**66**	105	**6**	9	listed
T.S.I. Roads Limited Partnership	**17.82**	19.52	**101**	127	**9**	11	not listed
Tower Semiconductor capital notes	**-**	-	**49**	49	**4**	4	not listed
Visa International	**-**	-	**-**	35	**-**	3	listed
CLS Bank	**-**	-	**21**	21	**2**	2	not listed
Funds	**-**	-	**1,140**	861	**103**	77	746 not listed
Apax	**-**	-	**69**	60	**6**	5	not listed
Others	**-**	-	**251**	279	**24**	27	186 not listed
Total	**-**	-	**2,552**	3,136	**230**	282	

* The value of the investment in the consolidated balance sheet equals the balance of fair value of the investment.

(1) See page 180 for details of non-banking investments reported on equity basis.
(2) Transferred to companies included on equity basis.
(3) On 30 September 2011, impairment of NIS 239 million was recorded.

Partner Communication Ltd.

Leumi Partners Ltd. (hereinafter, "Leumi Partners") has decided to write down the investment in the shares of Partner Communication Ltd. (hereinafter, "Partner") and transfer the balance of the negative reserve from capital reserves to profit and loss. The write-down is derived from the difference between the market price at 30 September 2011 and the nominal purchase price (ex-dividend) of the shares which amounted to some NIS 239 million. The said write-down was made in accordance with Leumi Group's accounting policy, which requires such amortization in a situation in which there is a significant and continuing impairment. In the fourth quarter of 2011, a reduction in value of shares of Partner Communications Ltd. amounting to NIS 19.7 million was recorded in a capital reserve. As of 30 June 2011, a fall in the value of the shares of Partner amounting to NIS 121.5 million was recorded as a capital reserve.

From the date of the investment in Partner which was made in October 2009, Leumi Partners received payments in connection with the transaction, including dividends and commissions, amounting to NIS 187.4 million, gross before tax.

TSI Roads Limited Partnership
On 31 December 2010 Leumi Partners invested (as a limited partner) in the limited partnership, TSI Roads Limited Partnership ("the Partnership"), which purchased 50% in Derech Eretz Highways (1997) Ltd. ("Derech Eretz").

In August 2011, Leumi Partners signed an agreement for a further investment in the partnership ("additional investment") which was intended to enable the partnership to invest in Derech Eretz for the purpose of exercising the right of first refusal vis-à-vis the State, for the purpose of purchasing certificates and debt that the State was entitled to allocate. The State has not approved the notice of the exercise of the right of refusal by Derech Eretz and this matter has been forwarded for discussion in arbitration between Derech Eretz, the State of Israel and the body that has been announced by the State as the winning party. On 10 October 2011, the decision was given by the arbitrator approving the State's notice on the rejection of the exercise of the right of first refusal. As a result of the arbitrator's decision, the participation certificates of the State were sold to the winning party ("the winning party"). On 13 September 2011, the partnership signed an agreement with Housing and Construction Ltd. to purchase the entire holdings of Housing and Construction in Derech Eretz. The agreement is contingent on conditions precedent, which have not yet been given, including the approval of the State and the approval of the senior lenders to Derech Eretz.

The following table shows investments (positions) in shares and funds in the securities item (available-for-sale portfolio and trading portfolio) (NIS millions):

	Balance sheet amount	
	2011	2010
Quoted shares	**1,367**	1,847
Funds according to quote by counterparty	**822**	714
Unquoted shares	**363**	575
Total	**2,552**	3,136

Securities Pledge

The Bank is a member of the Stock Exchange Clearing House Ltd. and of the Maof Clearing House Ltd.

The Bank, like all other Maof Clearing House members, pledges securities from the *nostro* to secure its customers' activities, the *nostro* activities and its part of the risks fund. The pledge also secures amounts due in respect of obligations of the other members of the risks fund, if the pledge provided by another member is not sufficient to cover all his obligations and in proportion to the relevant share of each of the members of the fund, up to the lower of the amount of the collateral provided or the amount of the sums due to the Maof Clearing House. As at 31 December 2011, the Bank had pledged debentures having a value of NIS 1.791 billion to the Maof Clearing House.

A similar collateral arrangement exists with the Stock Exchange Clearing House. The total value of debentures pledged by the Bank to the Stock Exchange Clearing House as at 31 December 2011 was NIS 191 million.

On 23 July 2007, the Bank signed a debenture in favor of the Bank of Israel as security for amounts due or that will be due to the Bank of Israel from the Bank. As collateral for the above, the Bank created a floating charge in favor of the Bank of Israel, unlimited in amount, over debentures deposited in a specific account maintained at the Tel Aviv Stock Exchange Clearing House in the name of the Bank of Israel. As at 31 December 2011 there were no balances outstanding.

As at 31 December 2011, the Bank had no outstanding loans from the Bank of Israel while the balance of the Bank's deposits with the Bank of Israel amounted to NIS 36.7 billion.

The Bank is executing short-term lending of securities in foreign currency from the available portfolio, via the Euroclear clearinghouse, for other customers of the clearinghouse, without knowing the identity of the borrowers. The lending is carried out under a full guarantee of the Euroclear clearinghouse which is an AA+ rated financial institution. The value of the balance of the securities lent to the Euroclear clearinghouse as of 31 December 2011 stood at some NIS 75 million.

Other assets and debit balances in respect of derivative instruments

At the end of 2011, other assets amounted to NIS 4.2 billion, compared with NIS 2.6 billion at the end of 2010, an increase of some 61.4%, or some NIS 1.6 billion. The increase in this item resulted from an increase in the balance of deferred tax receivable.

The balance of the fair value of derivative instruments made with and for customers increased from NIS 8.7 billion at 31 December 2010 to NIS 11.6 billion at 31 December 2011. At the same time, there was an increase in the item, liabilities in respect of derivative instruments from NIS 10.0 billion to NIS 12.1 billion.

Fixed assets and plant

Buildings and equipment - the amortized cost of buildings and equipment as at 31 December 2011 amounted to NIS 3,653 million, compared with NIS 3,638 million as at 31 December 2010.

Investments in buildings and equipment as at 31 December 2011 are as follows:

	Cost	Accumulated depreciation	Net book value	
			31 December 2011	31 December 2010
	NIS millions			
Buildings and land	**3,338**	**1,716**	**1,622**	1,646
Equipment, furniture and vehicles	**3,534**	**2,775**	**759**	703
Software	**3,627**	**2,355**	**1,272**	1,289
Total	**10,499**	**6,846**	**3,653**	3,638

The above buildings and equipment are used mainly for the activities of the Group. Buildings that are not used by the Group and are leased to non-Group parties are included in the consolidated balance sheet as at 31 December 2011 amounted to NIS 24 million.

The majority of the premises in which the business of the Group is conducted in Israel are owned by the Bank or by subsidiaries. Most of the properties in which the business of the Group is conducted abroad are leased.

Real estate assets of the Bank are owned by the Bank, Binyanei Bank Ltd. and Lyn City Center Ltd. (wholly-owned subsidiaries of the Bank). The Group owns 181 properties, of which 124 are branches and archives and 19 are Head Office buildings. The total area under ownership is some 268,000 sq. mtrs. divided into branches - some 81,000 sq. mtrs., Head Office buildings - some 40,000 sq. mtrs. (excluding the Bank Leumi Service Center complex in North Lod), and the balance, divided amongst offices in use by subsidiaries, a logistical center, plots, vacant properties etc. Properties designated for sale constituted 5,442 sq. mtrs. as of 31 December 2011, and are presented at the lower of amortized cost or realization value.

Investment in buildings in 2011 amounted to NIS 41 million (including property purchases amounting to NIS 20 million) compared with NIS 125 million in 2010 (including property purchases of NIS 21 million). In addition to areas owned by the Bank, the Bank leases 212 properties under unprotected leases and eight properties under protected leases. Total property leased constitutes some 78,000 sq. mtrs.

"Keshev" – "The Yitzhak Rabin Bank Leumi Service Center", "Hatam" – the Operations and Computerized Operating Services Division of the Bank, is located in Lod, within a facility comprising a total area of 78.8 dunams.

Leumi has established a new underground facility for the computer complex. The facility is protected against rocket attack, biological and chemical warfare and earthquakes. The facility is constructed with advanced technology enabling day-to-day operation at a high level and independent functioning in times of emergency. The transfer of the computer system to the facility was completed at the end of 2010. The infrastructure in the new computer center is at an optimal level of survivability and redundancy and the structure is built in accordance with international standards.

Leumi has 2 mainframe computers produced by IBM, part of the Z Series range. For use by the production systems: a primary computer with an operating power of some 9778 mips, with a current operating capacity of 8943 mips (number of instructions in millions per second) and a secondary computer with an operating power of some 471 mips. The secondary production computer is expandable to a capacity of some 9284 mips for internal back-up purposes in the Keshev facility.

One computer, with an operating power of some 2,147 mips, operates at the Tel Aviv facility, and serves as the development and testing environment. This computer is expandable to a capacity of some 13,662 mips in emergency situations in which the Keshev facility ceases to operate.

The Bank has a database of historical data stored on discs and cassettes in the main computer facility at Keshev and in the back-up facility in Tel-Aviv. A third copy of data is stored elsewhere in Israel.

Leumi's branches are computerized and connected on-line to the Bank’s computer center at Keshev. Some 327 servers and some 7,094 work-stations, mostly PC-based, have been installed in the branches. There are 337 innovative automatic teller machines for use by customers and some 570 self-service "Leumi Information" stations (350 stations in the branches and 220 external information stations in the outside walls of branches). At head office and district management units there are 8,000 personal computers connected in local area networks, with the capability of communicating directly with the computer center and a separate external internet connection.

During the years 2008-2009, the Bank upgraded the network of "Leumi Information" external customer stations with new and advanced equipment. In 2010, a process began of replacing internal customer stations. In 2011, an upgrade of internal customer stations was carried out and 161 stations were replaced.

Information security at Leumi is based on the principle of banking secrecy and various laws and directives, such as the provisions of the Protection of Privacy Law and related regulations, the provisions of the Computers Law, directives of the Bank of Israel, including Information Technology Management Directive 357, and accepted standards of information security.

Based on these directives, extensive activity is undertaken in defining organizational information security policy, structuring work programs for the implementation of supervision and information security mechanisms, establishing systems and integration of information security management, and planning and execution of information security controls, including the drafting of procedures.

The operations and computer function of subsidiaries in Israel and abroad are based on independent systems, with the managements and boards of directors of those companies having professional and administrative responsibility. Within the context of a multi-year program, together with the overseas subsidiaries, the Bank is improving and upgrading the systems at the overseas subsidiaries to uniform computerized banking systems.

Hatam operates an array of computerized systems for the Arab Bank of Israel and for the Union Bank. There is an agreement with them relating to computer services that Hatam provides, which includes operating services, computer systems development, consultancy services, organization and method services, back-ups, training and other services.

The computer center of Leumi Mortgage Bank is located outside of its offices, and is operated by means of outsourcing by IBM.

The overseas subsidiaries are connected to each other and to the Bank in Israel via a private communication network. This system is used for voice communication as well as for transmitting encrypted data in a secured manner. The Bank invests in maintaining and developing internet sites for the Bank’s overseas subsidiaries based on the Bank's infrastructure. In addition, the technological infrastructure was upgraded to improve the availability of the systems.

Bank Leumi USA has outsourcing agreements with a number of U.S. companies regarding the information systems used for the management of its banking business.

In 2011, the Group invested in equipment including software some NIS 647 million, compared with some NIS 624 million in 2010. The budget was adapted to support the strategic goals as defined by the Bank Management, as well as the operating requirements for banking in the future. Projects carried out in 2011 were designed for the benefit of the customers, to increase their satisfaction, to reinforce their loyalty and to prevent their leaving. The major investment in 2011 (as in previous years) was focused on the following spheres: the distribution network (with the aim of increasing the shift to direct channels), improving the "customer experience" through Leumi Digital, Leumi Cellular, trading on the capital market via the Internet, initiation of campaigns, Digital Teller, developments in BI CRM, Internet for commercial companies, data services for sub-custodial customers on the Internet. In addition, as in each year emphasis was placed on compliance with regulatory directives. This year, some of the investments were directed to the leverage of the implementation of the Basel regulations in favor of educated risk management and transaction services and the realization of an optimal business technological solution, which contributes directly to the maintenance of Leumi's risk level under changing market conditions.

In order to supply the needs of capital market customers, to strengthen the business connection with its customers and to withstand the competition in the market, some of the investments were directed, *inter alia,* to the development and expansion of data channels from the Bank to the systems of the customers in their offices. In addition, in 2011, the Trading Room Project continued for the replacement of the core foreign currency trading systems, large parts of which are already in operation (the project is being developed in stages.) Development work on the following projects was completed: upgrade and improvement of the Internet system (Project Kochav) and the upgrade and improvement of the content management system.

In 2010, an innovative business service was launched, enabling the transfer of money from the customer's account and its withdrawal by another (beneficiary) from a Leumi ATM (automated telling machine) through a one-time withdrawal code sent to the beneficiary's cellular phone (without the need a magnetic card, in all Leumi facilities). In 2011, this service was expanded to enable the transfer of the money to the Bank's account in Israel in the name of the beneficiary or in the name of a third party.

In 2010, another four modules were developed in Leumi Trade for capital market customers (a module for ETF shorts in Israel and abroad, a module for shares and express shares, a module for issues and purchase offers for Israeli securities and a revised module for mutual funds). In 2011, further services were developed in Leumi Trade: trading in ETFs express trade in Israeli and global goods, the possibility of giving complex and automatic orders and trading in foreign currency American Express securities. In addition, new indices were launched on the Tel Aviv Stock Exchange, new options for stock exchange securities and new options for debentures.

In the cellular field, an "iLeumi" application has been developed, for information and executing transactions from an account to an iPhone. In addition, a Leumi Wallet application has been developed, for information and executing transactions from an account to 3G devices. In 2011, the iLeumi Trade application was developed, enabling the receipt of information and trading in securities by cellular phone.

On 11 January 2011, a project for disclosing and measuring problem debts went into operation. As part of the project, the Problem Debt (Hovav) system and systems interfaced to it were adapted to the Bank of Israel regulations regarding the management of problem debts. The aim: the improvement of the management of risks deriving from problem debts. As part of the adaptation process, a new system was developed for dealing with credit risks and a new process for calculating group allowances was devised.

Against the background of various requirements by the authorities (Bank of Israel, Ministry of Finance etc.) for the execution of various directives, in 2011, the Bank invested in computer–related expenses estimated at some NIS 48 million (some NIS 51 million in 2010). The principal issues were Basel II, pension counseling, impaired debts, information technology directives, and SOX 404.

The increase in investments in buildings and equipment is intended to adapt the logistical infrastructure and deployment of the Bank's branches to the expansion that has occurred in business activity, and to the operational needs of modern banking.

The operations and computer division has been certified for quality standards in the following areas: software quality, data security, quality management systems, information technology services management, business continuity, safety and occupational hygiene, and fire safety.

The Procurement, Building and Logistics Department has a Gold Medal (Tav Hazahav) for its certification for 3 standards: Safety and Hygiene Standard, Quality Management System, and Quality of the Environment.

In 2011, the applicability of Safety and Hygiene Standard and the Quality of the Environment Standard was expanded to the level of the whole Bank.

In addition, with effect from 2011, the system is certified for the Conservation of Energy Standard.

See Note 7 to the financial statements for further details.

Intangible Assets

1. The Bank is the sole proprietor of the "Leumi" trademark, and its accompanying design logo, in the banking and finance services field in Israel.

2. In addition, the Group makes use of the names of its companies and their logos for the purposes of its activities, and the names of services and products, some of which are registered as trademarks and service marks.

3. The Group has registered data bases in which information is stored, *inter alia*, regarding customers, suppliers and employees of Leumi. Advanced technological means are used that are designed to protect customer activity and the Bank's business activity, while reducing the risks arising from the use of information systems.

4. The Group holds various intellectual property rights and user rights in various computer programs and information systems for purposes of managing its business, including the provision of services to customers.

Operating Segments in the Group

This chapter describes the business development according to operating segments.

For a description of the methodology of the operating segments, see above on page 21.

Following are principal data according to operating segments of the principal balance sheet items as at 31 December:

Segments	Credit to the public			Deposits of the public			Total assets		
	2011	2010	Change	**2011**	2010	Change	**2011**	2010	Change
	NIS millions		%	NIS millions		%	NIS millions		%
Households[1]	**83,045**	76,341	**8.8**	**130,276**	118,266	**10.2**	**83,831**	76,929	9.0
Small businesses	**20,039**	19,018	**5.4**	**18,109**	16,579	**9.2**	**20,068**	19,039	5.4
Corporate banking	**77,571**	73,163	**6.0**	**28,179**	26,281	**7.2**	**80,896**	75,108	7.7
Commercial banking	**50,536**	47,226	**7.0**	**46,527**	36,421	**27.7**	**51,431**	49,316	4.3
Private banking	**9,074**	7,738	**17.3**	**39,999**	36,241	**10.4**	**13,989**	10,618	31.7
Financial management capital markets and others	**1,055**	495	**+**	**16,314**	15,796	**3.3**	**115,639**	97,312	18.8
Total	**241,320**	223,981	**7.7**	**279,404**	249,584	**11.9**	**365,854**	328,322	11.4

(1) Credit to households also includes housing loans (mortgages). After neutralizing this credit, credit excluding mortgages to households increased by 7.0%. Housing loans amounted to NIS 55.9 billion at the end of 2011, having increased by 9.7%. The rate of increase on credit (banking and finance) in 2010 was 5.4%.

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Following are principal data according to operating segments of off-balance sheet items and data on customers' balances in the capital market:

Segments	Guarantees and documentary credit			Securities portfolios, including mutual funds		
	2011	2010	Change	**2011**	2010	Change
	NIS millions		%	NIS millions		%
Households	**499**	519	(3.9)	**88,849**	96,212	(7.7)
Small businesses	**1,331**	1,307	1.8	**6,485**	9,404	(31.0)
Corporate banking	**26,297**	24,114	9.1	**72,639**	94,234	(22.9)
Commercial banking	**6,772**	6,789	(0.3)	**44,225**	45,615	(3.0)
Private banking	**469**	482	(2.7)	**80,115**	75,201	6.5
Financial management – capital markets and others	**883**	757	16.6	**170,005**	174,658	(2.7)
Total	**36,251**	33,968	6.7	**462,318**	495,324	(6.7)

Following are details of the net profit and the net operating profit by operating segments:

Segment	Net profit, after canceling the effect of special salary expenses			Net operating profit, after canceling the effect of special salary expenses(1)		
	2011	2010	Change	**2011**	2010	Change
	NIS millions		%	NIS millions		%
Households	**364**	177	105.6	**364**	177	105.6
Small businesses	**320**	256	25.0	**320**	256	25.0
Corporate banking	**761**	1,198	(36.5)	**761**	1,198	(36.5)
Commercial banking	**437**	303	44.2	**437**	303	44.2
Private banking	**174**	87	100.0	**174**	87	100.0
Financial management – capital markets and others (2)	**144**	480	(70.0)	**142**	297	(52.2)
Total	**2,200**	2,501	(12.0)	**2,198**	2,318	(5.2)

(1) After canceling special salary expenses, as detailed above on pages 85-86.
(2) The extraordinary profit amounting to NIS 183 million in 2010, which is primarily attributable to the sale of shares in Paz, was attributed to this segment.

For further details, see Note 28 to the Financial Statements.

Return on equity by operating segments

The equity for the purpose of calculating the capital to risk assets ratio (Tier 1 and Tier 2 capital) was allocated to the segments according to the relative share of each segment in the total of all the weighted risk assets of the Group, and according to the allocation of Pillar 2 equity for each segment according to its characteristics and constituents.

The profit of the operating segments has been adjusted for risk capital in each segment. The risk-adjusted yield has been calculated as the ratio of the adjusted profit to shareholders' equity allocated to the segment, constituting the share of the allocated risk capital (Tiers 1 and 2).

The following table shows the net profit return on Tier 1 equity, adjusted for risk, by operating segment, calculated as stated above:

Segment	Return of the net profit on equity as a percentage				Return of the net operating profit on equity as a percentage			
	31 December 2011	31 December 2010	**31 December 2011 ***	31 December 2010*	**31 December 2011**	31 December 2010	**31 December 2011***	31 December 2010*
Households	**8.5**	4.4	**8.7**	4.4	**8.5**	4.4	**8.7**	4.4
Small businesses	**22.8**	18.7	**23.0**	18.7	**22.8**	18.7	**23.0**	18.7
Corporate banking	**9.3**	14.3	**9.3**	14.3	**9.3**	14.3	**9.3**	14.3
Commercial banking	**11.3**	8. 1	**11.4**	8. 1	**11.3**	8.1	**11.4**	8. 1
Private banking	**22.0**	12.7	**22.1**	12.7	**22.0**	12.7	**22.1**	12.7
Financial management – capital markets	**(10.0)**	8.0	**(2.7)**	12.2	**(10.0)**	3.5	**(2.7)**	7.6
Other	**70.7**	(2.0)	**70.7**	(2.0)	**70.1**	(2.2)	**70.1**	(2.2)

* After canceling the effect of special salary expenses.

Below is the return on risk adjusted capital (RORAC) and the economic value added (EVA) taking into account the cost of capital according to the multi-year return set out in the work plan, by operating segments:

The EVA and RORAC amounts were calculated according to the allocation of all of the Bank's capital between the segments (according to actual capital adequacy pursuant to Basel II.

Segment	As at 31 December 2011		As at 31 December 2010	
	Allocation of all the capital		Allocation of all the capital	
	RORAC	EVA	RORAC	EVA
	%	NIS millions	%	NIS millions
Households	**8.5**	(61)	4.4	(225)
Small businesses	**22.8**	179	18.7	119
Corporate banking	**9.3**	(60)	14.3	362
Commercial banking	**11.3**	51	8.1	(70)
Private banking	**22.0**	94	12.7	18
Financial management – capital market	**(10.0)**	(816)	8.0	(80)
Other	**70.7**	218	(2.0)	(57)
Total to net profit	**8.3**	(395)	10.3	67

The following table shows the quarterly development of the net operating profit by operating segment, after canceling special salary expenses:

Segment	**2011**				2010			
	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
	NIS millions							
Households	**18**	145	91	110	18	64	64	31
Small businesses	**47**	87	90	96	60	70	54	72
Corporate banking	**115**	122	187	337	336	343	289	230
Commercial banking	**97**	104	89	147	42	53	96	112
Private banking	**35**	33	46	60	13	22	22	30
Financial management (1)	**(54)**	(168)	161	(49)	99	46	6	157
Other (2)	**322**	(28)	(17)	(25)	(21)	(10)	57	(37)
Total	**580**	295	647	676	547	588	588	595

(1) In the third quarter, the loss derives mainly from the recording of amortization of Partner Communication Ltd., and from the decline in value of the provident and severance pay funds of the Bank's employees.
(2) The increase in profit derives from the recording of deferred taxes as a result of the cancelation of the outline plan to reduce company tax rates and increase the rate of company tax to 25%.

For the criteria for classifying customers according to operating segments, see page 23.
For further details regarding activities of the principal investee companies, see page 190 below.
A breakdown of the results of the operating segments is presented in Note 28 to the Financial Statements.

1. Household Segment

General

Banking in the household segment provides a range of financial services and products to individual customers according to their varying needs, while segmenting customers according to demographics, place of residence, occupation, financial characteristics and stages of life, from which the customers' financial needs are deduced.

Objectives and strategy

The following information is "forward-looking information." For the meaning of this term, see page 61.

The strategic objectives for banking in the household segment are to increase profitability by broadening the customer base and by expanding the activities of existing customers, while placing emphasis on the provision of efficient service that is adapted to their needs. Household credit is an important growth driver for retail activity, in light of the high level of dispersion and good risk management capabilities.

Project "Advancing Together"

The information below is "forward-looking information". For an explanation of this phrase, see page 61.

In 2011, Leumi initiated the "Advancing Together" project which is aimed at upgrading the customer experience, while improving operating efficiency. As part of this project, several activities and procedures that are not involved with contact with customers are being taken from the branches and are being transferred to the remit of national centers of expertise. At the same time, in the branch and various channels, new initiatives are being launched to improve customer experience and service and adapt them to customer's needs. The project is being implemented gradually in all of the Bank's branches and full deployment is expected by the end of 2013.

In connection with the approval of the Board of Directors to merge Leumi Mortgage Bank, see page 192-193 below

The important points of emphasis in the household segment are:

- a systematic and constant focus on improving the **level of service** to the customer by upgrading employees' skills, and measuring and controlling the work procedures and customer interface;
- **broadening the availability of service to customers** by increasing the number of branches and adapting them to future banking needs, while integrating advanced automated instruments, and adapting them to the various customers' needs;
- **expanding the direct marketing channels**: advanced telephone, cell phone and Internet response services and instruments for self-service performance of financial operations;
- **developing financial products and services** by providing professional and objective counseling in relation to financial investment products and pension products that correspond to the needs of customers, while using data mining and analytical models to analyze and forecast the customers' financial activities and needs;
- systematic, information-based **initiative** *vis-à-vis* customers in all operating segments: investments, pension counseling, consumer and commercial credit and current account services; improving the level of service in order to increase customer satisfaction and loyalty by creating advantages for groups of customers through differential service**;**
- **cooperation with companies in the Group,** such as Leumi Mortgage Bank and Leumi Card, in order to exploit the Group's abilities in providing comprehensive banking solutions to customers.

Pension Counseling

The balances of the pension assets held by customers receiving consultation in the Leumi Group known at the end of December 2011, including advance training funds in respect of which consultancy is provided in the framework of pension consulting and/or investment consulting amounts to some NIS 14.43 billion.

Structure of the Segment

Household banking segments its customers according to their characteristics, needs, preferences and contribution to profitability, and develops services, products and distribution channels for them according to this segmentation. Service is provided through the various distribution channels: 238 branches (including 15 counters and branches of the Arab Israel Bank Ltd.), located throughout the country and organized into eight districts on a geographical basis, and by means of direct/technological distribution channels, such as the Leumi Call center, the Internet, Leumi information terminals and more.

In-branch service to customers is provided by banking teams divided into customer segments. All aspects of customer service are coordinated by these teams, who specialize in providing service according to the customer's characteristics and needs.

Service to these customers is multi-channel and is provided both by means of the broad distribution of branches, the Leumi Call center, Leumi Data Services, Cellular Phone and via advanced internet solutions adapted to meet customers' needs.

Legislative Restrictions, Regulations and Special Constraints that apply to Banking in the Household Segment

The Bank, and the household segment, in particular, operates within the context of laws, regulations and directives of authorities imposed on the banks by the Banking Supervision Department, the Israel Securities Authority, the Commissioner of the Capital Market, Insurance and Savings, and by the Antitrust Commissioner.

For information regarding the team examining Increasing Competitiveness in the Banking Sector, see page 36.

Changes in the Markets of the Household Segment or in Customer Characteristics

The household segment was affected by changes in the demographic and economic data for the population of the State, by changes in private consumption and by customers' saving characteristics. Private consumer expenditure increased in real terms in 2011 by 4.0%, and in terms of private consumption per capita, by 2.1%, similar to the average of the previous five years. This involved a slower expansion in comparison to 2010, in which expenditure for private consumption in real terms increased by 5.3%, mainly due to a rapid expansion in the consumption of durable products. The slowdown in expenditure for private consumption in 2011 began in the second quarter of the year, against the backdrop of a slowdown in economic activity in the entire economy and in the impact of declines in the capital market ("the wealth effect"). On the other hand, the rate of unemployment, which reached a peak during the year, supported the continuation of the growth in private consumption at rates similar to the medium-term average (the last five years).

The segment is focused on improving and expanding the telephone service provided by the Leumi Call center, to which hundreds of thousands of customers are connected, and who perform most of their day-to-day transactions in their accounts via the center.

An increase in activity is also expected on the Internet, through which thousands of operations are performed every day as a result of technological improvements and adaptations of Leumi's websites to the different customer segments. Developments in computerization enable information on customer activity to be managed intelligently and efficiently. Advanced tools enable data mining and analysis for the purpose of developing products and services, and for tailoring services to customers.

Critical success factors in the segment

- Maintaining pro-active service pursuant to the needs and wishes of the customers;
- Efficiency: constant examination of retail operating costs against the benefits derived from them, and reduction of the cross subsidization between the various activities and populations;
- Quality: abiding by the rules of consistent and methodical documentation, while strictly adhering to rules of compliance with consumer laws and regulations;
- Provision of investment counseling and pension counseling services by making available suitable manpower and technological support;
- Distribution and availability of points of sale and service: expanding the distribution of the branches and adapting operating hours to the region and type of population;
- Broadening the exposure and availability of direct technological channels (Internet and telephone) to customers and broadening the geographical distribution (ATMs).

Main entry and exit barriers in the segment

- The technological and physical infrastructure (branch distribution) and the quality of the manpower are relative advantages of banking in the household segment, and constitute entry barriers to competitors. The importance of the infrastructure increases as the regulatory requirements increase.
- The investment required in physical and technological infrastructure constitutes a barrier to both entry and exit.
- The development of analytical capabilities to effectively adapt solutions for customers based on historical data on customer activity and market behavior.
- The training of skilled human resources in light of increasingly strict and frequently changing regulations.

Alternatives to banking products and services in the segment

Following the reform in the capital market, the banks constitute the main entity providing objective counseling to customers – both in the capital market and in the pension field.

Current accounts can only be managed at banks. Other products and services may be purchased outside of the banks as well. The following are the main alternatives:

Consumer credit – credit card companies, retail food chains, insurance companies.

Capital market – brokers, insurance companies, fund managers.

Pension savings – pension marketers (insurance companies, companies managing provident funds, supplementary training funds, pension funds and insurance agents, private pension consultants).

Mortgages - contractors, construction companies, insurance companies.

Structure of the Competition

Competition is over the fundamental principles of success: the availability and correct usage of distribution channels, segmentation and understanding of customer needs, and efficiency.

Some of the banks take aggressive marketing measures, making use of price strategy. Other banks have merged their mortgage activities and are leveraging synergetic activities in order to expand the potential customer base for mortgages and for opening current accounts.

In addition, competition in retail banking has been developing in recent years from financial and other entities, primarily from credit card companies – while in the field of consumer credit, competition is developing from mortgage banks, insurance companies and retail marketing chains. The competition is created by entities that are not subject to supervision by the Bank of Israel, or not supervised at all, and do not operate under the restrictions that apply to the banks.

The directives issued by the Supervisor of Banks, which make it easier for customers to move from bank to bank, are expected to increase the competition between banks in this segment.

In the field of pension counseling, the competition over customers is intense; competitors include insurance agents, pension arrangement managers and companies that manage their own pension funds.

Products and Services of the Segment

As part of its overall service concept, Leumi has invested considerable resources in development, and has reached a high degree of multi-channel availability: via telephone, the internet and branches, in order to provide customers with an interface with the Bank for executing transactions and receiving information.

In the credit field, Leumi offers, *inter alia*, a product that enables customers to enjoy pre-approved loans via all of the self-service channels, including ATMs, according to their characteristics and needs. Customers are also offered various credit products, which are appropriate for their needs and the various stages of their lives.

In the investments field, Leumi offers a variety of both single deposit and installment-based deposits, and savings schemes, with various linkage bases, for periods that suit the customer, as well as a variety of investment products, including structured deposits in Israeli and foreign currency and savings schemes. The Bank also offers investment counseling and pension counseling services.

Customers

Leumi is able to offer its services with segmental adaptations to the following population groups: households with medium to low levels of wealth, customers with growth potential: young people, discharged soldiers, students and new immigrants, pensioners and wealthy private customers whose main activities are in the field of investments.

For further details, see page 23.

Marketing and Distribution

The following information is "forward-looking information." For the meaning of this term, see page 61.

Household banking is based on a countrywide distribution network, professional and skilled manpower and technological systems that enable the provision of efficient service to customers, as well as measurement and control tools for the Management. Leumi sees strategic importance in a broad distribution network. Five new branches were opened during 2011 and eight new branches are planned to be opened during the course of 2012 to serve customers of this segment. In addition, emphasis is placed on offering service via a multitude of channels, while maintaining a uniform customer experience and level of service. The principal distribution channels of the household segment are the branch channel, while some of the direct channels - the Internet, Leumi Call and ATMs - are in a continuing growth trend, both for execution of transactions and for informational needs. The Bank also makes use of direct mailings, advertising on websites in general and on the Bank’s websites in particular, and other media, including newspapers and television. In addition, Leumi operates a number of communication channels on social networking media including a Twitter account and banking blog and an exclusive page on Facebook. Through these channels, the Bank provides a service to customers, and general and marketing information for the use of the Internet users.

Marketing activity is based on advanced analytical information systems, enabling customers' needs and behavior to be characterized, with a view to offering customers products and services tailored to their needs.

Human Capital

In 2011, the average number of positions assigned to the household segment totaled 7,151, of which 1,372 were management staff, compared with 7,152 positions in 2010, of which 1,369 were management staff.

Tenured employees, who have been trained for various positions according to banking needs, are employed in the branches. In addition, external staff are employed in basic positions, having received appropriate training.

Credit Cards

See page 183 below.

Housing Loans – Mortgages -– is a supplementary product to the package of services being provided to Leumi's customers, and to customers of other banks. These loans are provided by Leumi Mortgage Bank

Ltd. ("Leumi Mortgage Bank"). Leumi Mortgage Bank has 93 representative offices operating in Leumi branches and 11 independent representative offices.

The majority of Leumi Mortgage Bank's activity is in mortgage loans for the purchase of residential apartments. Leumi Mortgage Bank offers a number of services, the purpose of which is to turn the process of taking out a mortgage into a simple process for the customer, such as "Leumi Mortgage Running for You" and "Time Out from the Mortgage".

The policy of Leumi Mortgage Bank's Management is to continue focusing its activity in the loan segment for residential apartment purchases and in the loan segment using residential apartments as collateral.

In addition, Leumi Mortgage Bank also provides loans for purchasing groups; see Exhibit E – Economic Sectors.

For additional details relating to the Bank of Israel's instructions on mortgages, see page 108.
For additional details on Leumi Mortgage Bank, see page 192 of the Report.

Information regarding risk characteristics of housing loans * granted by Leumi Mortgage Bank.

Pursuant to a letter of the Bank of Israel dated 15 May 2011, the Bank is required to include in the Report of the Board of Directors a disclosure in connection with developments in credit risk in the housing loan portfolio as defined in Proper Conducts of Banking Business Regulation 451 of the Bank of Israel (hereinafter, "housing loan") and the measures that are being taken for managing these risks.

The data relating to the risk characteristics of the housing loans pursuant to the abovementioned letter from the Bank of Israel, the developments in credit risks and the ways of managing them, including reference to steps taken by Leumi Mortgage Bank for contending with these risk characteristics are set forth below:

* The definitions mentioned in the disclosure below (e.g., repayment ratio, rate of financing, etc.) are according to the reports of Leumi Mortgage Bank to the Bank of Israel.

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

	2011	2010	
	Annual total	Annual total	Change
	NIS millions		%
From bank funds	**11,930**	14,158	(15.7)
From Ministry of Finance funds:			
Directed loans	**15**	33	(54.5)
Bullet loans	**4**	5	(20.0)
Total new loans	**11,949**	14,196	
Refinanced loans	**1,182**	1,351	(12.5)
Total performance	**13,131**	15,547	(15.5)

Development of credit balance for housing, net:

	Balance of credit portfolio	Rate of growth
	NIS millions	%
December 2008	39,344	
December 2009	42,734	8.6
December 2010	* 49,319	15.4
December 2011	**54,386**	**10.3**

The increase in the volume of credit for housing in recent years is attributable to the increase in demand for housing units and a rise in the prices of housing units, and mostly constitutes credit for the purpose of purchasing apartments.

* Data in the tables below as of 31 December 2010 below are presented after implementing the directive of the Supervisor of Banks regarding measurement and disclosure of impaired debts.

Development of credit balance, net by linkage basis:

	Unlinked	Percentage of credit portfolio	Index-linked	Percentage of credit portfolio	Foreign currency	Percentage of credit portfolio	Total portfolio
	NIS millions	%	NIS millions	%	NIS millions	%	NIS millions
December 2009	15,585	36.5	26,114	61.1	1,035	2.4	42,734
December 2010 *	21,552	43.7	26,619	54.0	1,148	2.3	49,319
December 2011	**22,973**	**42.5**	**29,802**	**54.6**	**1,611**	**3.0**	**54,386**

The increase in the unlinked credit portfolio from 2009 to 2011 was on account of the decrease in the index-linked credit portfolio. However, in the second half of 2011, there was a marked slowdown in the increase in the balance of the unlinked credit portfolio, in light of the directive of the Supervisor of Banks relating to extending loans at variable interest, including Prime-based loans.

* Data in the tables below as of 31 December 2010 below are presented after implementing the directive of the Supervisor of Banks regarding measurement and disclosure of impaired debts.

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

	Fixed		Variable			Total credit portfolio
	Unlinked	Index-linked	Unlinked	Index-linked	Foreign currency	
	NIS millions					
December 2010 *	766	11,309	20,786	15,310	1,148	49,319
December 2011	**1,142**	**11,125**	**21,831**	**18,677**	**1,611**	**54,386**

* Data for 31 December 2010 in the table below are presented after implementation of the directives of the Supervisor of Banks with regard to measurement and disclosure of impaired debts.

Development of new housing credit balance by interest path:

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

	2011				2010				2009
	Fourth quarter	Third quarter	Second quarter	First quarter	Fourth quarter	Third quarter	Second quarter	First quarter	Annual average
	Percentage of loans granted %								
Fixed – linked	**15.1**	14.6	5.9	6.1	7.1	5.6	6.9	7.1	6.5
Variable – Linked to index – 5 years and over	**43.8**	42.5	17.5	8.9	10.3	10.7	13.1	12.0	4.5
Fixed – unlinked	**5.3**	5.4	2.1	2.8	6.0	2.7	5.0	3.0	1.2
Variable – Linked up to 5 years	**7.3**	9.4	19.2	15.3	11.6	15.9	15.4	15.3	15.0
Variable unlinked	**26.2**	25.0	48.8	61.6	61.2	61.9	56.7	60.1	70.5
Variable – foreign currency	**2.3**	3.1	6.5	5.3	3.8	3.2	2.9	2.5	2.3

The increase in the proportion of the index-linked variable interest loans including loans with variable interest every five years and more was on account of a decrease in the proportional share of variable interest loans on an index-linked basis, in light of the directive of the Supervisor of Banks relating to extending loans at variable interest.

The percentage of new credit extended by Leumi Mortgage Bank in variable interest housing loans during 2011 stood at 88%, similar to the corresponding period last year. The figures relate to all of the various interest paths and linkage segments, including loans in which the interest varies each period of five years and more. After canceling the effect of index-linked variable interest which varies each period of five years and more, which the directive of the Banking Supervision Department departs from the definition of variable interest loans, 66% were extended in 2011 on a variable interest basis, compared with 77% in the corresponding period last year.

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

	Balance of recorded debt	Amount in arrears	Percentage of amount in arrears
	NIS millions		%
December 2008	40,024	1,587	4.0
December 2009	43,317	1,306	3.0
December 2010	49,911	1,046	2.1
December 2011	**54,888**	**918**	**1.7**

The allowance for credit losses as at 31 December 2011, including the collective allowance on housing loans (hereinafter: "the overall allowance") as required in a letter of the Bank of Israel dated 1 May 2011, is NIS 502 million, representing 0.92% of the housing credit balance, compared to the same allowance as at 1 January 2011, amounting to NIS 592 million, representing 1.19% of the housing credit balance. The decrease in the allowance for credit losses derives from a decrease in the balance of arrears in the credit portfolio of Leumi Mortgage Bank.

Data relating to new housing credit:

In 2011, Leumi Mortgage Bank extended new housing loans amounting to NIS 11.1 billion of the Bank's funds, compared to NIS 13.3 billion in 2010, a decrease of 16.7%. These amounts include a total of NIS 19 million of credit that was granted from designated deposits whose repayment was contingent on the extent of collection, compared to a total of NIS 38 million last year.

The share of Leumi Mortgage Bank in extending new loans from the total of the system in 2011, according to the Bank of Israel's Activity Report, was 22.2%, compared to 24.2% in 2010.

The total refinancing of Leumi Mortgage Bank fell in 2011 to NIS 1.2 billion (9.6% of the loans extended by Leumi Mortgage Bank), compared with some NIS 1.4 billion in 2010.

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

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

	2011				2010				2009
	Fourth quarter	Third quarter	Second quarter	First quarter	Fourth quarter	Third quarter	Second quarter	First quarter	Annual average
Rate of financing	%								
Between 60% and 70%	**26.2**	24.0	20.9	21.7	21.5	21.6	28.7	30.1	32.3
Between 70% and 80%	**12.0**	11.2	10.4	15.3	18.8	18.1	22.3	19.3	14.8
Above 80%	**2.7**	3.3	3.6	3.0	2.8	3.7	3.5	2.6	2.0

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

The average rate of financing of the credit portfolio balance for 2011 stands at 51.4%.

Development of new credit, in which the repayment ratio is lower than 2:

The percentage of new credit of housing loans in the fourth quarter of 2011 in which the repayment ratio is lower that 2 to income-earners of NIS 10,000 and below, at the date of approval of the credit, stood at 1% of the total extensions of new credit, and on average 2% in the whole of 2011, similar to 2010 (the repayment ratio is calculated as follows: fixed monthly income of the borrower divided by the total monthly repayments in respect of the existing mortgage loans and the new loan).

This calculation complies with the Bank of Israel directives reporting to the Banking Supervision Department pursuant to Bank of Israel Reporting Regulation 876.

Development of new credit, in which the repayment dates are longer than 25 years:

The percentage of the new credit of housing loans in 2011, in which repayment dates according to loan contracts longer than 25 years, stood on average at 39% of the total of new credit extended. From the second half of the year, there was a significant fall in the percentage of loans extended for a period exceeding 25 years. In the fourth quarter, the percentage of these loans stood at 28% of the total housing loans extended by Leumi Mortgage Bank, compared to an average rate of some 37% in 2010.

In general, Leumi Mortgage Bank does not extend new loans whose terms enable the borrower to make a payment which is lower than the interest accrued on the loan, except in extraordinary cases.

Leumi Mortgage Bank does not extend loans secured by a secondary mortgage, except in extraordinary cases.

According to Leumi Mortgage Bank's credit policy, it extends new loans in which the information it has on the borrower or on the collateral, at the time of granting the loan, is complete, updated and verified.

Developments in credit risks

In recent years, against a background of rising demand for housing units, both for residential purposes and for investment, there has been a significant increase in housing prices, resulting in a substantial increase in the level of housing credit. Against the backdrop of this price increase, the risk inherent in the extension of loans at high financing rates has increased, attributable to the high debt burden on the borrower and a higher exposure when there is an impairment in the security.

In addition, the low interest rates which prevailed in the economy in recent years, particularly unlinked Prime interest, led to a sharp increase in the proportion of unlinked variable interest loans, out of the total credit to the public in the mortgage market. Accordingly, in an environment of an increase in interest, the borrowers are exposed to an increase in the level of mortgage payments.

As a result of the economic developments that have occurred in recent years, as presented above, the Bank adopted a number of measures in order to contend with the increase in the abovementioned credit risks.

- As part of the risk management of Leumi Mortgage Bank at the beginning of 2011, it was decided to tighten the administrative limits for the following features: high financing rates, current monthly repayment ability, credit rating according to Leumi Mortgage Bank's internal statistical model, loan products/paths, interest types and extent of loan.

- Leumi Mortgage Bank examined the effect of collateral impairments and interest increases on its losses in the framework of a stress scenario.

As a part of its capital planning and its goals, Leumi Mortgage Bank maintains further "capital buffers" to deal with higher risk features, such as: a capital buffer in respect of loans at high financing rates, a capital buffer in respect of the gap between the current rate of allowance for credit losses and the average rate over an economic cycle and a capital buffer in respect of the possibility of a fall in real estate prices.

In 2011, Leumi Mortgage Bank extended some 18,042 new credit facilities, with the aggregate amount of the loans amounting to NIS 540 thousand, compared to NIS 665 thousand in 2010 and NIS 596 thousand in 2009.

Following are condensed operating results of the Household Segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Activity abroad: Banking and finance	Activity abroad: Mortgages	Total
	2011						
	NIS millions						
Net interest income:							
From external sources	**(774)**	**236**	**7**	**2,267**	**(8)**	**11**	**1,739**
Intersegmental	**2,736**	**(50)**	**(4)**	**(1,817)**	**20**	**(3)**	**882**
Operating and other income:							
From external sources	**581**	**488**	**500**	**112**	**5**	**-**	**1,686**
Intersegmental	**1**	**204**	**-**	**16**	**-**	**-**	**221**
Total income	**2,544**	**878**	**503**	**578**	**17**	**8**	**4,528**
Expenses in respect of credit losses	**62**	**21**	**-**	**(21)**	**1**	**6**	**69**
Operating and other expenses:							
To external sources	**2,670**	**612**	**304**	**275**	**17**	**6**	**3,884**
Intersegmental	**5**	**(4)**	**-**	**19**	**-**	**-**	**20**
Operating profit (loss) before taxes	**(193)**	**249**	**199**	**305**	**(1)**	**(4)**	**555**
Provision for (benefit from) taxes on operating profit	**(69)**	**72**	**69**	**97**	**1**	**-**	**170**
Operating profit (loss) after taxes	**(124)**	**177**	**130**	**208**	**(2)**	**(4)**	**385**
Net operating profit attributable to non-controlling interests	**-**	**(28)**	**-**	**-**	**-**	**-**	**(28)**
Net profit (loss)	**(124)**	**149**	**130**	**208**	**(2)**	**(4)**	**357**
% Return on equity							**8.5%**
Average balance of assets	**18,593**	**7,506**	**125**	**53,932**	**107**	**156**	**80,419**
of which: investments in companies included on equity basis	**-**	**5**	**-**	**-**	**-**	**-**	**5**
Average balance of liabilities	**117,188**	**958**	**-**	**9,260**	**842**	**8**	**128,256**
Average balance of risk assets	**20,818**	**7,407**	**123**	**28,575**	**290**	**55**	**57,268**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**53,540**	**-**	**-**	**-**	**53,540**
Average balance of securities	**-**	**-**	**50,640**	**-**	**166**	**-**	**50,806**
Average balance of other assets under management	**254**	**-**	**-**	**5,643**	**-**	**-**	**5,897**
Margin from credit-granting activities*	**854**	**180**	**3**	**285**	**(4)**	**9**	**1,327**
Margin from deposit-taking activities*	**1,081**	**1**	**-**	**45**	**15**	**-**	**1,142**
Other	**27**	**5**	**-**	**120**	**1**	**(1)**	**152**
Total net interest income	**1,962**	**186**	**3**	**450**	**12**	**8**	**2,621**
Balance of credit to the public	**19,119**	**7,615**	**134**	**55,925**	**73**	**179**	**83,045**
Balance of deposits of the public	**124,787**	**32**	**-**	**4,607**	**842**	**8**	**130,276**

* The margin is, in effect, the interest gap between the interest received from the granting of credit and the interest paid on raising deposits, and the transfer prices set by the Finance Division.
This comment relates to all of the operating segments.

Household Segment (cont.):

	Banking and finance	Credit cards	Capital market	Mortgages	Activity abroad	Total
	2010					
	NIS millions					
Net interest income:						
From external sources	(334)	185	4	1,591	2	1,448
Intersegmental	1,989	(24)	(2)	(1,208)	14	769
Operating and other income:						
From external sources	599	462	539	126	6	1,732
Intersegmental	1	216	-	20	-	237
Total income	2,255	839	541	529	22	4,186
Expenses in respect of credit losses	172	21	-	(34)	10	169
Operating and other expenses:						
To external sources	2,575	566	254	256	25	3,676
Intersegmental	5	(3)	-	24	-	26
Operating profit (loss) before taxes	(497)	255	287	283	(13)	315
Provision for (benefit from) taxes on operating profit	(176)	73	102	111	-	110
Operating profit (loss) after taxes	(321)	182	185	172	(13)	205
Net operating profit attributable to non-controlling interests	-	(28)	-	-	-	(28)
Net profit (loss)	(321)	154	185	172	(13)	177
% Return on equity						4.4%
Average balance of assets	16,482	6,982	108	47,537	288	71,397
of which: investments in companies included on equity basis	-	8	-	-	-	8
Average balance of liabilities	111,684	877	-	9,991	928	123,480
Average balance of risk assets	20,404	6,860	104	25,170	352	52,890
Average balance of mutual funds and supplementary training funds	-	-	49,162	-	-	49,162
Average balance of securities	-	-	50,264	-	157	50,421
Average balance of other assets under management	168	-	-	6,439	-	6,607
Margin from credit-granting activities*	743	159	2	214	2	1,120
Margin from deposit-taking activities*	775	1	-	43	13	832
Other	137	1	-	126	1	265
Total net interest income	1,655	161	2	383	16	2,217
Balance of credit to the public at 31 December 2010	17,717	7,247	123	51,002	252	76,341
Balance of deposits of the public at 31 December 2010	111,989	27	-	5,378	872	118,266

Main Changes in the Volume of Activity

Total credit to households in 2011 amounted to NIS 83.045 billion, an increase of 8.8%, of which consumer credit totaled NIS 27.1 billion, an increase of 7.0% and credit for housing totaled NIS 55.9 billion, an increase of 9.7%. Deposits of the public increased from NIS 118.3 billion to NIS 130.3 billion, an increase of 10.2%.

There was a decrease in the securities portfolios of the segment of some NIS 7.4 billion 7.7%, mainly resulting from a decrease in market values.

Main Changes in the Net Profit

Net profit from the household segment totaled NIS 357 million in 2011, compared with NIS 177 million in the corresponding period in 2010, an increase of NIS 180 million (102%).

The main reasons for the increase in profits are as follows:

- An increase in income amounting to NIS 342 million 8.2%, and a decrease of NIS 100 million in provisions for doubtful debts 59.1%.
- On the other hand, an increase of NIS 202 million in operating expenses, mainly in salary expenses, with an increase of 5.4%, offset most of the aforementioned increase.

The net profit in the mortgage product amounted in 2011 to NIS 208 million, compared with NIS 172 million in 2010, an increase of NIS 36 million.

Mortgage Product

Net interest income and operating revenues increased by 49 million from NIS 529 million in 2010 to NIS 578 million in 2011, as a result of an increase in activity, which was partly offset by a fall in the financial margin.

There was a surplus reduction and collection of allowances for credit losses amounting to NIS 21 million in 2011, compared with a surplus reduction and collection amounting to NIS 34 million in 2010. Operating results in 2011 amounted to NIS 294 million, compared with NIS 280 million in 2010.

2. Small Business Segment

General

Banking in the small business segment provides a variety of financial services and products to small and medium-sized business customers according to their varying needs, while segmenting customers according to their business activity turnovers, the extent of their credit needs and the sector in which their businesses operate.

This segment also includes the activities of Bank Leumi Romania, which operates through 23 branches and offices.

The Bank also handles the personal accounts of the proprietors of the businesses in the segment, such that they receive all their services in one place.

Objectives and Strategy

The following information is "forward-looking" information. For the meaning of this term, see page 61.

The strategic objectives of banking in the small business segment are to increase profitability by broadening the customer base and expanding the activities of the existing customers, while placing emphasis on the provision of efficient service that is adapted to their needs.

In connection with the project "Advancing Together", see above on page 137.

The business line emphases in the small business sector are:

- systematic and constant focus on improving **the level of service** to the customer by upgrading employees' skills, and measuring and controlling the work procedures and customer interface;
- **expanding the direct marketing channels**: advanced telephone, fax and Internet response services;
- developing financial products and services adapted to the needs of customers, using data and analytical models to analyze and forecast the customers' financial activities and needs;
- systematic, information-based **initiative** *vis-à-vis* customers in all operating segments: commercial credit, consumer credit, international trade, investments and current account services; improving the level of service in order to increase customer satisfaction and loyalty, by creating advantages for groups of customers through differential service**;**
- **collaboration with companies in the Group,** in order to exploit the Group's abilities in providing comprehensive banking solutions to customers.
- Increasing the use of analytical models as supporting tools for decisions regarding client activities.

Structure of the Segment

The small business segment provides a variety of services to small and medium-sized business customers. These customers receive services from business teams in the branches, who specialize in the needs of the segment, and from an Internet channel designated for the segment's customers.

The segment specializes in the provision of banking solutions, including counseling with regard to commercial credit, investments and routine business activities, while determining sub-segments by level of activity and risk.

The main products supplied to the small business segment are credit and investment products, unique financial products and credit cards.

Legislative restrictions, regulations and special constraints that apply to the Segment:

The small business segment in particular operates within the context of laws, regulations and directives issued by the authorities, imposed on the banks by the Banking Supervision Department, the Israel Securities Authority, the Commissioner of the Capital Market, Insurance and Savings and by the Antitrust Commissioner.

For information regarding the team evaluating Increased Competitiveness in the Banking Sector, see page 36.

Developments in the markets of the segment, or changes in the characteristics of its customers:

There were no significant changes in the small business segment during the past year.

Critical success factors in banking in the small business segment:

Critical success factors in the segment are:

- High levels of management and interpersonal capabilities of the bodies responsible, such as business centers (both *vis-à-vis* customers and within the organization);
- Familiarity with the customers, including their financial position, and the prospects/risks inherent in working with them;
- Ongoing monitoring of the changes occurring in the market in order to identify potential and to avoid risk; credit risk management and control;
- Quality: abiding by the rules of consistent and methodical documentation, and strictly abiding by rules of compliance with consumer laws and regulations;
- The distribution and availability of points of sale and service: expanding the distribution of the branches and adapting operating hours to the region and types of businesses;
- Increasing the exposure and availability of direct channels (Internet and fax) to customers;
- Focusing on the provision of proactive service and initiatives according to the needs and wishes of the customers.

Main entry and exit barriers in the segment

- The technological and physical infrastructure (branch distribution) and the quality of the manpower are relative advantages of banking in the small business segment, and constitute entry barriers to competitors. The importance of the infrastructure increases as the regulatory requirements increase.
- The investment required in physical and technological infrastructure constitutes a barrier to both entry and exit.
- The training of high-quality human resources possessing a high level of skill and familiarity with the customers’ fields of activity.
- The development of analytical capabilities to effectively adapt solutions for customers based on historical data on customer activity and market behavior.

Alternatives to the products and services

In recent years, the competition in the small business segment has become increasingly intense. The direct competitors are all commercial banks in Israel and insurance companies.

Business Credit – insurance companies, credit card companies, suppliers

Capital Market – brokers, insurance companies, fund managers

Structure of the Competition

The main competition is between the major banks. In recent years, the smaller banks have been expanding their activities in this segment by means of aggressive marketing tactics and the use of price strategy.

In addition, competition has been developing recently from financial and other entities, primarily from credit card companies by means of supplier cards, and from insurance companies, which are showing an interest in financing small businesses.

Directives issued by the Supervisor of Banks, which make it easier for customers to move from bank to bank, are expected to increase the competition between banks in this segment.

Segment Products and Services

The services provided include, *inter alia*, ongoing financing according to customers' needs, financing of investments to maintain and expand activity, the provision of solutions in the field of financing and international trade. In addition, the service includes banking services for companies' employees and management.

In the investments field, Leumi offers a variety of both single deposit and installment-based deposits, and savings schemes, with various linkage bases, for periods that suit the customer, as well as a variety of investment products, including structured deposits in Israeli and foreign currency, savings schemes, provident funds and mutual funds.

In addition, Leumi has invested considerable resources in development and has reached a high level of multi-channel availability (telephone, fax and the internet), in order to provide customers with an efficient interface with the Bank for executing transactions and receiving information any place and any time.

Customers

The customers associated with this segment are characterized by diverse business activities (small to medium sized) and a great number and variety of sectors and fields.

For further details, see page 23 above.

Marketing and Distribution

The small business segment is based on a nationwide distribution network, professional and skilled manpower, technological systems that enable the provision of efficient service to customers, as well as measurement and control tools for Management. Leumi sees strategic importance in a broad distribution network; consequently, business segments are established in most of the branches in the Banking Division for handling business customers, with the emphasis on deepening the familiarity with these customers and their needs, and on finding appropriate solutions for them. Marketing activity is based on advanced information systems that enable activities to be initiated with existing customers and with potential customers.

Competition

The competition that the Bank has been facing in the small to medium-sized business segment has been intensifying in recent years. The competitors that the Bank faces include all commercial banks in Israel, and recently, also credit card companies and insurance companies.

The Bank competes by exploiting its expansive distribution advantages, professional and skilled manpower in the various banking fields and its data processing ability, all of which enable Leumi to be proactive and offer customers high-quality products and services.

Human Capital

In 2011, the average number of positions assigned to the small business segment totaled 1,866 of which 466 were management staff, compared with 1,839 positions, of which, 446 were management staff, last year.

The employees engaged in this segment are mainly employees with academic education. In addition to their educational qualifications, the employees undergo professional training on an ongoing basis in various fields of banking, as part of their training at the Bank.

Following are condensed operating results of the Small Business Segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Real estate	Overseas activity: Banking and finance	Overseas activity: Real estate	Total
	2011							
	NIS millions							
Net interest income:								
From external sources	**750**	**25**	**2**	**5**	**314**	**36**	**3**	**1,135**
Intersegmental	**(68)**	**(7)**	**(1)**	**(3)**	**(103)**	**(7)**	**-**	**(189)**
Operating and other income:								
From external sources	**315**	**106**	**25**	**-**	**53**	**11**	**1**	**511**
Intersegmental	**-**	**(52)**	**-**	**-**	**-**	**-**	**-**	**(52)**
Total income	**997**	**72**	**26**	**2**	**264**	**40**	**4**	**1,405**
Expenses in respect of credit losses	**55**	**(2)**	**-**	**-**	**17**	**17**	**2**	**89**
Operating and other expenses:								
To external sources	**627**	**47**	**12**	**-**	**106**	**30**	**2**	**824**
Intersegmental	**2**	**3**	**-**	**-**	**-**	**-**	**-**	**5**
Operating profit (loss) before taxes	**313**	**24**	**14**	**2**	**141**	**(7)**	**-**	**487**
Provision for taxes	**105**	**7**	**5**	**1**	**49**	**-**	**-**	**167**
Operating profit (loss) after taxes	**208**	**17**	**9**	**1**	**92**	**(7)**	**-**	**320**
Net operating profit attributable to non-controlling interests	**-**	**(2)**	**-**	**-**	**-**	**-**	**-**	**(2)**
Net profit (loss)	**208**	**15**	**9**	**1**	**92**	**(7)**	**-**	**318**
% Return on equity								**22.8%**
Average balance of assets	**12,383**	**810**	**30**	**104**	**5,474**	**549**	**115**	**19,465**
Average balance of liabilities	**14,171**	**1,395**	**-**	**-**	**2,980**	**412**	**72**	**19,030**
Average balance of risk assets	**10,725**	**632**	**30**	**80**	**5,403**	**666**	**115**	**17,651**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**2,199**	**-**	**-**	**-**	**-**	**2,199**
Average balance of securities	**-**	**-**	**5,698**	**-**	**-**	**4**	**-**	**5,702**
Average balance of other assets under management	**244**	**-**	**-**	**-**	**-**	**-**	**-**	**244**
Margin from credit-granting activities	**502**	**17**	**1**	**2**	**172**	**14**	**2**	**710**
Margin from deposit-taking activities	**151**	**-**	**-**	**-**	**27**	**14**	**1**	**193**
Other	**29**	**1**	**-**	**-**	**12**	**1**	**-**	**43**
Total net interest income	**682**	**18**	**1**	**2**	**211**	**29**	**3**	**946**
Balance of credit to the public	**12,741**	**814**	**31**	**93**	**5,750**	**488**	**122**	**20,039**
Balance of deposits of the public	**14,547**	**-**	**-**	**-**	**3,076**	**416**	**70**	**18,109**

Small Business Segment (continued):

	Banking and finance	Credit cards	Capital market	Mortgages	Real estate	Overseas activity Banking and finance	Overseas activity Real estate	Total
	2010							
	NIS millions							
Net interest income:								
From external sources	767	20	1	6	225	42	3	1,064
Intersegmental	(91)	(3)	-	(3)	(47)	(14)	-	(158)
Operating and other income:								
From external sources	306	104	26	-	45	11	1	493
Intersegmental	-	(56)	-	-	-	-	-	(56)
Total income	982	65	27	3	223	39	4	1,343
Expenses in respect of credit losses	106	3	-	-	22	17	(1)	147
Operating and other expenses:								
To external sources	612	43	9	-	95	31	2	792
Intersegmental	-	3	-	-	-	-	-	3
Operating profit (loss) before taxes	264	16	18	3	106	(9)	3	401
Provision for taxes	95	5	6	1	37	-	-	144
Operating profit (loss) after taxes	169	11	12	2	69	(9)	3	257
Net operating profit attributable to non-controlling interests	-	(1)	-	-	-	-	-	(1)
Net profit (loss)	169	10	12	2	69	(9)	3	256
% Return on equity								18.7%
Average balance of assets	11,912	777	29	130	4,867	635	112	18,462
Average balance of liabilities	12,756	1,404	-	-	2,264	424	81	16,929
Average balance of risk assets	10,811	586	26	100	4,774	776	112	17,185
Average balance of mutual funds and supplementary training funds	-	-	2,027	-	-	-	-	2,027
Average balance of securities	-	-	5,231	-	-	5	-	5,236
Average balance of other assets under management	301	-	-	-	-	-	-	301
Margin from credit-granting activities	500	14	1	3	137	11	2	668
Margin from deposit-taking activities	97	-	-	-	12	11	1	121
Other	79	3	-	-	29	6	-	117
Total net interest income	676	17	1	3	178	28	3	906
Balance of credit to the public at 31 December 2010	12,171	778	42	114	5,238	572	103	19,018
Balance of deposits of the public at 31 December 2010	13,402	-	-	-	2,705	386	86	16,579

Main changes in the volume of activity

In the small business segment there was an increase of NIS 1.02 billion 5.4%, all of which was from domestic activities. The total deposits of the public in Israel increased by NIS 1.5 billion, 9.2%, all of which was from domestic activity.

The securities portfolios recorded a decrease of some NIS 2.9 billion (31.0%).

Main changes in the net profit

Net profit in the small business segment totaled NIS 318 million in 2011, compared with NIS 256 million in the corresponding period in 2010, an increase of 24.2%.

The increase in profit derives mainly from an increase in income amounting to NIS 62 million, a decrease in expenses in respect of credit losses amounting to NIS 58 million, a decrease of 39.4%, representing 0.8% of the credit portfolio at the end of 2011. The above increase was partially offset by an increase in operating expenses of NIS 34 million 4.2%.

The entire positive impact above was as a result of the segment's domestic activities, whereas the segment's overseas activities, mainly in Romania, offset this increase in part.

3. Corporate Banking Segment

General

Corporate banking specializes in providing banking and financial services to large corporations, including corporations with multi-national activities. The customers belonging to this segment are characterized by their leading position in the market and dominance in their sphere of business. The services provided are based on the provision of an overall solution for all of the customer's needs, with a view to the entire range of their business activity, *inter alia*: various types of credit, financing and international trade, investment services, capital market activities, financial instruments designed to hedge against market risks, complex transactions (projects, mergers and acquisitions, syndicate organization), etc. Services outside of Israel are provided to the corporate segment primarily by Bank Leumi USA, Bank Leumi (UK), Bank Leumi Romania and other overseas offices of the Bank.

Structure of the segment [(1)]

The corporate banking segment is managed in Israel by the Corporate Division, which is comprised of four sectors. Service to customers is provided by customer relations managers, who coordinate the Group's services to the customer and specialize in sector activity in which the customer operates. The customers' accounts are mainly managed through departments located in central branches, which specialize in handling large customers and customers with diverse activities, as well as through the Bank's overseas offices. Transactions involving the acquisition of means of control are handled by a designated unit specializing in handling transactions of this kind, due to the complexity and level of risk involved. In addition, a special unit exists that handles complex transactions involving the financing of investments in infrastructure projects (power stations, desalinization plants, toll roads, BOT (Build-Operate-Transfer) projects, etc.). This unit examines the transactions and builds the financing packages, including possible involvement of additional banks and institutional market entities in the financing of such transactions.

With the aim of tightening credit controls, improving the quality of the Bank's credit portfolio, complying with regulatory requirements and improving service to customers, the Credit Risk Management Unit (CRMU), operates, independently and autonomously, within the framework of the Credit Department in the Corporate Division. This unit is responsible for the analysis and independent examination of credit facilities and the detection of customers whose situation has deteriorated, indicating the main risks characterizing the credit and making recommendations for the continuation for handling the customers. In addition, it performs systematic credit controls, making recommendations on classifications and allowances and is engaged in the development of methodologies and financing "structures".

The Credit Department's activities include developing control processes and assimilating work procedures for granting credit at the Bank level, for implementing and assimilating the Basel II regulatory directives, which came into effect as of 31 December 2009; as well as the directives regarding measurement and disclosure of impaired debts, credit risks and provisions for credit losses, which became effective from 1 January 2011.

Bank Leumi USA and Bank Leumi (UK) enable Israeli and local companies belonging to the corporate banking segment to receive banking services, and credit for financing their activities in international trade, real estate, mergers and acquisitions. The subsidiary in the United States, which is headquartered in New York, and the subsidiary in the United Kingdom, which is headquartered in London with a branch in Manchester, view the servicing of Israeli companies as a direct extension of their activities in Israel.

Business objectives and strategy, and expectations for development in the coming year

The following information is "forward-looking information." For the meaning of this term, see page 61.

2011 was characterized by an increase in the level of geopolitical uncertainty and that which relates to economic and financial developments around the world, mainly in respect of the crisis in Europe, but also with regard to a fear of a renewed slowdown in the United States. The assessment is that the western world is about to enter a prolonged period of budget "austerity", with negative repercussions for the growth potential and world trade. This would have possible effects on the security and political front and

[1] Regarding the Construction and Real Estate Division, see below on pages 158.

with regard to investments in the Israeli economy and on sectors of the economy, for example, the tourism industry. The social protest in Israel also has an impact on the direction of a possible expansion of Government expenditure and an increase in the budget deficit. These factors and the possibility of a significant economic slowdown in Israel as a result of impairment to economic growth around the world reflect a high degree of uncertainty.

For that reason, selective policy steps have been taken to expand activity, distinguishing between the various risk levels and a widening of credit margins and their conditions accordingly.

Inter alia, activity in the main service centers of the Bank abroad continues to contribute to the dispersal of risks through exposure to different macro-economic environments and customers' various features, with the understanding that the yield from international activity can be lower than the return on Group capital.

Restrictions, legislation, regulations and special constraints that apply to the segment

The Bank operates within the context of laws, regulations and regulatory directives imposed on the banking system in Israel by entities such as the Banking Supervision Department, the Commissioner of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority and additional entities. Overseas, the Bank's subsidiaries and representative offices operate by virtue of permits from the Banking Supervision Department, and are also subject to local regulations.

For information regarding the Committee for Increasing Competitiveness, see page 36.

The restrictions that are especially relevant for the corporate banking segment are the restrictions prescribed in Proper Conduct of Banking Management Regulation No. 313 (for further information see page 237) and the restriction in accordance with Proper Conduct of Banking Business Regulation 323 relating to the balance of credit for all transactions for purchase of control in a controlling instrument (for further information see below on page 238).

Since 2007, corporate banking has been making preparations to analyze and examine the potential implications of the changes deriving from the International Financial Reporting Standards (IFRS), in all areas of reference, such as: mapping of the economic sectors with company-wide characteristics; mapping and examination of key issues and potential customers in respect whereof an in-depth examination is required, due to the sensitivity and the potential impact on the financial statements, as well as the establishment a professional work team and support unit for the purpose of providing solutions and assistance in this regard; the dissemination of procedures and guidelines for modes of operation and for dealing with issues; and the instituting of many measures in order to enhance business entities at the Bank.

Developments in the markets of the segment or changes in the characteristics of its customers

Within the context of merger and acquisition activities that have taken place in the economy in recent years, the proportion of large borrowers and large groups in banking activities has grown, and today they constitute a significant share of the Bank's corporate segment customers.

For an expansion on the subject of the world economy, see the chapter, "Economic Review". Regarding the developments in each of the sectors that comprise the segment, see pages 102 above.

Technological changes that may have a material impact on the segment

The information systems that serve the corporate banking segment are intended to assist in analyzing customers' needs and in the ongoing work with them, in the analysis and measurement of credit risks and in the monitoring and control of customers' activities. The various technological systems are updated and upgraded on an ongoing basis for the benefit of the segment.

Critical success factors in the segment

Critical success factors in the segment are: staff possessing high levels of management and interpersonal abilities (both *vis-à-vis* the customers and within the organization), familiarity with the customers, including their financial position and the prospects/risks inherent in working with them, improvement of professionalism and ongoing monitoring of the changes occurring in the market in order to identify potential and avoid risk, a high degree of skill in planning complex financing packages, constant investment in technological aids, and diligence in providing solutions to customers' needs within suitable response times, credit risk management and control.

Main entry and exit barriers in the segment

In order to provide service to customers in the corporate banking segment, high-quality personnel are required, possessing considerable professional skill in familiarizing themselves with the customers in the segment, the diversity of their activities and in analyzing their needs. The management of customers in this segment requires an in-depth familiarity with the customers, their financial data and their spheres of activity, and requires the Bank to adapt its products to these data. Moreover, appropriate preparation is required for complying with the regulatory restrictions and for monitoring and controlling various risks and exposures.

Alternatives to the products and services of the segment, and the changes that have occurred therein

Since the sources available to the Bank for providing long-term financing are limited in comparison with the sources available for short to medium-term financing, it is expected that, in relation to the financing of long-term projects (primarily infrastructure projects and income-generating properties), institutional investors will continue to participate in the financing of such projects through their participation in financing consortia or by means of the sale of portions of the long-term bank credit.

Products and services of the segment

The services provided include, *inter alia*, ongoing financing according to the customers' needs, financing of investments to maintain and expand operations, provision of solutions in the spheres of financing and international trade (including the financing of projects abroad), financing and guidance of national and international projects, financing of mergers and acquisitions, organization of syndicates, financial instruments to hedge against currency risks, interest risks and fluctuations in commodities prices. The service also includes the initiation and promotion of banking services to the managements and employees of companies in the segment.

Customers

Customers belonging to this sector are characterized by their leading position in the market and dominance in their field of activity by operating turnovers exceeding NIS 400 million, by high financing needs and a credit framework exceeding NIS 120 million. (Customers with a credit framework exceeding NIS 80 million will also be associated with this segment, if they have in the banking system an overall credit framework exceeding NIS 250 million. For further details, see page 23.) These companies are, for the most part, public companies from a variety of different sectors of the economy, with complex organizational structures comprised of numerous management echelons and a broad span of control.

Marketing and distribution

Service and marketing to customers are provided by customer relations managers who specialize in the sector of the economy in which the customers operate, and who coordinate the Group's services to customers.

Competition

The status of the Israeli banks as the sole financers of corporations has continued to dwindle over the years, so that the weighting of credit to the business sector provided by the banking system has decreased from 76% in 1999 to some 52% at the end of 2011.

With regard to the anticipated competition in the non-banking market, on the one hand, due to the substantial issues of government debt anticipated in the coming years, the volume of available sources in the capital market will dwindle. Also, the debt agreements with those companies that raise funds will not improve the fund-raising ability of the business sector in the near future, especially with regard to companies identified by the capital market, institutional investors and those who determine economic policy will seem less attractive than in the past.

Moreover, according to recommendations of the Concentrations Committee and Hodek Committee, restrictions will apply to the financing of firms by institutional investors. On the other hand, the implementation of the recommendations of the Concentrations and Competition committees, when they are ready for legislation, will create a need for alternative financing sources of a large volume, so as to perform the mergers and purchases that will be required, within a relatively short period.

In addition, in the current economical and geo-political conditions, it is anticipated that, in the near future, there will not be any significant return of foreign financial entities to the activities of the Israeli financing market. Accordingly, the burden is likely to fall on the local banking system, and it is doubtful whether it will be able to address that need in full, especially given regulation affecting the concentration of sectors of industry, groups of borrowers and capital adequacy.

Human Capital

In order to bring employees engaged in the field of credit to the required professional level, there is an appropriate training system. On specific topics, there is the support of a specialist or outside unit (for example, appraisal experts, team of accounts, project support unit for financing international trade, unit for financing syndicate participation, etc.).

There is a trend for the concentration of experts in specialist branches and designated head office units (within the framework of a "segmentation" process).

In 2011, the average number of positions assigned to the segment (including the Real Estate Division) totaled 1,108 positions, of which, 451 were management positions, compared with 1,077 positions in 2010, 425 of which were management staff. Most of the employees have an academic education. In addition to their educational qualifications, as part of their training at the Bank, the employees undergo regular professional training in various fields of banking, as well as management courses. Within the scope of their work, employees must possess the ability to analyze complex credit applications, to lead complicated transactions, and the ability to provide service of the highest standard.

Construction and real estate division operates under the corporate banking segment

General

The Construction and Real Estate Division specializes in providing financial services to customers whose principal business is in the field of construction and real estate, and in the field of infrastructure projects. The construction sector is financed using instruments and analytical tools which are unique to the segment, while instituting prudent policies. Project financing is provided in the form of closed construction lending, which is subject to tight supervision and control with an emphasis on meticulous scrutiny of each project.

The Credit Risk Management Unit in the Credit Department examines and approves the transactions or submits them for deliberation by the appropriate credit committee.

Structure of the Division

Most of the corporate activity in the construction and real estate sector, including large infrastructure projects, is carried out through the Construction and Real Estate Division. The division supplies a comprehensive range of banking services to major business enterprises in the economy, middle-market business enterprises engaging in construction and real estate and entrepreneurs whose goal is to set up and operate projects in the field of infrastructure.

The division is divided into three sectors, each operated by two to four senior customer relations managers, with specific expertise in the real estate sector and in the field of infrastructure and performing contractors. The senior customer relations managers coordinate all handling of the banking needs of the customers assigned to them.

The sectors in the division are:

a. The construction companies sector, which supplies an extensive range of banking services to the major customers in the economy in the field of construction and real estate in Israel and abroad.

b. The real estate promotion sector, which specializes in providing services to middle-market business customers, with the majority of its activity focusing on financing the residential housing branch and which is handled via the closed construction loan method.

c. The infrastructure sector, which is engaged in the financing of national infrastructure projects employing the P.P.P. (Public Private Partnership) method (which is based on cooperation between the public and private sectors) and in the provision of services to corporate customers in the field of infrastructure and performance contracting.

The Bank, through the Construction and Real Estate Division, occasionally participates in the provision of credit by participating in the initiation and development of projects and by purchasing properties via the Bank's subsidiaries in the United States, England and Romania. Financing, as stated, is provided to the Bank's customers in Israel for their activities abroad or to other customers of the above-mentioned subsidiaries operating in the sector.

Business objectives and strategy, and expectations for development in the coming year

The following information is "forward-looking information." For the meaning of this term, see page 61.

The Real Estate Division is involved in the segment of major and middle-market customers in the real estate field. The strategic objective is to deepen its relative advantage and to continue to improve its contribution to the Group's profits. The division's goals are to guide the activity in this sector, while carefully and prudently scrutinizing the exposures deriving from customers' activity and the unique risks for this industry. At the same time, it is the division's goal to expand the variety of products and services being offered to customers, and to leverage its long-standing relations with customers in order to develop businesses in conjunction with various units of the Leumi Group in Israel and abroad. (See also the above mentioned in this paragraph in the chapter on the Corporate Division, above.)

Restrictions, legislation, regulations and special constraints that apply to the segment

The Bank, and the construction and real estate segment, in particular, operate within the context of laws, regulations and regulatory directives imposed on the banking system in Israel by entities such as the Banking Supervision Department, the Commissioner of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority and additional entities. The Bank's subsidiaries and representative offices overseas, operate by virtue of permits from the Banking Supervision Department, and are also subject to local regulations.

For further details, see page 156 above under the corporate banking segment.

Project financing using the closed construction lending format is carried out, *inter alia*, through operational systems for depositing payments from purchasers of housing units in projects being handled using the voucher method, and for handling the issuance of uniform sale guarantees, pursuant to legislation of the Knesset and with directives prescribed by the Bank of Israel.

Pursuant to a Bank of Israel directive, when the total indebtedness of a particular sector to a banking corporation exceeds 20% of the total indebtedness of the public to the banking corporation (the bank on a nonconsolidated basis), this excess is considered an exceptional excess in terms of the concentration of sectoral indebtedness. In such a case, a supplementary allowance for credit losses is required in respect of the sum of the amount of the excess. The sectoral excess in this sector (according to the Bank of Israel's definition) in the Bank at the end of 2011 reached the rate of 4.50%, compared with the excess of 4.14% at the end of 2010. Pursuant to the aforementioned directive, when the minimum capital ratio is over 12%, then the bank is not required to make a provision for the excess in the sector according to the formula set out in the abovementioned directive.

In addition, from 1 January 2011, the directive governing the measurement and disclosure of impaired debts came into force, pursuant to which a collective allowance for credit losses must be made on all of the credit in the bank. In accordance with the above mentioned directive, if the total collective allowance is higher than the allowance required as a supplementary allowance (pursuant to Proper Conduct of Banking Business Regulation 315), there is no need to make a supplementary allowance.

In January 2012, the Leumi Board of Directors approved management's intention to merge Leumi Mortgage Bank Ltd., a wholly-owned subsidiary. It should be noted that in the inclusion of the credit portfolio of Leumi Mortgage Bank, the rate of concentration of the real estate division as of the end of 2011 (the Bank on a consolidated basis) with Leumi Mortgage Bank does not exceed the regulatory limit mentioned above, and stands at some 19.9%.

Developments in the markets of the segment or changes in the characteristics of its customers

The relative stability of the Israeli economy, prominent against the background of the global crisis and its repercussions, has a significant impact on the position of the Israeli real estate industry.

From the second half of 2009 to the first half of 2011, the real estate industry, and, in particular, the residential segment, was characterized by growth and diverse activity. The performance of the real estate sector in Israel is even more prominent against a backdrop of the volatility that characterized the real estate markets in most countries of the world, in particular, the United States, the United Kingdom, most countries of Eastern Europe, Spain, etc.

It was apparent that by the end of 2011, the rate of sales slowed down considerably and the rise in housing prices was halted. (From a number of points around the world, reports have even been received of slight falls in prices.) The atmosphere created and the uncertainty generated, against a backdrop of the social protest, world developments and, thus the economic projections for 2012, point to a trend of price stability with an increase in the probability of price falls, even in areas in demand.

It should be noted that the area of income-producing property also displays a trend of stability which is more prominent in the corporate segment and less so in the office market segment. However, an increase in the supply of space, in combination with a slowdown in economic activity, is likely to result in a certain decline in rental prices and in occupancy rates, albeit after a time lag.

In building contracting activity, it is apparent that the increase in the volume of residential housing construction, a certain recovery in non-residential construction (office and commercial buildings) and with the addition of public building – has led to a stabilization of the activity of performance contractors. This trend has yet to find expression in a significant improvement in their profitability. The increase in the budgets of Ma'atz (the Public Works Department) and the issuing of tenders for work on large projects (including those that were supposed to be executed in collaboration with the private sector (P.P.P. – Public Private Partnership) and were canceled) will probably lead to an increase in the activity of infrastructure contractors – and the profit margins in this segment are still low.

In the field of large infrastructure projects (Project Finance), there is a noticeable progress towards financial closure and execution of a number of projects, particularly in the area of desalination, electricity production by private manufacturers and the production of natural gas from the deposits discovered in the sea off the coast of Israel.

Technological changes that may have a material impact on the segment

The information systems that serve the construction and real estate segment are intended to assist in analyzing customer needs and in the ongoing work with them, in the analysis and measurement of credit risks and the assessment of borrowers and in the monitoring and control of customers' activities. The various technological systems are updated and upgraded on an ongoing basis for the benefit of the segment.

Critical success factors in the segment

Critical success factors in the segment are: staff possessing high levels of professional, management and interpersonal abilities (both *vis-à-vis* the customers and within the organization), expertise in the segment, familiarity with the customers, including their financial position, and the prospects/risks inherent in working with them, proper management and control of the Bank's financing of the project, correct reading of the market in order to identify potential and avoid risk, credit risk management and control, constant investment in technological aids, and diligence in maintaining contact, providing service and providing solutions for the customers' banking needs.

Main entry and exit barriers in the segment

In order to provide service to customers in this segment, high quality personnel are required, who possess considerable skill in familiarizing themselves with the segment's customers, the diversity of their activities and in analyzing their needs. The management of customers in this segment requires an in-depth familiarity with them, their financial data, their fields of activity, and adaptation of the Bank's products to these data. Moreover, appropriate preparations are required for complying with the regulatory restrictions and internal restrictions imposed by the Bank's Board of Directors, as well as for monitoring and controlling various risks and exposures. The Credit Risk Management Unit of the Credit Department is involved in these preparations.

Alternatives to the products and services of the segment, and the changes that have occurred therein

The financial crisis, and its impact on the value of the institutional entities' assets, on the one hand, and the significant erosion in the value of the assets (particularly abroad) in which the proceeds of the mobilization of debt were invested, on the other, led to cash-flow difficulties and the need for debt arrangements with regard to some of the mobilizing companies. All this brought about a freeze in the provision of finance by entities in the non-banking market, against the background of the debt crisis in the European Union and the expanding phenomenon of debt agreements in the economy.

Towards the middle of 2010, the number of purchasing groups stabilized (mostly the restructurings in the area of housing construction), mainly as a result of intervention by the Bank of Israel, and they appeared to be replaced by many purchasing groups for office accommodation. In 2011, there was a further material moderation in the activity of the purchasing groups in view of the limits imposed by the Bank of Israel on the issue of raising the shareholder equity requirements in taking mortgages and the duty to pay VAT on the land component.

In light of the unique nature of projects of this type, and since the financing is provided to each member of the group according to its particular abilities and needs, the financing to the acquiring groups within the Leumi Group is provided by Leumi Mortgage Bank and sometimes, in cooperation with Leumi.

Structure of the Competition in the Segment and the Changes that have occurred therein

There is strong competition over financing of the real estate sector, both from the four major banking groups in Israel, and from small banks in the system, including mortgage banks. In recent years, the involvement of institutional entities, such as insurance companies and pension funds, has become considerable, and foreign banks have also entered the arena of long-term financing of income-producing properties and of infrastructure projects. This trend weakened during the global financial crisis and subsequently became more significant again.

Products and services of the segment

The construction and real estate sector is financed by using specific analytical and monitoring tools that assist in the decision-making process and in controlling the financing granted to the various projects. The sector is financed with the aim of diversifying the credit portfolio and differentiating between the various segments – residential, income-producing properties designated for commerce and offices, and construction for industry and commerce. The financing policy of the Construction and Real Estate Division for 2012 will focus on giving preference to the financing of residential projects in the typical high-demand areas in Israel, intensifying the activity of financing for national projects and selective financing of Israeli entrepreneurs abroad through the Bank's overseas subsidiaries. Residential projects will be financed, as a rule, using the closed construction lending method, which enables high frequency, tight supervision of the project being overseen. Furthermore, the Construction and Real Estate Division continues its involvement in the financing of national projects under the various P.P.P. methods. These transactions are analyzed in conjunction with a special unit in the division’s Complex Finance and International Trade Department, which examines the transactions and collaborates on the formulation of the financing package, taking into account the characteristics of the customer, analysis of its debt servicing ability, the right of recourse to the customer, the operating contract limitation, technical constraints, etc.

Customers

The Division's customers are major companies in the economy in the field of real estate initiatives, infrastructure and performance and contractors, and select middle-market business entities engaging in real estate and contracting initiatives.

Marketing and distribution

The Real Estate Division’s activity *vis-à-vis* its customers is coordinated by senior customer relations managers who maintain regular, constant contact with the customers and provide solutions for all their banking needs.

Following are condensed operating results of the Corporate Banking segment:

	Banking and finance	Credit cards	Capital market	Real estate	Overseas activity: Banking and finance	Overseas activity: Real estate	Total
	2011						
	NIS millions						
Net interest income:							
From external sources	**1,342**	**30**	**7**	**1,457**	**16**	**(1)**	**2,851**
Intersegmental	**(295)**	**(11)**	**(7)**	**(782)**	**(3)**	**6**	**(1,092)**
Operating and other income:							
From external sources	**140**	**193**	**20**	**94**	**4**	**1**	**452**
Intersegmental	**-**	**(115)**	**-**	**-**	**-**	**-**	**(115)**
Total income	**1,187**	**97**	**20**	**769**	**17**	**6**	**2,096**
Expenses in respect of credit losses	**(2)**	**(3)**	**-**	**317**	**-**	**-**	**312**
Operating and other expenses:							
To external sources	**400**	**73**	**11**	**133**	**10**	**3**	**630**
Intersegmental	**-**	**1**	**-**	**-**	**-**	**-**	**1**
Operating profit before taxes	**789**	**26**	**9**	**319**	**7**	**3**	**1,153**
Provision for taxes	**268**	**6**	**3**	**110**	**1**	**1**	**389**
Operating profit after taxes	**521**	**20**	**6**	**209**	**6**	**2**	**764**
Net operating profit attributable to non-controlling interests	**-**	**(4)**	**-**	**-**	**-**	**-**	**(4)**
Net profit	**521**	**16**	**6**	**209**	**6**	**2**	**760**
% Return on equity							**9.3%**
Average balance of assets	**49,958**	**417**	**158**	**26,462**	**576**	**25**	**77,596**
Average balance of liabilities	**26,478**	**2,611**	**46**	**5,551**	**232**	**262**	**35,180**
Average balance of risk assets	**71,421**	**388**	**157**	**26,608**	**824**	**25**	**99,423**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**1,281**	**-**	**-**	**-**	**1,281**
Average balance of securities	**-**	**-**	**82,557**	**-**	**145**	**-**	**82,702**
Average balance of other assets under management	**221**	**-**	**-**	**-**	**-**	**-**	**221**
Margin from credit-granting activities	**858**	**18**	**-**	**495**	**9**	**3**	**1,383**
Margin from deposit-taking activities	**36**	**-**	**-**	**23**	**4**	**2**	**65**
Other	**153**	**1**	**-**	**157**	**-**	**-**	**311**
Total net interest income	**1,047**	**19**	**-**	**675**	**13**	**5**	**1,759**
Balance of credit to the public	**49,899**	**387**	**162**	**26,389**	**609**	**125**	**77,571**
Balance of deposits of the public	**22,898**	**-**	**-**	**4,894**	**218**	**169**	**28,179**

Corporate Banking Segment (continued)

	Banking and finance	Credit cards	Capital market	Real estate	Overseas activity: Banking and finance	Overseas activity: Real estate	Total
	2010						
	NIS millions						
Net interest income:							
From external sources	627	25	(2)	1,024	17	(2)	1,689
Intersegmental	627	(6)	2	(244)	(7)	7	379
Operating and other income:							
From external sources	169	187	26	67	3	2	454
Intersegmental	-	(122)	-	-	-	-	(122)
Total income	1,423	84	26	847	13	7	2,400
Expenses in respect of credit losses	(375)	5	-	299	-	-	(71)
Operating and other expenses:							
To external sources	406	66	8	122	8	5	615
Intersegmental	-	1	-	-	-	-	1
Operating profit before taxes	1,392	12	18	426	5	2	1,855
Provision for taxes	493	3	6	151	1	1	655
Operating profit after taxes	899	9	12	275	4	1	1,200
Net operating profit attributable to non-controlling interests	-	(2)	-	-	-	-	(2)
Net profit	899	7	12	275	4	1	1,198
% Return on equity							14.3%
Average balance of assets	45,801	455	156	26,915	576	43	73,946
Average balance of liabilities	24,845	2,622	38	5,317	113	356	33,291
Average balance of risk assets	64,125	407	156	26,885	764	43	92,380
Average balance of mutual funds and supplementary training funds	-	-	1,098	-	-	-	1,098
Average balance of securities	-	-	85,903	-	160	-	86,063
Average balance of other assets under management	201	-	-	-	-	-	201
Margin from credit-granting activities	921	14	-	519	9	-	1,463
Margin from deposit-taking activities	28	-	-	12	1	5	46
Other	305	5	-	249	-	-	559
Total net interest income	1,254	19	-	780	10	5	2,068
Balance of credit to the public at 31 December 2010	45,508	398	155	26,422	680	-	73,163
Balance of deposits of the public at 31 December 2010	20,791	-	89	4,940	144	317	26,281

Main Changes in the Volumes of Activity

In the corporate banking segment, there was an increase in credit to the public of some NIS 4.4 billion, 6.0%, primarily from domestic banking and financial activities. There was an increase in deposits of the public of some NIS 1.9 billion, 7.2%. There was a decrease in activity in securities of some NIS 21.5 billion, or 22.9%. In off-balance sheet activity, there was an increase of 9.1% in guarantees and documentary credit in the segment.

Main Changes in the Net Profit

Net profit in the corporate banking segment in 2011 totaled NIS 760 million, compared with NIS 1,198 million in the corresponding period in 2010, a decrease of 36.5%. The decrease in profit derived mainly from an increase in expenses in respect of credit losses of some NIS 383 million, mainly from a decrease in the collection of debts and an increase in the Group allowance and a decrease in the net interest income amounting to NIS 309 million. As a result of an increase in the allowance for indebtedness in respect of doubtful debts in accordance with the new directive of Bank of Israel and a change in the collection of debts, allowances are made first to the principal and then to the interest.

4. Commercial Banking Segment

General

Commercial banking specializes in the provision of the entire spectrum of financial services to middle-market business entities in all sectors of the economy, for which credit facilities of usually from NIS 10 million to NIS 120 million were approved, with the customer's total obligo in the banking system not exceeding NIS 250 million and up to NIS 80 million when the customer's total obligo in the banking system exceeds NIS 250 million and the customer's total activity turnover does not exceed NIS 400 million. In addition, the interested parties of the business companies, including shareholders and senior office holders are also dealt with in this segment.

Service and marketing to these customers are carried out on an individual basis, including the financing of transactions with credit instruments tailored to the customers' unique requirements, the adaptation of investment products and financial instruments for hedging risks, the financing of international trade transactions, the financing of active customers in the capital market and start-up companies.

The commercial banking segment also includes activities outside of Israel through the Bank's subsidiaries abroad. Companies that are served by the Commercial Banking Division leverage their relations with the Bank in Israel in order to expand their activities abroad. Banking services abroad, including the provision of credit lines to finance international trade, real estate purchases, and company mergers, are available to companies mainly through Bank Leumi USA, Bank Leumi (UK) and Bank Leumi Romania. The subsidiaries in the United States, the UK and Romania view the ongoing servicing of these companies as a direct continuation of the banking activities in Israel.

For further details about the subsidiaries abroad, see pages 200.

Structure of the segment

The segment is managed in Israel by the Commercial Banking Division. This division has an organizational structure that is unique in the Israeli banking system, which enables it to provide its customers with all-inclusive and comprehensive service (a one-stop shop) and affords the Division a competitive edge. The principal contact with customers is through designated commercial branches located throughout the country. The Commercial Banking Division has a main branch in Tel Aviv and 24 business branches located in industrial zones and in the major cities, which are attributed geographically to four commercial districts. The branches specialize in the management of business activities characteristic of the Division's customers, giving it a competitive advantage.

Leumi USA has branches in New York, California, Florida, Illinois and a branch in the Cayman Islands. Leumi UK has a main branch in London, a banking subsidiary company, a trustee company on the Isle of Jersey and a company operating in the field of asset-based lending (including the discounting of invoices) in Brighton (in the south of England). Leumi Romania has 23 branches and offices across Romania.

For further details, see page 197.

Within the scope of the measures to improve the quality of the Bank's credit portfolio, and in order to comply with the regulatory requirements, the Credit Risk Management Department (CRM) was established during 2008 in the Commercial Banking Division. The CRM Department is responsible for managing all aspects of the credit risks in the division, including determining the methodology for the activity segments that are relevant and/or unique to the division, for the assimilation of the various credit methodologies in all units of the division, for scrutinizing and thoroughly analyzing the credit applications of the division's customers, while assessing the risk and issuing preliminary opinions to the credit committees, for approving credit applications that are within the scope of its authority, for handling and approving applications relating to problem loans, including management of the portfolio of problem loans in the division.

Goals and business strategy and expectations for developments in the coming year

The following information is "forward-looking information". For the meaning of this term, see page 61.

Commercial banking serves middle-market business customers. The strategic objective of commercial banking is to continue to strengthen its competitive advantage by expanding the activities with existing customers and by recruiting new customers, placing an emphasis on financing customers characterized by potential for growth and an appropriate level of risk, while providing comprehensive solutions for the benefit of its customers operating in Israel and abroad.

The division continues to adopt a conservative and responsible policy, in accordance with the Bank's policy, with regular examination of the credit portfolio.

Restrictions, legislation, regulations and special constraints that apply to the segment

See details on page 49 of the Report.

Developments in the markets of the segment, and in its customers' characteristics

The main activities of the segment's customers are in the local market, in the industrial, infrastructure, trade and services and real estate sectors of the economy and markets abroad, either directly or through subsidiaries.

Expectations for 2012 are for an economic slowdown around the world and in Israel which is expected to have implications for export customers and customers active in the domestic market. Accordingly, the Division is taking steps in careful risk management, regularly reviewing the customer population, and, in particular, sensitive customers, in particular, and reviewing trends of developments and their implications.

For details on the sectors of the economy, see page 102 of the Report.

Technological changes

- The segment's employees are assisted by computerized systems that support various processes carried out in the segment, such as control, definition and measurement of targets, marketing and business development.
- The segment supplies its customers with technological tools, similar to those used by all of the Bank's customers, through, among other things, a business portal, which expands the range of services for the convenience of the corporate customer. The Bank continues striving to develop these systems in order to respond to the changing and developing needs of the segment's customers.

Critical success factors in the segment

- Identifying the customer's needs and adapting appropriate inclusive solutions, while reducing response time and raising the standards of service;
- Familiarity with the customer, including his financial position and the prospects/risks inherent in working with him, as a basis for optimal risk management;
- Cultivating human capital and constantly raising its professional level at the required pace, in light of the changes in the capital market and the business environment;
- Maintaining a control system to reduce the credit risks and a strict approach in relation to all matters pertaining to compliance.

Main entry and exit barriers in the segment

- Training professional manpower with diverse skills;
- Maintaining a range of products tailored to the customers' needs;
- Establishing a network of distribution channels whose spread corresponds to the business potential;
- Establishing and developing technological means to serve customers and employees.

Competition

Competing parties in this segment of activity, in both the credit and investments spheres, are all of the banks operating in Israel (domestic and foreign), overseas banks, entities operating in the capital market, and insurance companies. The insurance companies compete for customers in the segment in both the credit sphere and the investment services sphere, while private investment houses are competitors in the investments sphere. The intensity of the competition that the Bank has been facing in the commercial banking segment in recent years has been strong.

Human Capital

- The average number of positions assigned to the segment in 2011 totaled 1,981, of which 787 were management positions, compared with 1,815 positions in 2010, 724 of which were management staff positions.
- The branches and the headquarters are staffed by employees and managers who have undergone appropriate training in accordance with the needs of commercial customers and have gained expertise in the management of the typical business activities of the division’s customers.

Following are the condensed operating results of the Commercial Banking Segment:

	Banking and finance	Credit cards	Capital market	Real estate	Overseas activity: Banking and finance	Overseas activity: Capital market	Overseas activity: Real estate	Total
	2011							
	NIS millions							
Net interest income:								
From external sources	**1,081**	**11**	**5**	**441**	**529**	**-**	**137**	**2,204**
Intersegmental	**(346)**	**(4)**	**(3)**	**(223)**	**(56)**	**-**	**(39)**	**(671)**
Operating and other income:								
From external sources	**237**	**67**	**41**	**34**	**39**	**7**	**9**	**434**
Intersegmental	**-**	**(37)**	**-**	**-**	**-**	**-**	**-**	**(37)**
Total income	**972**	**37**	**43**	**252**	**512**	**7**	**107**	**1,930**
Expenses in respect of credit losses	**84**	**(1)**	**-**	**43**	**37**	**-**	**55**	**218**
Operating and other expenses:								
To external sources	**533**	**26**	**33**	**70**	**336**	**5**	**43**	**1,046**
Intersegmental	**(1)**	**1**	**-**	**1**	**-**	**-**	**-**	**1**
Operating profit before taxes	**356**	**11**	**10**	**138**	**139**	**2**	**9**	**665**
Provision for taxes	**121**	**3**	**3**	**49**	**46**	**1**	**5**	**228**
Operating profit after taxes	**235**	**8**	**7**	**89**	**93**	**1**	**4**	**437**
Net operating profit attributable to non-controlling interests	**-**	**(1)**	**-**	**-**	**-**	**-**	**-**	**(1)**
Net profit	**235**	**7**	**7**	**89**	**93**	**1**	**4**	**436**
% return on equity								**11.3%**
Average balance of assets	**23,906**	**325**	**471**	**8,029**	**13,857**	**-**	**3,306**	**49,894**
Average balance of liabilities	**31,173**	**892**	**-**	**2,560**	**9,045**	**-**	**373**	**44,043**
Average balance of risk assets	**24,726**	**263**	**468**	**8,705**	**13,605**	**-**	**3,306**	**51,073**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**4,101**	**-**	**-**	**139**	**-**	**4,240**
Average balance of securities	**-**	**-**	**38,932**	**-**	**-**	**1,899**	**-**	**40,831**
Average balance of other assets under management	**702**	**-**	**-**	**-**	**-**	**-**	**-**	**702**
Margin from credit-granting activities	**515**	**7**	**1**	**177**	**241**	**-**	**88**	**1,029**
Margin from deposit-taking activities	**96**	**-**	**1**	**14**	**195**	**-**	**7**	**313**
Other	**124**	**-**	**-**	**27**	**37**	**-**	**3**	**191**
Total net interest income	**735**	**7**	**2**	**218**	**473**	**-**	**98**	**1,533**
Balance of credit to the public	**23,086**	**312**	**481**	**8,283**	**15,113**	**-**	**3,261**	**50,536**
Balance of deposits of the public	**32,684**	**-**	**-**	**2,676**	**10,770**	**-**	**397**	**46,527**

Commercial Banking Segment (continued)

	Banking and finance	Credit cards	Capital market	Real estate	Overseas activity: Banking and finance	Overseas activity: Capital market	Overseas activity: Real estate	Total
	2010							
	NIS millions							
Net interest income (expenses):								
From external sources	766	9	6	320	476	-	144	1,721
Intersegmental	1	(2)	(4)	(115)	(75)	-	(56)	(251)
Operating and other income:								
From external sources	230	63	50	28	42	10	8	431
Intersegmental	-	(38)	-	-	-	-	-	(38)
Total income	997	32	52	233	443	10	96	1,863
Expenses in respect of credit losses	113	2	-	44	130	-	52	341
Operating and other expenses:								
To external sources	528	23	43	62	304	6	67	1,033
Intersegmental	1	1	-	-	-	-	-	2
Operating profit (loss) before taxes	355	6	9	127	9	4	(23)	487
Provision for (benefit from) taxes	124	2	3	46	14	1	(7)	183
Operating profit (loss) after taxes	231	4	6	81	(5)	3	(16)	304
Net operating profit attributable to non-controlling interests	-	(1)	-	-	-	-	-	(1)
Net profit (loss)	231	3	6	81	(5)	3	(16)	303
% return on equity								8.1%
Average balance of assets	22,694	321	538	7,035	12,357	-	3,722	46,667
Average balance of liabilities	26,476	887	-	2,264	8,382	-	409	38,418
Average balance of risk assets	25,135	263	411	6,679	12,177	-	3,722	48,387
Average balance of mutual funds and supplementary training funds	-	-	3,388	-	-	153	-	3,541
Average balance of securities	-	-	37,066	-	-	2,266	-	39,332
Average balance of other assets under management	563	-	-	-	-	-	-	563
Margin from credit-granting activities	544	6	2	154	200	-	82	988
Margin from deposit-taking activities	62	-	-	7	152	-	6	227
Other	161	1	-	44	49	-	-	255
Total net interest income	767	7	2	205	401	-	88	1,470
Balance of credit to the public at 31 December 2010	22,291	306	1,045	7,781	12,042	-	3,761	47,226
Balance of deposits of the public at 31 December 2010	25,837	-	-	2,183	7,989	-	412	36,421

Main Changes in the Volumes of Activity

Credit to the public increased by some NIS 3.3 billion, 7.0%, of which an increase of NIS 2.5 billion was from the activity of the segment abroad.
Deposits of the public increased by some NIS 10.1 billion, (27.7%), of which NIS 7.6 billion is in domestic activity. Activity in securities decreased by NIS 1.3 billion, at the rate of 3.0%, which derived mainly from a decrease in activity and depreciation in market values.

Main Changes in the Net Profit

Net profit in the commercial banking segment totaled NIS 436 million in 2011, compared with NIS 303 million in the corresponding period in 2010, an increase of 43.8%.

The increase in profit derives from an increase in activities abroad, from NIS 18 million in 2010 to a profit of NIS 98 million in 2011, resulting from a decrease of some NIS 90 million mainly in the expenses in respect of credit losses in Romania and the United States.

In domestic activities, there was a profit increase of NIS 17 million, 5.3%. Most of this increase is derived from a decrease amounting to NIS 33 million, 20.7%, in respect of expenses in respect of credit losses. On the other hand, an increase of NIS 12 million in operating and other expenses partially offset the above increases.

5. Private Banking Segment

General

Private banking provides services to wealthy customers in Israel and worldwide. The activities are carried out through unique centers in Israel designated for foreign and Israeli residents, as well as through the Bank's subsidiaries in the United States, the United Kingdom, Switzerland, Luxembourg, Romania, Uruguay and Jersey. In addition, the Group has a presence in a number of countries abroad through representative offices in Europe, Latin America, Canada, Hong Kong and Australia. Furthermore, Leumi Switzerland and Leumi USA operate representative offices in Israel. The strategic objective of private banking is to expand the customer base and to increase the volume of activity of private banking customers in Israel and worldwide.

The structure of the segment

The private banking line operates in Israel by way of the provision of exclusive and personal service by professional teams in seven unique centers around the country, who serve local residents and foreign residents in their own language, and who are familiar with the customers' needs, preferences and areas of interest.

Outside of Israel, private banking services are provided within the framework of the subsidiaries and representative offices

Goals and business strategy

The vision of private banking is to be "the private banking choice of customers as the leading private banker in Israel." This vision emphasizes a number of core values: focus on and attention to each existing and potential customer, to the profitability of his or her asset portfolio, to the level of professionalism and excellence in service, while developing professional and competitive teams with initiative, and the highest standards of service orientation. This strategy also applies to the Bank's overseas units, which also operate to increase business with new and existing customers.

Restrictions, legislation, regulations and special constraints that apply to the segment

The private banking segment in Israel operates within the context of laws, directives and regulations, which are imposed on the banking system in Israel by entities, such as the Banking Supervision Department in the Bank of Israel, the Commissioner of the Capital Market, Insurance and Savings, the Antitrust General Director, the Israel Securities Authority, the Authority for the Prohibition on Money Laundering and other entities. The Bank's overseas subsidiaries and representative offices operate by virtue of permits from the Banking Supervision Department in the Bank of Israel, and are also subject to local regulation.

For additional information regarding FATCA, see page 59.
For further information regarding "American customers", see page 268.

Developments in the markets of the activity segment, or changes in its customers' characteristics

2011 was characterized by a crisis in the PIIGS states (Portugal, Ireland, Italy, Greece and Spain), in particular, and in the Eurozone, in general. As a consequence, there was a slowdown in the activity of customers, whereby the general trend was to maintain the existing portfolio, reducing the risk components therein.

Technological changes

The private banking segment has at its disposal technology systems such as Odyssey, which provides detailed reports to customers regarding their investments and assets. This is an advanced technological system, which is tailored to the segment's customers, improves service, and assists the counselors to better manage and monitor the customers' portfolios. The system works in all of the Division's centers and new modules are added to it from time to time.

The Division has an exclusive advanced CRM system, which enhances relations between the counselors and customers, with the objective of providing maximum service and increasing customer satisfaction. In addition, the "Odem" system was developed, which serves as a tool for examining the needs of customers and for obtaining recommendations about the level of risk and the recommended investment mix for the customer. In addition, use is made of the Reuters and Bloomberg systems as decision-making support information.

New Internet sites for subsidiaries abroad

Leumi has launched and upgraded new international websites for the Leumi subsidiaries overseas, with a line of uniformity with the international website that was also upgraded. There are currently advanced new and dynamic websites for the benefit of customers, which assist in presenting the Bank and its range of activities around the world. The information and the way in which it is presented are utilized as a premier level marketing tool *vis-à-vis* the customers and *vis-à-vis* the competition in Israel and worldwide.

Critical success factors in the private banking segment

- A range of comprehensive and advanced solutions and products for managing customers' assets and responding to their needs;
- Counseling of customers by a professional team supported by analysts and information systems;
- Provision of personal and customized VIP services, over and above routine financial services;
- Expansive international spread of the Group's subsidiaries and representative offices.

The main entry and exit barriers in the segment

- Training of skilled, qualified manpower possessing high levels of professionalism and service abilities;
- International spread of centers of activity throughout the world;
- Implementation of means of control over the entire range of activities;
- Establishment, maintenance and upgrading of advanced technological information systems;
- Offering a broad spectrum of financial products and services.

Marketing and distribution

The marketing objective is to increase the customer base while creating image differentiation, both within the Group and *vis-à-vis* the competition. In addition, marketing efforts are geared to retaining customers and increasing the Bank's share in the customers' asset portfolio. Marketing the private banking segment is carried out through image advertising in the media and press aimed at an affluent target audience, as well as through customer events, professional conferences, sponsorships and collaborations with leading cultural institutions in Israel, direct mailings and the Internet.

Competition

In the private banking segment, Leumi competes in Israel with Israeli banks and with local representative offices of foreign banks, which have the same customer targets. Overseas, the Bank competes with local banks and investment houses that offer private banking and investment services, as well as with branches and representative offices of Israeli banks.

Seasonality

There is no significant seasonality in the segment. Nonetheless, the periods of the religious holidays are characterized by substantial financial activity among foreign residents as a result of tourists visiting Israel from abroad, some of whom are existing customers while others are new customers.

Intangible assets

Private banking has two significant intangible assets. The first is the segment's logo, which was designed by an international advertising agency on the basis of Leumi's logo, and includes the words "Private Banking." In addition, a trademark has been registered in Israel and abroad in the name of the "Leumi Global Managers" series of funds and for its abbreviation, "LGM."

Human capital

In 2011, the average number of positions assigned to the segment was 818, of which 401 were management positions, compared with 854 positions in 2010, of which 401 were management positions**.**

Employees of the private banking segment undergo comprehensive training, including wide-ranging professional and management training courses, including professional courses and management training for the management staff. In addition, the employees attend extensive workshops for acquiring high service skills.

Cooperation agreements

As stated, the private banking segment offers customers a broad range of products in cooperation with international entities, within the framework of open architecture. Through this cooperation, Leumi offers a range of advanced investment products constituting the main attraction for foreign resident investors – both existing and new – which consequently increases the volume of assets that they hold in the Group.

Since 2004, there has been significant cooperation in the segment with the SEI Investments Company, which serves as a sub-investment manager for the Leumi Global Managers' series of funds that are distributed abroad.

For further details, see page 206 below.

Acquisition of a Swiss bank

On 10 February 2011, an agreement was signed to purchase Banque Safdié in Switzerland.
On 30 November 2011, after obtaining approval from the relevant authorities and having complied with the requisite conditions, the purchase transaction was completed. Leumi acquired the entire share capital of Banque Safdié. The purchase substantially increased the scope of activities of the Group in Switzerland.

On 3 January 2012, and after approval from the regulatory authority in Switzerland, the official merger took effect and Banque Safdié was consolidated into Bank Leumi Switzerland.

For further details, see page 202 below.

Securities activity in Canada

Following the Bank's application to the Securities Authority in Ontario and Quebec, Canada, in December 2011, the Bank received an exemption from the obligation to register as a dealer international dealer exemption. This exemption will enable the Bank to offer consulting services in Canadian securities to eligible customers from these provinces.

Following are condensed operating results of the Private Banking Segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Real estate	Overseas activity: Banking and finance	Overseas activity: Capital market	Overseas activity: Mortgages	Overseas activity: Real estate	Total
	2011									
	NIS millions									
Net interest income (expenses):										
From external sources	**(169)**	**-**	**-**	**1**	**4**	**67**	**-**	**39**	**(2)**	**(60)**
Intersegmental	**328**	**-**	**-**	**(1)**	**9**	**179**	**-**	**(19)**	**5**	**501**
Operating and other income:										
From external sources	**29**	**1**	**154**	**-**	**8**	**124**	**131**	**5**	**1**	**453**
Intersegmental	**2**	**1**	**-**	**-**	**-**	**9**	**-**	**-**	**-**	**12**
Total income	**190**	**2**	**154**	**-**	**21**	**379**	**131**	**25**	**4**	**906**
Expenses (income) in respect of credit losses	**(10)**	**-**	**-**	**-**	**1**	**(23)**	**-**	**1**	**-**	**(31)**
Operating and other expenses:										
To external sources	**170**	**2**	**53**	**-**	**10**	**311**	**122**	**14**	**2**	**684**
Intersegmental	**-**	**1**	**-**	**-**	**-**	**2**	**1**	**-**	**-**	**4**
Operating profit (loss) before taxes	**30**	**(1)**	**101**	**-**	**10**	**89**	**8**	**10**	**2**	**249**
Provision for taxes	**12**	**-**	**33**	**-**	**3**	**23**	**1**	**2**	**-**	**74**
Operating profit (loss) after taxes	**18**	**(1)**	**68**	**-**	**7**	**66**	**7**	**8**	**2**	**175**
Net operating profit attributable to non-controlling interests	**-**	**-**	**-**	**-**	**-**	**(2)**	**-**	**-**	**-**	**(2)**
Net profit (loss)	**18**	**(1)**	**68**	**-**	**7**	**64**	**7**	**8**	**2**	**173**
Return on equity %										**22.0%**
Average balance of assets	**1,646**	**57**	**9**	**40**	**429**	**8,140**	**-**	**913**	**14**	**11,248**
Average balance of liabilities	**19,929**	**-**	**-**	**-**	**995**	**16,257**	**-**	**14**	**198**	**37,393**
Average balance of risk assets	**1,430**	**43**	**10**	**31**	**432**	**7,144**	**-**	**320**	**14**	**9,424**
Average balance of mutual funds and supplementary training funds	**-**	**-**	**4,754**	**-**	**-**	**-**	**1,636**	**-**	**-**	**6,390**
Average balance of securities	**-**	**-**	**38,201**	**-**	**-**	**-**	**29,870**	**-**	**-**	**68,071**
Average balance of other assets under management	**224**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**224**
Margin from credit-granting activities	**18**	**-**	**-**	**-**	**5**	**42**	**-**	**19**	**-**	**84**
Margin from deposit-taking activities	**128**	**-**	**-**	**-**	**6**	**153**	**-**	**-**	**3**	**290**
Other	**13**	**-**	**-**	**-**	**2**	**51**	**-**	**1**	**-**	**67**
Total net interest income	**159**	**-**	**-**	**-**	**13**	**246**	**-**	**20**	**3**	**441**
Balance of credit to the public	**2,010**	**57**	**8**	**34**	**414**	**5,405**	**-**	**1,146**	**-**	**9,074**
Balance of deposits of the public	**19,676**	**-**	**-**	**-**	**1,212**	**18,866**	**-**	**14**	**231**	**39,999**

Private Banking segment (continued)

	Banking and finance	Credit cards	Capital market	Mortgages	Real estate	Overseas activity: Banking and finance	Overseas activity: Capital market	Overseas activity: Real estate	Total
	2010								
	NIS millions								
Net interest income:									
From external sources	(158)	-	-	1	6	102	-	(1)	(50)
Intersegmental	289	-	-	(1)	-	165	-	4	457
Operating and other income:									
From external sources	29	1	157	-	4	124	135	1	451
Intersegmental	2	1	-	-	-	7	-	-	10
Total income	162	2	157	-	10	398	135	4	868
Expenses in respect of credit losses	1	-	-	-	-	6	-	1	8
Operating and other expenses:									
To external sources	169	2	56	-	6	368	117	3	721
Intersegmental	(1)	1	-	-	-	3	1	-	4
Operating profit (loss) before taxes	(7)	(1)	101	-	4	21	17	-	135
Provision for taxes (benefit)	(1)	-	34	-	1	5	5	-	44
Operating profit (loss) after taxes	(6)	(1)	67	-	3	16	12	-	91
Net operating profit attributable to non-controlling interests	-	-	-	-	-	(4)	-	-	(4)
Net profit (loss)	(6)	(1)	67	-	3	12	12	-	87
% Return on equity									12.7%
Average balance of assets	1,219	55	2	49	456	8,992	-	24	10,797
Average balance of liabilities	22,003	-	-	-	749	16,451	-	226	39,429
Average balance of risk assets	1,447	40	1	38	451	7,173	-	24	9,174
Average balance of mutual funds and supplementary training funds	-	-	3,872	-	-	-	1,486	-	5,358
Average balance of securities	-	-	36,930	-	-	-	30,140	-	67,070
Average balance of other assets under management	253	-	-	-	-	-	-	-	253
Margin from credit-granting activities	17	-	-	-	4	48	-	-	69
Margin from deposit-taking activities	100	-	-	-	1	145	-	3	249
Other	14	-	-	-	1	74	-	-	89
Total net interest income	131	-	-	-	6	267	-	3	407
Balance of credit to the public at 31 December 2010	1,340	61	7	45	472	5,793	-	20	7,738
Balance of deposits of the public at 31 December 2010	20,460	-	-	-	785	14,760	-	236	36,241

Main changes in volume of activity in the segment

The total monetary assets of customers under management of the private banking segment totaled NIS 120.1 billion as at 31 December 2011, compared with NIS 111.4 billion at the end of 2010, an increase of 7.8%.

Deposits of the public in this segment increased by some NIS 3.7 billion, or 10.4%, deriving mainly from the purchase of Banque Safdié in Switzerland. Credit to the public in this sector increased by some NIS 1.3 million. There was an increase in the value of securities, including mutual funds, of some NIS 4.9 billion, 6.5%, as a result of the purchase of Banque Safdié, which was partially offset by a decrease in the market value of securities

Changes in net profit

Net profit of the private banking segment in 2011 amounted to NIS 173 million, compared with NIS 87 million in the corresponding period in 2010, an increase of NIS 86 million. The increase in profit is derived mainly from an increase in revenues amounting to NIS 38 million, in respect of a decrease in credit losses of NIS 39 million, mainly as the result of canceling of the provision for debt in overseas activities, and a decline in the operational expenses in the amount of NIS 37 million, mainly in overseas activities.

6. Financial Management Segment – Capital Markets

General

This segment centralizes the financial management of the Bank and of the Group and the management of the dealing room, coordinates the contacts, and provides various services to banks and institutional investors. The areas of activity of the segment are as follows:

- Capital management, including public and private offerings of subordinated capital notes and debentures;
- Management of the *nostro*, i.e., the investment of the Bank's independent financial means in tradable investment instruments (primarily debentures and derivatives) and in non-tradable investment instruments (primarily debentures and deposits with banks);
- Management of market risk exposures – including the management of basis, interest and liquidity exposures;
- Management of the dealing rooms, which provide trading services to customers of the Bank, primarily in currencies, securities and derivative instruments;
- Price management – by setting transfer prices and costing special financial transactions;
- Development of financial instruments;
- Inter-bank activity in Israel and abroad;
- Coordination of banking activity of customers that are institutional investors;
- Sub-custodial management.

Structure and business strategy of the segment

The financial management activity is carried out by the Capital Markets Division and in the subsidiaries in Israel and abroad by the market risk managers in the subsidiaries. The activities include the Bank's dealing rooms, management of the *nostro*, and the provision of service to customers active in the capital and money markets, including institutional customers.

The segment's business strategy is based on the Group's capital adequacy policy and its policies for managing market risks and the *nostro*, while addressing the management of the current liquidity and durability under stress conditions, and the interest and financial margin policies. The business objectives of the financial management segment are to meet profit targets adapted to risk in those segments where this can be done with activities being conducted within the framework of restrictions on risk exposure set by the Board of Directors. In the context of implementing the business strategy, the Division develops advanced financial instruments, including structured products and innovative products in the dealing room, in collaboration with the Bank's other operating segments.

Legislative restrictions, regulations and special constraints that apply to the segment

The Bank's activities are subject to laws, regulations and regulatory directives imposed on the banking system in Israel.

The Bank is subject to the supervision of various authorities, including: the Bank of Israel and the Banking Supervision Department, the Commissioner of the Capital Market, Insurance and Savings, the Antitrust General Director and the Israel Securities Authority. The Bank's overseas subsidiaries and representative offices operate by virtue of permits from the Banking Supervision Department, and are also subject to local regulations.

Profit of the segment

The segment's profit is mainly influenced by the *nostro* activities and the dealing rooms, as well as the results of non-banking companies included on equity basis. The principal components of net interest income are as follows:

- Results of market risk management, including the changes that have occurred in transfer prices. Income and expenses resulting from changes in transfer prices are attributed in full to the financial segment, to which all of the market risks from the other operating segments are also transferred.
- Results of capital management, including the raising of capital and offerings to the public;
- Profits/losses from the realization of securities and from provisions for declines in values of securities in respect of declines of a non-temporary nature, and from unrealized profits/losses from adjustments of securities for trading to market value.
- Adjustments of derivative instruments to market value;
- Effects of foreign currency/shekel exchange rate and consumer price index differentials, including adjustments from the translation of overseas investments, including the effects of related taxes;
- Income/expenses deriving from the investment for pension, jubilee and regular holiday reserves;
- Particular costs relating to pension liabilities;
- Profits of companies included on equity basis.

Operating expenses of the segment include mainly direct operating expenses, as well as indirect expenses involved in the management of market risks, management of the independent securities (the *nostro*) portfolios and management of the dealing rooms.

Principal developments in the business environment

In 2011, Leumi Finance issued NIS 3.4 billion subordinated notes, which served as Tier 2 capital.

During the year, following the regulatory outline plan noted in the Basel III Liquidity Rules, when the Bank's position regarding the risks inherent in the nostro investments in foreign securities materialized, the Bank significantly reduced its holdings in securities issued by foreign banks, including subordinated securities. The Bank also reduced its holdings in corporate securities. At the same time, the investment in debentures with high liquidity and of a high quality was increased, principally in United States government debentures. Because of this, exposure to market and credit risks on foreign markets fell and liquidity in foreign currency was significantly improved. Further improvement in liquidity and foreign currency was achieved by the raising of foreign currency public deposits for longer periods.

During 2011, success was attained in expanding the operating services granted by the Bank to the institutional customers, particularly in the operation of provident funds.

Critical success factors in the segment

The critical success factors in the segment are mainly human capital, supported by advanced computer systems, working in an efficient and flexible management framework of control and monitoring. Human capital, requiring managerial, analytical, professional and commercial abilities, in the area of capital markets in Israel and abroad. These abilities relate to both operations in the capital market and to activities with and in the service of customers. Professionalism and constant updating is required regarding financial innovations, and in developments with implications on the capital markets, together with concentrated efforts to provide a response to the needs of customers and working in the proper time-frames.

Customers

The customers belonging to this segment are the mutual funds, provident funds, training funds, pension funds, commercial banks and investment banks, as well as other customers operating intensively in the capital markets.

Competition

The Bank faces strong competition in the field of its activities in the capital market and brokerage from investment houses, provident funds, training funds, and domestic and overseas banks.

Human capital

In 2011, the average number of positions assigned to the segment was some 620 positions, of which 270 were management positions, compared with 482 positions in 2010, 232 of which were management staff positions. Most of the employees have academic qualifications and, in addition, the employees attend professional courses in various fields and management courses arranged by the Bank

The summary of the results of operations of the financial management segment – capital markets – is as follows:

	2011	2010
	(NIS millions)	
Net interest income:		
From external sources	**(319)**	1,553
Intersegmental	**555**	(1,198)
Operating and other income:	**-**	-
From external sources	**171**	449
Intersegmental	**32**	4
Total income	**439**	808
Expenses in respect of credit losses	**77**	(6)
Operating and other expenses:	**-**	-
To external sources	**1,281**	1,033
Intersegmental	**42**	29
Operating loss before taxes	**(961)**	(248)
Provision for taxes (benefit)	**(415)**	28
Operating loss after taxes	**(546)**	(276)
Group share in operating profits of companies included on equity basis after effect of tax	**148**	420
Net operating profit attributed to non-controlling interests	**(9)**	(3)
Net operating profit (loss)	**(407)**	141
Profit from extraordinary activities after taxes	**-**	182
Net profit (loss)	**(407)**	323

In 2011, the net loss of the segment amounted to NIS 407 million, compared with a profit of NIS 323 million in 2010. The net profit in 2010 includes the extraordinary profits from the sale of Paz amounting to NIS 177 million. This segment includes the Group's share in the profits of companies included on equity basis.

In 2011, a loss from ordinary activities after taxes amounting to NIS 546 million was incurred in the segment, compared with a loss amounting to NIS 276 million last year.

The loss from ordinary activities is mainly explained by the following factors:

a. The decrease in operating income derives from the decline in market value of shares in Partner amounting to NIS 239 million and from a decrease in Electra shares in the amount of NIS 29 million.

b. An increase in operating expenses amounting to NIS 261 million, deriving from an increase in operating expenses that were not loaded on the other activity segments, mainly an increase in liabilities for pension and severance pay as a result of a fall in the profits of severance pay and pension funds, compared with profits in the corresponding period last year, a net effect of an increase in salary expenses of NIS 247 million.

c. A decrease in the Group's share in the profits of companies included on equity basis amounting to NIS 272 million.

Companies included on equity basis (non-banking) (presented in the financial management segment).

The operating results of the Group's real investments are presented in the financial management segment.

Total investments of the Leumi Group in companies included on equity basis totaled some NIS 2,270 million on 31 December 2011, compared with NIS 1,924 million on 31 December 2010.

Investments in the Shares of Companies included on Equity Basis (Table 13 (b) - Basel II):

	Balance sheet value			**Market value**		**Capital adequacy requirements**	
Name of Company	**31 December 2011**	31 December 2010	Change	**31 December 2011**	31 December 2010	**31 December 2011**	31 December 2010
	NIS millions		%	NIS millions			
The Israel Corporation Ltd.	**1,748**	1,635	6.9	**3,291**	5,953	**157**	147
Others	**522**	289	+	**-**	-	**47**	26
Total	**2,270**	1,924	18.0	**3,291**	5,953	**204**	173

The contribution of the companies included on equity basis to the Group's profit in 2011 was positive, amounting to a profit of NIS 148 million, compared with a profit of NIS 420 million for the corresponding period in 2010. The decrease in the contribution to the Group's profit in 2011 arose from a decrease in the profits of the Israel Corporation Ltd. ("the Israel Corporation"), compared to 2010, and from the sale in the holdings in Paz Oil Company Ltd. ("Paz").

The contributions of the companies to the Group's net profit (in NIS millions) are as follows:

	2011	2010	% change
The Israel Corporation Ltd.	**97**	350	-
Paz Oil Company Ltd.	**-**	29	-
Others	**51**	41	24.4
Total	**148**	420	-

Holdings in Real (Non-banking) Holding Corporations (Conglomerates)

The Bank's holdings in real (non-banking) corporations are subject to restrictions prescribed in the Banking (Licensing) Law, 1981 ("the Banking Law"). The Banking Law provides, *inter alia*, in section 24A of the Law, that a banking corporation may hold more than 1% of the means of control in one conglomerate only a "real (non-banking) holding corporation" (a corporation whose capital exceeds some NIS 2,000 million and that operates in more than three branches of the economy). The Bank holds one conglomerate - The Israel Corporation Ltd.

It should be noted that pursuant to the legislation enacted following the reforms in the capital market, a bank is entitled to hold 5% of the equity of an insurance company and 10% of the equity in a corporation that controls an insurance company. In addition, pursuant to the amendment to the Banking Law (Licensing) from March 2010, a bank is entitled to have holdings in only one insurance company where the shareholders' equity, pursuant to Section 35 of the Supervision of Financial Services Law (Insurance), 1981, exceeds NIS 2,000 million.

Avgol Industries 1953 Ltd.

On 29 June 2011, Leumi Partners Ltd. (a wholly-owned company of the Bank) (hereinafter: "Leumi Partners") signed an agreement with Petrochemicals Investments (2006) Ltd., Yehoshua Goldwasser, Music-Net Ltd., Ahai Boneh, Ahai Boneh Holdings Ltd., Avraham Zilberfeld and Avzil Holdings Ltd. (hereinafter "the sellers") for the acquisition from the sellers of a total of 34,253,163 ordinary shares of Avgol Industries 1953 Ltd. (hereinafter "the Company"), representing, as of that date, some 11.26% of the issued and paid-in capital of the Company (in full dilution) and options to purchase 25,317,555 ordinary shares of the Company (hereinafter: "the options"), representing, as of that date, some 8.32% of the issued and paid-in capital if the Company (in full dilution) in consideration of NIS 110 million (hereinafter: "the agreement"). The options are exercisable for a period of three years from the date of signing the agreement in consideration of an exercise price of NIS 3.25 per share, net of dividend. The agreement includes customary rights to protect the investment of Leumi Partners. The transaction pursuant to the agreement was completed on 29 June 2011.

7. "Others" Segment – This segment includes activities not attributed to other segments.

This segment includes the other activities of the Group, each of which does not meet the criteria to be considered a profit segment, pursuant to the directives of the Bank of Israel.

This activity mainly includes a portion of the activities of the capital market companies that is not attributed to other segments. The main companies are Leumi Partners and Leumi Capital Market Services. Leumi Capital Market Services engages mainly in the provision of operating services to management companies in the field of provident funds and in the provision of distribution operating services (monitoring the performance of the counselors' recommendations, receiving answers and forwarding forms) of pension products, including supplementary training funds, for Bank Leumi. In November 2011, the company began providing operating services in the field of mutual funds.

Leumi Capital Market Services provides operating services to 18 management companies. The value of the assets being operated by the company amounted to some NIS 68 billion on 31 December 2011.

In 2011, the profit of the Others segment totaled NIS 254 million, compared with a loss of NIS 10 million in 2010, an improvement of NIS 264 million.

The following table presents a summary of the main changes, in NIS millions:

	2011	2010	Difference
Profit from extraordinary items	**2**	6	(4)
Operating activity at the Bank	**19**	20	(1)
Other companies in Israel	**6**	17	(11)
Companies abroad	**21**	(5)	26
Tax adjustments (1)	**206**	(48)	254
Total	**254**	(10)	264

(1) Tax differentials between the tax calculations in the segments and the effective tax in the consolidated financial statements.

Activities in Products

A. Capital market activities

The Group's activities in the capital market include investment and pension counseling activities, brokerage in the securities and financial instruments market, including activity carried out through the foreign currency dealing rooms and the Israeli and foreign securities dealing rooms, brokerage and custodial and sub-custodial services, and banking and financial services to entities active in the capital market. A subsidiary of Leumi Partners Ltd., Leumi Partners Underwriters Ltd. engages in underwriting and the distribution of private and public offerings. The Group's activity in the capital market was materially affected by the capital market reform.

Net profit from capital market activities totaled NIS 264 million, compared with NIS 355 million in the corresponding period in 2010, a decrease of NIS 91 million. The decrease in the net profit arose from a decrease in the operating income amounting to NIS 74 million and an increase in operating expenses amounting to NIS 68 million

The following table presents data on the activities in the capital market as presented in the various operating segments, including the activities of customers in the capital market, and the results of Leumi Partners Underwriters:

	House-holds	Small businesses	Corporate banking	Commercial banking	Private banking	Financial management and Others	Overseas activities	Total
	2011							
	NIS millions							
Net interest income	**3**	**1**	**-**	**2**	**-**	**5**	**-**	**11**
Operating and other income	**500**	**25**	**20**	**41**	**154**	**104**	**144**	**988**
Total income	**503**	**26**	**20**	**43**	**154**	**109**	**144**	**999**
Operating and other expenses	**304**	**12**	**11**	**33**	**53**	**59**	**131**	**603**
Operating profit before taxes	**199**	**14**	**9**	**10**	**101**	**50**	**13**	**396**
Net profit	**130**	**9**	**6**	**7**	**68**	**33**	**11**	**264**

	House-holds	Small businesses	Corporate banking	Commercial banking	Private banking	Financial management and Others	Overseas activities	Total
	2010							
	NIS millions							
Net interest income	2	1	-	2	-	6	-	11
Operating and other income	539	26	26	50	157	113	151	1,062
Total income	541	27	26	52	157	119	151	1,073
Operating and other expenses	254	9	8	43	56	40	125	535
Operating profit before taxes	287	18	18	9	101	79	26	538
Net profit	185	12	12	6	67	53	20	355

B. Credit cards - Leumi Card

This activity is carried out by the subsidiary, Leumi Card, and includes mainly the activity of issuing and operating credit cards to customers, providing financial services and solutions to cardholders and providing clearing and payment securing services against transactions executed by credit cards .

Leumi Card was established at the beginning of 2000 and has licensing agreements with the international Visa and MasterCard organizations, under which Leumi Card received licenses for the issuance of Visa cards and MasterCard cards.

As from 2001, Leumi Card has operated as the company issuing credit cards under the brand names, "Visa" and "MasterCard".

Leumi Card, Bank Leumi and Arab Israel Bank Ltd. (""Arab Israel Bank") jointly issue the credit cards to their customers. In addition, Leumi Card independently issues credit cards to customers of all of the banks, the majority of these customers being members of various clubs. In addition, Leumi Card operates in the field of clearing transactions under the brand names, "Visa" and "MasterCard" for businesses.

The slowdown in the rate of growth of economic activity was also felt in the credit card sector, and according to data from the Central Statistical Bureau, the comparison between 2011 and 2010 indicates a slowdown in the growth rate of purchasing cyclers by credit card. A growth rate of 3.7% in fixed prices in 2011, compared with 8.2% in 2010.

During 2011, Leumi Card continued to offer card holders a range of financial services and solutions.

The "revolving credit" credit card continues to be Leumi Card's leading product and the company has expanded its activity in issuing club cards.

To date, the company has issued more than 2 million cards under the brand names, Visa and MasterCard.

The activity turnover of the cards in Leumi Card increased by 7.3% in 2011, compared to 2010.

The company offers business customers a range of services in the area of credit, including: clearing services, securing payment against vouchers for transactions made by credit card in exchange for a commission collected from a business, credit products offered to businesses within the framework of the clearing activity, such as: loans, discounting of vouchers and advancing payments.

In addition, the company expanded its services in the field of Business-to-Business payments. Pursuant to these services, the company offers its customers an efficient and innovative tool to manage financial activity between a supplier and its customers through a payment system developed in Leumi Card.

Profitability

The income of Leumi Card, before operating, marketing, administrative and general expenses, totaled some NIS 938 million in 2011, compared with some NIS 876 million in 2010.

Leumi Card ended 2011 with a net profit of NIS 177 million, compared with NIS 158 million in 2010, an increase of some 12.0%.

The following table presents data on credit card activities as presented in the various operating segments:

	Households	Small businesses	Corporate banking	Commercial banking	Private banking	Total
	2011					
	NIS millions					
Net interest income	**186**	**18**	**19**	**7**	**-**	**230**
Operating and other income	**692**	**54**	**78**	**30**	**2**	**856**
Total income	**878**	**72**	**97**	**37**	**2**	**1,086**
Expenses in respect of credit losses	**21**	**(2)**	**(3)**	**(1)**	**-**	**15**
Operating and other expenses	**608**	**50**	**74**	**27**	**3**	**762**
Operating profit (loss) before taxes	**249**	**24**	**26**	**11**	**(1)**	**309**
Operating profit (loss) after taxes	**177**	**17**	**20**	**8**	**(1)**	**221**
Net operating profit attributable to non-controlling interests	**(28)**	**(2)**	**(4)**	**(1)**	**-**	**(35)**
Net profit (loss)	**149**	**15**	**16**	**7**	**(1)**	**186**

	Households	Small businesses	Corporate banking	Commercial banking	Private banking	Total
	2010					
	NIS millions					
Net interest income	161	17	19	7	-	204
Operating and other income	678	48	65	25	2	818
Total income	839	65	84	32	2	1,022
Expenses in respect of credit losses	21	3	5	2	-	31
Operating and other expenses	563	46	67	24	3	703
Operating profit (loss) before taxes	255	16	12	6	(1)	288
Operating profit (loss) after taxes	182	11	9	4	(1)	205
Net operating profit attributable to non-controlling interests	(28)	(1)	(2)	(1)	-	(32)
Net profit (loss)	154	10	7	3	(1)	173

Interchange Fee

For information see Note 18 (K)(2) of the financial statements.

C. Construction and real estate

This activity includes the activity in the field of construction and real estate in the Bank's various operating segments.

For further details see pages 158 under the operating segments.

The following table sets out data regarding construction and real estate activities, as presented in the various operating segments:

	Small businesses	Corporate banking	Commercial banking	Private banking	Overseas activity	Total
	2011					
	NIS millions					
Net interest income	**211**	**675**	**218**	**13**	**143**	**1,260**
Operating and other income	**53**	**94**	**34**	**8**	**12**	**201**
Total income	**264**	**769**	**252**	**21**	**155**	**1,461**
Expenses in respect of credit losses	**17**	**317**	**43**	**1**	**57**	**435**
Operating and other expenses	**106**	**133**	**71**	**10**	**50**	**370**
Operating profit before taxes	**141**	**319**	**138**	**10**	**48**	**656**
Net profit	**92**	**209**	**89**	**7**	**31**	**428**

	Small businesses	Corporate banking	Commercial banking	Private banking	Overseas activity	Total
	2010					
	NIS millions					
Net interest income	178	780	205	6	152	1,321
Operating and other income	45	67	28	4	16	160
Total income	223	847	233	10	168	1,481
Expenses in respect of credit losses	22	299	44	-	52	417
Operating and other expenses	95	122	62	6	77	362
Operating profit before taxes	106	426	127	4	39	702
Net profit	69	275	81	3	22	450

Profit centers in the Group

The following table presents details on the contribution of the Group's principal profit centers to the net operating profit:

	2011(1)	2010(1)	Change	**2011(2)**	2010(2)	Change
	NIS millions		%	NIS millions		%
The Bank (3)	**1,143**	1,260	(9.3)	**957**	1,433	(33.2)
Consolidated companies in Israel (4) (3)	**432**	639	(32.4)	**432**	639	(32.4)
Consolidated companies abroad (5)	**209**	(103)	+	**395**	(276)	+
Companies including on equity basis (4)	**105**	355	+	**105**	355	+
Net operating profit (3) (6)	**1,889**	2,151	(12.2)	**1,889**	2,151	(12.2)
Profit of the subsidiaries abroad, in nominal terms (US$ millions) (7)	**47.5**	14.5	+	**47.5**	14.5	+

(1) Translation adjustments in respect of overseas investments were offset against translation adjustments of the sources of financing at the Bank after the effect of taxes.
(2) According to the Financial Statements.
(3) 31 December 2010 data have been restated in accordance with the directive of the Supervisor of Banks, see below Note 1s.2.
(4) Companies including on equity basis of subsidiaries in Israel were included in consolidated subsidiaries in Israel.
(5) Following particular adjustments to Israeli accounting principles.
(6) After canceling the effect of special salary expenses, net operating profit fell by NIS 106 million.
(7) As reported by the subsidiaries abroad.

Following are the principal changes in the contributions of the profit centers (after translation adjustments):

- The decrease in operating profit after taxes in the Bank derives from an increase in credit loss expenses and from an increase in operating expenses, mainly in salary expenses that were partially offset by a decrease in tax expenses. Most of the explanations for the above changes are presented as part of the discussion on the Group's results.

  For further information, see page 75.

- The decrease in the net operating profit of consolidated companies in Israel derive mainly from a fall in the profits of Leumi Partners and Leumi Real Holdings, which was partly offset by an increase in profits of Leumi Mortgage Bank, Arab Israel Bank, Leumi Card and Leumi Leasing and Investments.
- The increase in the profit of overseas subsidiaries derives from an increase in the profit of the subsidiaries, as well as positive exchange rate differentials in respect of overseas investments, compared to negative exchange rate differentials in the corresponding period last year.
- The decrease in the profit of companies included on equity basis derives from a fall in the profit of the Israel Corporation.

The operating profit from overseas units in nominal terms as published by those entities in the convenience translation to the U.S. dollar amounted to some US$ 47.5 million, an increase of US$ 33.0 million, compared to the corresponding period last year. The contribution of the overseas units in shekels and with certain adjustments for Israeli accounting principles, amounted to a profit of NIS 395 million, compared to a loss of NIS 276 million in the corresponding period last year. After offsetting the impact of exchange rate differentials in respect of the cost of sources of finance, net, the profit of the overseas units amounted to NIS 209 million compared to a loss of NIS 103 million in the corresponding period last year, an increase of NIS 312 million which derives mainly from the positive exchange rate differentials in respect of overseas investments, as a result of the devaluation of the shekel in relation to foreign currencies, an increase in the profitability of a few overseas units as specified below. In the whole of 2011, there were positive exchange rate differentials amounting to NIS 274 million compared to negative exchange rate differentials of NIS 251 million in the corresponding period last year.

With effect from 1 January 2012, the Bank has applied IAS 21, and within this context, it was decided that exchange rate differentials in respect of the investment in subsidiaries in the United States and in Switzerland will be recognized in other comprehensive income and presented in a capital reserve and the exchange rate differentials in respect of investments of the other foreign subsidiaries will be recognized within profit and loss.

The Bank

The decrease in net operating profit is due mainly to:

- a decrease in net interest income amounting to NIS 504 million
- an increase in expenses in respect of credit losses amounting to NIS 260 million.
- an increase in operating and other expenses amounting to NIS 391 million.

On the other hand, the following items partially offset these decreases:

- an increase in operating income amounting NIS 19 million.
- a decrease in provisions for taxes amounting to NIS 660 million, of which NIS 302 million is the result of the increase in deferred taxes.

Subsidiaries in Israel

The decrease in net operating profit of consolidated companies in Israel is due mainly to a decrease in the profits of Leumi Partners amounting to NIS 278 million, mostly as a result of recording declines in the value of shares amounting to NIS 268 million, which was partly offset by an increase in the profits of Leumi Mortgage Bank amounting to NIS 26 million, an increase in the profits of Leumi Card amounting to NIS 15 million and a increase in the profit of Arab Israel Bank amounting to NIS 33 million.

Subsidiaries Abroad

The increase in the profit of subsidiaries abroad derives from an increase in the profitability of the subsidiaries in the United States and the United Kingdom and Leumi Re. The total contribution to profit of the overseas subsidiaries (excluding branches) as a convenience translation to U.S. dollars amounted to some US$ 46.2 million, compared with some US$ 14.9 million in the corresponding period last year. The overseas subsidiaries' contribution to net operating profit in shekels and with certain adjustments to Israeli accounting principles, and after offsetting exchange rate differentials in respect of sources of financing after the effect of taxes, amounted to a profit of NIS 209 million, compared with a loss of NIS 103 million in the corresponding period last year. Excluding the effect of exchange rate differentials in respect of the cost of financing sources, net, the profit in the overseas subsidiaries amounted to NIS 395 million, compared with a loss of NIS 276 million in the corresponding period last year.

The following table presents a summary of the aforesaid data:

	For the year ended December 31	
	2011	2010
	NIS millions	
Operating profit (loss) of the subsidiaries in shekels (the Group's share) from ordinary activities	**121**	(25)
Exchange rate differentials in respect of the investment	**274**	(251)
Exchange rate differentials in respect of the net cost of the sources of financing, after tax	**(186)**	173
Total contribution of the subsidiaries (after offsetting the net cost of the sources of financing)	**209**	(103)
Total contribution of the subsidiaries without offsetting the cost of the sources of financing	**395**	(276)

For further details about the subsidiaries, see pages 200.
See above regarding "Handling of exchange rate differentials" effective 1 January 2012.

Companies included on equity basis

The decrease in the profits of companies included on equity basis is due to the decrease in the profits of the Israel Corporation.

For further details, see page 180.

Activities according to the Group's Structure

The volume of activities in Israel rose in 2011 by 10.6%, and abroad, it rose by 19.0%.

Credit to the public in activities in Israel totaled some NIS 214.4 billion at the end of 2011, compared with NIS 200.4 billion at the end of 2010, an increase of 7.0%. Credit to the public in overseas activities totaled some NIS 27.0 billion at the end of 2011, compared with NIS 23.6 billion at the end of 2010, an increase of 14.2%.

Deposits of the public in activities in Israel totaled some NIS 245.9 billion at the end of 2011, compared with NIS 223.1 billion at the end of 2010, an increase of 10.2%. Total deposits in overseas activities totaled some NIS 33.5 billion at the end of 2011, a decline of 26.5%.

Information according to geographical regions*:

The following table presents principal data according to geographical regions (in NIS millions):

	Total Balance Sheet			Credit to the Public			Deposits of the Public		
	2011	2010	Change	**2011**	2010	Change	**2011**	2010	Change
Region			%			%			%
Israel	**325,272**	294,216	10.6	**214,356**	200,360	7.0	**245,948**	223,142	10.2
United States	**21,765**	18,523	17.5	**14,785**	12,544	17.9	**16,783**	14,083	19.2
United Kingdom	**9,051**	8,223	10.1	**7,696**	6,899	11.6	**5,683**	5,612	1.3
Switzerland	**4,259**	4,574	(6.9)	**2,312**	2,544	(9.1)	**4,960**	3,362	47.5
Luxembourg	**779**	954	(18.3)	**336**	287	17.1	**2,069**	2,175	(4.9)
Romania	**1,230**	1,268	(3.0)	**812**	900	(9.8)	**726**	692	4.9
Others abroad	**3,498**	564	+	**1,023**	447	128.9	**3,235**	518	+
Total	**365,854**	328,322	11.4	**241,320**	223,981	7.7	**279,404**	249,584	11.9

* Classified according to the location of the office.
For details regarding exposures to foreign countries, see the Management Review, Exhibit F of the Report.

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

Region	Net Profit NIS millions 2011	2010	Change %
Israel [(1)]	**1,489**	2,613	(43.0)
United States [(2)]	**213**	(94)	+
United Kingdom [(3)]	**102**	(29)	+
Switzerland [(4)]	**53**	34	55.9
Luxembourg [(5)]	**23**	(4)	+
Romania [(6)]	**(21)**	(181)	+
Others abroad [(7)]	**32**	(5)	+
Total	**1,891**	2,334	(19.0)

The profit from activities abroad is shown according to their contribution in the consolidated financial statements.

1. Net profit in Israel decreased by some NIS 1,124 million. Operating profit after tax at the Bank in Israel decreased due to the reasons detailed on page 75 above.

   The net profit also increased at a number of subsidiaries in Israel, mainly: Leumi Mortgage Bank, Arab Israel Bank and Leumi Card. On the other hand, the decrease in the profits of Leumi Card offset the above mentioned improvements.
2. The profits of the subsidiary in the United States increased in U.S. Dollar terms relative to the corresponding period last year, as well as in local currency terms, when translated to Shekels, as a result of the positive exchange rate differentials as a result of a devaluation of the shekel against the dollar.
3. The profit of the subsidiary in the United Kingdom increased relative to the corresponding period last year.
4. The fall in profits of the subsidiary in Switzerland in nominal terms derives mainly from an increase in the operational expenditures in comparison with corresponding period last year, and a fall in income, as a result of an appreciation of the Swiss franc against the dollar.
5. The increase in the profit of the subsidiary in Luxembourg derives from the devaluation of the shekel against the euro.
6. The decrease in loss of the subsidiary in Romania derives from a decrease in the allowances for credit losses.
7. The profit relates mainly to Leumi Re, as a result of an increase in profit and a devaluation of the shekel against the dollar.

For further details, see Note 28B to the Financial Statements.
For further details on the profits of the subsidiaries abroad, as reported by them, see below, on page 197.

Major Investee Companies*

The Leumi Group operates in Israel and abroad through subsidiaries which are: banks, a mortgage bank, finance companies and financial services companies. The Group also invests in non-banking corporations operating in the fields of insurance, infrastructure, food and real estate.
(See page 180 with regard to investments in non-banking corporations).

The Bank's total investments in subsidiaries and affiliates amounted to NIS 16,870 million on 31 December 2011, compared with NIS 15,278 million on 31 December 2010, and their contribution to the Group's net profit amounted to NIS 932 million, compared with NIS 718 million in 2010. After translation adjustments in respect of overseas investments, their contribution to the net profit was NIS 746 million, compared with NIS 891 million in 2010.

- For a definition of investee companies, see Note 1(B) to the financial statements.

The following table sets out the breakdown of the contribution of the Bank and its subsidiaries and affiliates to the net profit of the Group:[1]

		Return on Group's Investment		Contribution [1] to Group's Net Profit		
		2011	2010	**2011**	2010	Change
		%	%	NIS millions		%
The Bank [2] [4]		**11.5**	12.4	**1,147**	1,264	**(9.3)**
Consolidated subsidiaries in Israel, total [4]		**6.1**	12.3	**432**	822	**(47.4)**
of which:	Leumi Mortgage Bank [4]	**7.6**	7.0	**203**	177	**14.7**
	Arab Israel Bank [4]	**30.7**	21.8	**108**	75	**44.0**
	Leumi Card	**17.7**	17.9	**142**	127	**11.8**
	Leumi Partners [3]	**-**	36.5	**(114)**	164	**-**
	Leumi Securities and Investments	**5.8**	4.9	**2**	4	**-**
	Leumi Capital Market Services Ltd.	**27.1**	16.3	**7**	10	**(30.0)**
	Leumi L.P. Ltd.	**0.8**	1.3	**-**	1	**-**
	Leumi Real Holdings	**2.2**	30.8	**19**	227	**-**
	Leumi Industrial	**1.5**	1.0	**2**	1	**+**
	Leumi Agricultural	**1.2**	0.5	**1**	-	**+**
	Leumi Finance	**7.5**	6.2	**12**	10	**20.0**
	Leumi Leasing and Investments	**3.8**	1.9	**35**	17	**+**
	Others	**2.7**	2.0	**15**	9	**66.7**
Overseas consolidated subsidiaries, total [2]		**5.0**	-	**209**	(107)	**+**
of which:	Leumi USA (BLC)	**4.0**	-	**93**	(2)	**+**
	Leumi (UK)	**11.4**	2.0	**72**	12	**+**
	Leumi Switzerland	**3.8**	3.6	**25**	21	**19.0**
	Leumi Luxembourg	**15.9**	10.8	**19**	11	**72.7**
	Leumi Romania	**-**	-	**(27)**	(150)	**+**
	Leumi Re	**30.1**	1.4	**25**	1	**+**
Companies included on equity basis, total		**6.0**	23.7	**103**	355	**-**
Group's total net profit (4)		**8.3**	10.3	**1,891**	2,334	**(19.0)**

(1) The profit (loss) shown is according to the Group's share in the results.
(2) Translation adjustments in respect of overseas investments were offset against translation adjustments of the financing sources at the Bank after the effect of taxes. For details on profitability without the offset of translation adjustments see below on page 197.
(3) Including the profit and/or loss companies included on the equity basis of Leumi Partners.
(4) Data as at 31 December 2010 have been restated in accordance with the directives of the Supervisor of Banks, see note 1s.2 below.
See Note 28 to the Financial Statements for further details.
See Note 6 to the Financial Statements concerning the investment in and contribution to Group profit of each of the major companies.

Consolidated companies in Israel

The Bank's total investments in consolidated subsidiaries in Israel amounted to NIS 7,203 million on 31 December 2011, compared with NIS 7,101 million on 31 December 2010. Their contribution to Group net operating profit amounted to some NIS 432 million in 2011, compared with NIS 639 million in 2010, a decrease of NIS 207 million, or 32.4%. The decrease in profit stems mainly from a loss by Leumi Partners, which was partially offset by an increase in the profits of Leumi Mortgage Bank, Arab Israel Bank and Leumi Card. The Group’s return on its investment in the consolidated companies in Israel was 6.1% in 2011 compared with 12.3% in 2010.

Financial and other data concerning the major consolidated subsidiaries is presented below on the basis of their financial statements:

The Arab Israel Bank Ltd.

The Arab Israel Bank was established in 1960 with the object of providing financial services to, and providing solutions for, the special requirements of the Arab population.

The Arab Israel Bank operates through two districts (North and South Galilee and the Triangle) and 31 branches, situated mainly in the north of Israel and in the northern Triangle, and serves the Arab population. Arab Israel Bank engages in the entire range of banking activities. The Arab Israel Bank's total assets amounted to NIS 5,761 million at the end of 2011, compared with NIS 5,164 million at the end of 2010. Net profit of the Arab Israel Bank totaled NIS 109 million in 2011, compared with NIS 75 million in 2010, an increase of 45.3%. The net return on shareholders' equity reached 30.2% in 2011, compared with 21.2% in 2010.

Shareholders' equity of the Arab Israel Bank amounted to NIS 424 million as at 31 December 2011, compared with NIS 337 million as at 31 December 2010.

The ratio of equity to risk assets as at 31 December 2011, reached 15.60%, as compared with 14.61 % as at 31 December 2010.

The Arab Israel Bank receives comprehensive operating and financial services from the Bank. In consideration for the services received from the Bank, the Arab Israel Bank paid the Bank NIS 41 million in 2011, compared with NIS 42 million in 2010.

On 1 July 2011, an organizational change was made in the bank's structure. A risk management division was established and a chief risk officer (CRO) was appointed to the bank with the rank of a member of management. On 1 September 2011, a Customer Deposit and Investment Consulting Division was established, headed by a general manager with the rank of a member of management.

Since the beginning of 2011, and as a part of the implementation of the strategic work plan, the Bank has been operating on a number of levels to strengthen the bank in the Arab sector.

Medium and Long-Term Financing Companies [(1)]

The assets of these companies amounted to NIS 19.6 billion at the end of 2011, compared to NIS 16.0 billion in 2010. The business activity of these companies complements the activity of the Bank. The net profit of these companies amounted to some NIS 30 million in 2011, compared with NIS 28 million in 2010.

(1) Including: Leumi Industrial, Leumi Agricultural Development, Leumi Finance Company and Leumi Leasing and Investments Ltd.

Below are details concerning the main companies:

Leumi Leasing & Investments Ltd.

The company finances the acquisition of equipment for medium and long term periods.

The balance of credit to the public totaled NIS 981 million as at 31 December 2011, compared with NIS 1,002 million at the end of 2010.
The company's total assets totaled NIS 1,113 million as at 31 December 2011, compared with NIS 1,082 million at the end of 2010.
The net profit in 2011 totaled NIS 35 million, compared with a profit of NIS 17 million in 2010.

Leumi Finance Company Ltd.

The company engages in the raising of sources in Israel for the Bank through issues to the public and private placements of notes. The proceeds of these issues are deposited in the Bank for its use, at its discretion and its responsibility.

Total assets of the company amounted to NIS 18,307 million at the end of 2011, compared with NIS 14,762 million at the end of 2010. Shareholders' equity amounted to NIS 157.7 million as at 31 December 2011. The company's net profit amounted to NIS 11.8 million in 2011, compared to NIS 9.6 million in 2010.

The Bank has undertaken to indemnify Leumi Finance in respect of amounts that it is unable to pay, in respect of the indemnity that it granted to its directors and other officers and also to the lawyers of the said issues, with regard to these issues.

See page 32 above regarding the issue of capital notes by the company.

Leumi Industrial Development Ltd.

Leumi Industrial Development's total assets amounted to some NIS 106 million at the end of 2011, compared to some NIS 104 million at the end of 2010. Shareholders' equity amounted to NIS 105.7 million as at 31 December 2011. The net profit of Leumi Industrial Development amounted to NIS 1.6 million in 2011, compared with a net profit of NIS 1.0 million in 2010.

Leumi Agricultural Development Ltd.

Leumi Agricultural Development's total assets amounted to NIS 100.2 million at the end of 2011, compared to NIS 98.7 million at the end of 2010. Shareholders' equity amounted to NIS 100.2 million as at 31 December 2011. The net profit of Leumi Agricultural Development amounted to NIS 1.4 million in 2011, compared with NIS 0.7 million in 2010.

Leumi Mortgage Bank Ltd.

Leumi Mortgage Bank was founded in 1921 and is the oldest mortgage bank in Israel.

Leumi Mortgage Bank concentrates its activities mainly on the granting of loans to apartment purchasers, loans for construction and renovation of real estate and loans for any financing purpose on the basis of the pledge of an existing residential property. The main sources for the financing of its activity are provided by the Bank (the parent company) and the total of deposits that the Bank had made available to Leumi Mortgage Bank as at 31 December 2011 amounted to NIS 44 billion.

Total credit to the public at Leumi Mortgage Bank was NIS 56 billion at the end of 2011, compared with NIS 51 billion at the end of 2010, an increase of 9.8%. This amount does not include credit from deposits according to the extent of collection totaling NIS 5 billion, compared with NIS 6 billion at the end of 2010, which, in accordance with the directives of the Supervisor of Banks, may not be included in the balance sheet as the balance of credit to the public.

Leumi Mortgage Bank's share in providing new loans from the entire mortgage banking system in 2011, according to the Bank of Israel report on activities, was 22.2%, compared with 24.2% in 2010.

Leumi Mortgage Bank's total assets amounted to NIS 57 billion on 31 December 2011, compared with NIS 51 billion at the end of 2010, an increase of 11.8%.

The following table presents data on the performance of new loans provided and loans refinanced for the purchase of residential apartments, and of collateralization of residential apartments.

	2011	2010	Change
	NIS millions		%
From Leumi Mortgage Bank funds	**11,062**	13,261	(16.6)
From Ministry of Finance funds:			
Loans	**15**	33	(54.5)
Bullet loans	**4**	5	(20.0)
Total new loans	**11,081**	13,299	(16.7)
Refinanced loans	**1,182**	1,351	(12.5)
Total performance	**12,263**	14,650	(16.3)

The net profit of Leumi Mortgage Bank amounted to NIS 203 million in 2011, compared with NIS 176 million in 2010, an increase of 15.3%. The net return on shareholders' equity came to 7.6% in 2011, compared with 6.9% in 2010.

Shareholders' equity of Leumi Mortgage Bank amounted to NIS 2,770 million at the end of 2011, compared with NIS 2,642 million at the end of 2010, an increase of 4.8% deriving from the accumulation of net profit.

The capital adequacy ratio reached 12.88% at the end of 2011, compared with 13.92% at the end of 2010. The minimum rate required by the Supervisor of Banks is 9.0%.

Leumi Mortgage Bank operates through representative offices spread throughout the country and its operations in Leumi branches (93 mortgage desks) and through 11 independent representative offices.

In consideration for the use of the Bank's branches, and the use of communications and other services, Leumi Mortgage Bank paid NIS 41 million to the Bank in 2011, compared with NIS 43 million in 2010.

On 22 January 2012, the Board of Directors of the Bank approved management's intention to effect the merger of Leumi Mortgage Bank, a wholly-owned and controlled subsidiary of the Bank, with the Bank.

In the resolution, it was provided that the Bank's intention is that all of the business of Leumi Mortgage Bank will be absorbed into the Bank's business, maintaining an organizational focusing of mortgages, strengthening the synergy with the Bank's activities.

This process will enable the Bank to grant retail customers a proposal of value according to his basket of requirements, while reducing the expenses of the Group and more effectively utilizing its yields.

The mortgage activity will be centralized in the banking division of the Bank in a separate section that will operate within the existing organizational structure of Leumi Mortgage. In the framework of the section there will be 110 representative mortgages offices in branches of the Bank.

The Bank intends to complete the merger by the end of 2012.

In carrying out the merger as above, there will be no effect on the consolidated financial statements on the date of the merger.

It is clarified that the merger is subject to the receipt of the necessary confirmations from the authorized officials in the Bank and in Leumi Mortgage Bank and the relevant authorities.

Regarding legal claims against Leumi Mortgage Bank – see Notes 18 G(3) to G(4) to the Financial Statements.

Leumi Partners Ltd.

Leumi Partners is the non-banking investments vehicle of the Leumi Group and specializes in providing a full range of investment banking services, business and financial services, capital raising and investments, mergers and acquisitions services, underwriting, organizing public and private issues, economic advice and appraisals. With regard to underwriting services, see paragraph C below.

Leumi Partners and its subsidiaries employ 36 employees, most of whom are economists, accountants or graduates in other subjects.

Leumi Partners finished 2011 with a loss of NIS 108 million, compared with a profit of NIS 160 million in 2010. The loss arises mainly from recording a provision for impairment amounting to NIS 239 million in respect of the investment in Partner Ltd.

Shareholders' equity as at 31 December 2011 totaled NIS 446 million, compared with NIS 617 million at the end of 2010.

Below are details concerning developments and main fields of activity:

A. Investments in non-banking companies

Leumi Partners is responsible for the management of the non-banking investment portfolio of the Leumi Group.

Leumi Partners engages in initiating, locating and carrying out direct investments in businesses and companies. Leumi Partners has invested in 50 companies, venture capital funds and private equity funds active in the fields of hi-tech, communications, commerce and real estate. The balance of the investments and undertakings to invest in these companies and businesses as at 31 December 2011 amounted to some NIS 239 million.

The non-banking investment policy of the Leumi Group is in line with the restrictions of the Banking (Licensing) Law, and therefore includes minority holdings up to 20% of all means of control, and without control. The Group focuses on investments with the potential for long-term returns.

Leumi Partners invests in non-banking corporations as an auxiliary corporation under the provisions of the Banking (Licensing) Law.

Since it is unable to control the companies in which it has invested in the light of the law's restrictions, Leumi Partners stringently examines the quality of the management, the strength of the partners and the nature of the investment.

B. Investment banking services

Leumi Partners assists its customers in executing merger and acquisition (M&A) transactions. The services are provided to Israeli and foreign companies wishing to effect strategic expansion by way of acquisition, or to investors or controlling shareholders interested in selling or reducing their investments.

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

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

C. Underwriting and management of issues

The subsidiary company Leumi Partners Underwriting Ltd. engages in the management and underwriting of private and public issues of securities in the capital market in Israel.

In 2011, Leumi Partners Underwriting was one of the leading underwriters in the Israel market. Leumi Partners Underwriting participated in public issues for a total amount of some NIS 23.5 billion, and led 13 public issues for a total of some NIS 7.6 billion.

For expected changes in the regulation in the area of underwriting, see page 55.

D. Economic analyses and appraisals

The subsidiary Leumi Partners Research engages in economic analyses, economic appraisals and financial counseling for economic entities in the Israeli economy.

The company prepares economic studies and valuations for the purposes of capital raising, the examination of investments and the extension of credit.

In addition, the company reviews the large companies traded on the Israeli capital market on an ongoing basis as well as many Israeli companies traded on NASDAQ, for Bank Leumi and for institutional entities.

E. Leumi Start Venture Capital Fund

Leumi Partners manages the Leumi Start Venture Capital Fund Ltd. through the management company Leumi Start Management (2000) Ltd. (a wholly-owned subsidiary). The two companies were established in 2000. Leumi Start Ltd. is a fund which invests in venture capital funds through a Fund of Funds structure, which has raised some NIS 65.5 million from private customers and the Bank, and has invested in five venture capital funds. The state of the fund is influenced by the state of the companies and the technological ventures in which the venture capital funds have been invested, the state of the economy worldwide and of the technology sector in particular.

The Bank Leumi le-Israel Trust Co. Ltd.

This company, founded in 1939, provides a range of trust services which address the business and personal needs of its customers. In the capital market field, the company serves as trustee of issues of debentures and exchange traded certificates, and also as a trustee of pledged shares. Other fields of activity in which the company engages: trusteeship of financial assets for Israeli and foreign residents, management of real estate assets (including buying and selling), escrow accounts – supervision of agreement implementation, managing private and public funds, executing wills and administering estates and representation at general meetings of companies.

The company's income from trust business for 2011 amounted to NIS 13.4 million compared with NIS 13.9 million in 2010. The company's net profit in 2011 amounted to NIS 4.6 million, compared with NIS 4.9 million in 2010.

For information on the legal claims against the Trust Co., see Note 18(g)(3) in the Financial Statements.

Competition

The company's main competitors are trustee companies of large accounting/law firms, some of the banking trustee companies and other entities providing trust services.

Customers

The company provides services to a range of customers; to private customers, Israeli and overseas residents, it provides services in the fields of financial asset management, real-estate management and the execution of wills and the management of estates; to business customers, companies and institutional bodies it provides trust services for issues of debentures and ETF certificates, pledges on shares and representation at general meetings of companies.

Trust Business

In addition to the Bank Leumi le-Israel Trust Co. Ltd. mentioned above, a number of additional companies in the Group also engage in trust services, a subsidiary of Bank Leumi (UK) in the Island of Jersey and Bank Leumi USA.

The trust activities in the Group yielded the following income:

- Trusteeship for monies, securities, and real estate, some NIS 15.1 million (NIS 15.0 million in 2010)
- Estate and property management: , some NIS 0.9 million (NIS 1.0 million in 2010)
- Agent for deposits and loans, share transfers, and management of investment accounts, some NIS 5.9 million (NIS 7.7 million in 2010)
- Trustee for debenture and mutual fund holders, some NIS 4.7 million (NIS 4.4 million in 2010)

Overseas Consolidated Companies, Branches and Agencies

The Group's international activity is carried out by a network of investee companies, branches, agencies and representative offices spread across 17 countries in 61 offices and branches. The Bank's main subsidiaries are located in the world's most important financial centers: New York, London, Zurich and Luxembourg.

The Group’s deployment overseas is operated in order to maximize the potential for business with Israeli corporate customers, local middle-market customers operating in sectors of the economy in which Leumi has the expertise, know-how and resources needed to provide financial services, international entities operating in Israel and the local Jewish communities in the places where the units and representative offices are located. The Bank’s major overseas target population is commercial companies and wealthy private customers. These customers receive a range of services, such as private banking services, investment financing, foreign trade and transactions in foreign currency and their derivatives. The cooperation between the overseas units and the Bank in Israel and amongst the overseas units enables maximum utilization of the relative advantage of each and every unit.

At the same time as continuing the implementation of the strategic aim of expanding the Bank's international activity and as an integral part thereof, the Bank is strengthening the monitoring and control of its overseas units.

The International and Private Banking Division carries out routine monitoring, analysis, identification, mapping and evaluation of material focuses of risk in the overseas subsidiaries. Quarterly reports on ongoing developments and special findings are sent to the management every quarter and to the Board of Directors every six months. The risk management in the overseas subsidiaries is coordinated with the bank’s risk managers.

The Bank's total investment in overseas units at the end of 2011 amounted to NIS 4,754 million, compared with NIS 3,986 million at the end of 2010.

The following table sets out the contributions of the major overseas consolidated companies to the Group’s net profit:

	Yield on the Group’s investment for the year ended 31 December				Contribution to the Group's profit for the year ended 31 December					
	2011*	2010*	2011**	2010**	2011*	2010*	2011**	2010**	Rate of change	
	%		%		NIS millions				%*	%**
Leumi USA (B.L.C.)	**4.0**	-	**9.0**	-	**93**	(2)	**210**	(96)	**+**	**+**
Leumi UK	**11.4**	2.0	**16.1**	-	**72**	12	**102**	(29)	**+**	**+**
Leumi Switzerland	**3.8**	3.6	**8.2**	5.7	**25**	21	**53**	34	**19.0**	**55.9**
Leumi Luxembourg	**15.9**	10.8	**18.6**	1.3	**19**	11	**22**	1	**72.7**	**+**
Leumi Re	**30.1**	1.4	**35.5**	-	**25**	1	**29**	(2)	**+**	**+**
Leumi Romania	**-**	-	**-**	-	**(27)**	(150)	**(21)**	(181)	**+**	**+**
Others	**2.3**	-	**0.3**	-	**2**	-	**-**	(7)	**+**	**+**
Total of overseas consolidated companies	**5.0**	-	**9.5**	-	**209**	(107)	**396**	(280)	**+**	**+**

* Translation adjustments in respect of the overseas investments have been set-off against the translation adjustments in respect of the Bank’s sources of finance after the effect of tax amounting to NIS (186) million (NIS 173 million in the corresponding period in 2010).

** According to the financial statements.

With regard to the treatment of translation adjustments in respect of foreign investments since 1 January 2012, see Note (1).

The following amounts were offset:

	For the year ended 31 December			For the year ended 31 December		
	2011			2010		
	Exchange rate differentials on investment	Setoff of exchange rate differentials on the financing after tax	Total	Exchange rate differentials on investment	Setoff of exchange rate differentials on the financing after tax	Total
	NIS millions					
Leumi USA (B.L.C.)	**174**	**(117)**	**57**	(138)	94	(44)
Leumi UK	**43**	**(30)**	**13**	(60)	41	(19)
Leumi Switzerland	**41**	**(28)**	**13**	18	(12)	6
Leumi Luxembourg	**5**	**(3)**	**2**	(15)	10	(5)
Leumi Romania	**8**	**(6)**	**2**	(44)	31	(13)

The contribution of the consolidated overseas companies, including the effects of exchange rate differentials in respect of the investment, to the Group's reported net profit in shekels in 2011 amounted to a profit of NIS 395 million, compared with a loss of NIS 280 million in 2010.

The change in the contribution to profit derives mainly from the effect of the devaluation of the shekel against most currencies. The net effect of the exchange rate differentials was to increase the profit by NIS 274 million in 2011 compared with a NIS 251 million increase of losses in 2010. The net financing expenses of the Bank, which partially offset these exchange differentials, amounted to some NIS 186 million in 2011 compared with income of NIS 173 million in 2010.

The following table sets out a summary of the above data:

	For the year ended 31 December	
	2011	2010
	In NIS millions	
The units' profits (losses) in shekels (the Group's share) of operating activities	**121**	(25)
Exchange rate differentials in respect of the investment	**274**	(251)
Total	**395**	(276)
Exchange rate differentials in respect of the cost of sources of finance, net	**(186)**	173
Total contribution of the units (after offsetting the sources of finance, net)	**209**	(103)

The following table sets out details of the net profit (loss) of the overseas units, as reported by them:

	2011	2010	Change
	In millions		%
Leumi US (BLC) - $	**17.3**	14.8	16.9
Of which: Bank Leumi USA ($)	**20.1**	15.8	27.2
Bank Leumi UK (£)	**12.1**	6.4	89.1
Bank Leumi Switzerland (CHF)	**3.6**	6.5	(44.6)
Bank Leumi Luxembourg (euro)	**3.6**	3.3	9.1
Leumi Romania (ron)	**(24.1)**	(53.0)	54.5
Leumi Re ($)	**7.5**	(4.9)	+
Others ($)	**(0.5)**	(0.4)	-
Overseas branches ($)	**1.3**	(0.4)	+
Total in $	**47.5**	14.5	+

* 1 RON = NIS 1.1429

The following table sets out a summary of the assets and liabilities of the Bank's overseas units and branches (in US$ millions* prior to offsetting mutual balances):

	31 December 2011	2010
Credit to the public	**7,057**	6,624
Deposits with banks	**4,107**	2,012
Securities	**1,251**	1,623
Other assets	**390**	402
Total	**12,805**	10,661
Deposits of the public	**8,261**	7,734
Deposits from banks	**2,569**	690
Other liabilities	**743**	1,069
Shareholders' equity	**1,232**	1,168
Total	**12,805**	10,661
Total trust deposits and managed securities	**10,958**	9,762

The total balance sheet of the consolidated overseas subsidiaries and branches of the Bank amounted to NIS 48.9 billion (US$ 12.8 billion) at the end of 2011, compared with NIS 38 billion (US$ 10.7 billion) at the end of 2010.

* The translation to US$ is a convenience translation of the data according to the representative rates of exchange on 31 December 2011 and 31 December 2010, respectively.
- The amounts are as published by the units.
- The data in shekel terms is presented in the report according to sectors - see Note 28 to the Financial Statements.

The following table sets out principal data regarding the Bank's overseas units (in US$ millions) at 31 December 2011:

	USA	UK	Switzerland	Luxembourg	Romania
Total assets	**5,839**	**2,378**	**1,141**	**789**	**336**
Credit to the public	**3,856**	**2,014**	**605**	**88**	**213**
Deposits of the public	**4,436**	**1,519**	**830**	**535**	**190**
Shareholders' equity	**662**	**183**	**124**	**33**	**59**
Trust deposits and managed securities	**3,804**	**482**	**3,244**	**857**	**-**
Net profit	**17.3**	**18.7**	**3.8**	**4.6**	**(7.2)**
Return on equity (%)	**4.4**	**10.5**	**2.9**	**15.8**	**-**

The net profit for all the consolidated overseas companies, including overseas branches, as published by them, totaled US$ 47.5 million in 2011, compared with a profit of US$ 14.5 million in 2010, an increase of US$ 33.0 million.

The contribution of the overseas units to the net profit of the Group in shekels in 2011 amounted to a profit of NIS 395 million, compared with a loss of NIS 280 million in 2010.

The increase in the contribution of the units in shekels derives mainly from positive exchange rate differentials in 2011 compared to the negative exchange rate differentials in respect of foreign investments in 2010, as a result of the devaluation of the shekel against most currencies.

See Notes 6 and 28 to the Financial Statements for further details concerning the contribution of the units to the Group's profit.

Bank Leumi le-Israel Corporation

Bank Leumi le-Israel Corporation ("BLL Corp.") was incorporated in the United States in 1984 and is a wholly owned subsidiary of the Bank. BLL Corp. is defined under US law as a bank holding company, and its principal activity is the holding of its subsidiary, Bank Leumi USA.

BLL Corp.'s total assets amounted to US$ 5.8 billion as at 31 December 2011, compared with US$ 5.2 billion at the end of 2010, and the annual profit amounted to US$ 17.3 million, compared with US$ 14.8 million in 2010, an increase of 16.9%.

The increase in net profit resulted primarily from a decrease in expenses in respect of credit losses, which was partly offset by a decrease in net interest income and operating income. The return on equity of BLL Corp. reached 2.55% compared with 2.4% in 2010.

As at 31 December 2011, the equity amounted to US$ 662 million. The ratio of equity to total assets was 11.65% and the ratio of equity to risk assets was 14.46%.

Bank Leumi USA

Bank Leumi USA (BLUSA), incorporated in 1968, holds a commercial banking license from the State of New York and is a member of the FDIC (Federal Deposit Insurance Corp.). BLUSA has two branches in New York State, four branches in California, two branches in Florida, two in Illinois and an additional branch in the Cayman Islands.

On 30 June 2011, Mr. S. Levine, external director in the Bank, was appointed chairman of the board of directors. Mr. T. Gluck was appointed deputy chairman of the board of directors. Mr. T. Gluck acted as executive chairman of the board of directors following the retirement of Mr. E. Raff on 31 December 2010. On 1 September 2011, Mr. S. Arbel was appointed deputy general manager.

In September 2010, the bank opened a representative office in Israel, in order to expand its private banking business.

BLUSA engages in commercial banking, primarily in financing medium and larger sized local companies, in international banking and also private banking for US and non-US residents. BLUSA offers full banking services to Israeli companies and to Israeli residents interested in the products and services of an American bank.

BLUSA's consolidated assets amounted to US$ 5.7 billion on 31 December 2011, compared with US$ 5.2 billion at the end of December 2010. Total shareholders' equity amounted to US$ 517 million on 31 December 2011 compared with US$ 501 million at the end of 2010. Credit to the public totaled US$ 3,827 million at the end of 2011, a decrease of 9.4%, while deposits of the public, which totaled US$ 4,855 million, decreased by 14.9%.

Customers' managed securities portfolios, which are not included in the balance sheet, totaled US$ 3,804 million at the end of 2011, compared with US$ 3,685 million at the end of 2010.

BLUSA ended 2011 with a net profit of US$ 20.1 million, compared with US$ 15.8 million in 2010.

The increase in the net profit, resulted primarily from a decrease in expenses for allowances for credit losses in the amount of US$ 27 million, which was offset by a decrease in other incomes amounting to US$ 26 million.

The return on equity of net profit in 2011 was 4.37% compared with 3.5% in 2010.

The balance of the provision for doubtful debts amounted to US$ 58 million at the end of 2011, constituting 1.5% of total credit to the public.

The ratio of equity to total assets was 9.2% (9.6% in 2010) and the ratio of equity to risk assets was 13.26% (13.58% in 2010). These ratios exceed the US supervisory authorities' capital adequacy requirements.

BLUSA is taking steps to expand the volume of its activity organically, as well as by locating opportunities for acquisitions and mergers.

At the beginning of 2011, the supervisory authorities in the USA announced that BLUSA had taken steps to improve and strengthen its controls and procedures in respect of the prevention of money laundering, and that their requirements from the audits that had been carried out had been complied with.

The Bank's Branches and Agencies

The Bank operates an agency in New York, a branch in Panama and a branch in Georgetown.

Total assets of the agency in New York and the branches in Panama and Georgetown amounted to some US$ 1,351 million at the end of 2011 (before offsetting mutual balances), compared with some US$ 184 million at the end of 2010. Credit to the public totaled US$ 114 million at the end of 2011, compared with US$ 112 million at the end of 2010. Deposits of the public totaled US$ 116 million at the end of 2011, compared with US$ 128 million at the end of 2010. 2011 ended with a profit of some US$ 2 million, compared to 2010 which ended without profits.

The Panama branch provides banking services, including credit and international trade activities. The majority of its customers are business customers from the Panama free trade zone that import merchandise from the Far East and export it mainly to Central and South American countries. The principal services for these customers are within the fields of international trade and short-term financing.

The Georgetown branch is registered in the Cayman Islands and operates in accordance with the local laws and directives.

Return of the permit for operating the Miami, Florida agency to the supervising authorities in the US.

In January 2011, BLUSA returned the permit for operating the Miami, Florida agency, since this license had not been in use by the bank for a number of years, and it became apparent that there would be no use for it in the future.

Bank Leumi (UK)

Bank Leumi (UK) plc was founded in 1959 and continues the activity of the Group in England that began in 1902. It is currently the largest Israeli-owned bank in the UK. The bank operates in London and has a banking subsidiary on the Island of Jersey, and also a trust company in Jersey, Leumi Overseas Trust Corporation Limited, which is wholly-owned by Bank Leumi (Jersey) Ltd.

In addition, Bank Leumi UK operates through a subsidiary, Leumi ABL Ltd., in order to operate in the field of asset-based lending, also including the discounting and factoring of invoices.

Bank Leumi (UK) engages in commercial and private banking. The commercial banking activity includes real estate financing, international trade, Israel-related business and Israeli companies active in the UK.

Bank Leumi (UK) finances a wide range of activities in the real estate field in the UK and Western Europe, including real estate investment and development and financing of commercial and residential real estate. The financing is provided to both local and non-resident customers.

Bank Leumi (UK) has expanded its activity through the acquisition of private banking activity in Jersey and in London. Bank Leumi (UK) has also recruited a team that specializes in financing international commodity trade, and thus added to its many years of experience in the field of financing international trade and expanded its customer base.

Bank Leumi (UK) ended the year 2011 with a profit of £ 12.1 million, compared with a profit of £ 6.4 million in 2010, derived from a decrease in provisions in comparison with 2010.

Total consolidated assets of Bank Leumi (UK) amounted to £ 1,539 million at the end of 2011, compared with £ 1,504 million at the end of 2010.

Deposits of the public increased from £ 1,043 million at the end of 2010 to £ 985 million at the end of 2011. Bank Leumi (Jersey)'s portion of the balance of deposits at the end of 2011 was £ 256 million. Credit to the public increased from some £ 1,254 million at the end of 2010 to £ 1,304 million at the end of 2011. Bank Leumi (Jersey)'s portion of the balance of credit at the end of 2011 was £ 145 million.

Capital, reserves and surpluses totaled some £ 119 million at 31 December 2011, compared with some £ 109 million at the end of 2010.

On 2 February 2012, Bank Leumi UK increased Tier 2 capital by £ 11 million by the issue of a subordinated capital note to the Bank.

On 20 February 2012, the Bank invested £ 10 million in the share capital of Bank Leumi UK. The increase in capital was approved by the Supervisor of Banks.

In February 2010, the Committee for Risk Management of the Board of Directors and the Audit Committee of the Board of Directors, and the Board of Directors of Bank Leumi approved credit facilities to BLUK totaling £ 120 million to be utilized in a worst case liquidity scenario. This step was taken pursuant to the liquidity management directives published in October 2009 by the supervising authority over financial services in the U.K. (FSA).

The ratio of equity to assets amounted to 7.7% (7.2% in 2010).

Mr. Zvi Itzkovitch was appointed chairman of the board on 1 March 2011, instead of Mr. Eitan Raff, who resigned.

Leumi Private Bank S.A. (formerly Bank Leumi Switzerland)

Bank Leumi (Switzerland) (above and below "Bank Leumi Switzerland"), was founded in 1953.

Bank Leumi Switzerland has two branches, in Zurich and Geneva and a representative office in Israel. Bank Leumi Switzerland specializes in providing private banking services to international customers, including receiving trust deposits, managing securities investment portfolios, selling structured products and managing discretionary accounts.

Total assets of Bank Leumi Switzerland amounted to CHF 1,074 million at the end of 2011, compared with CHF 1,278 million at the end of 2010. The profit in 2011 amounted to CHF 3.6 million, compared with CHF 6.5 million in 2010, a decrease of 44.6%.

Total capital and reserves, including inner reserves, amounted to CHF 117 million at the end of 2011 (of which CHF 2 million was internal reserves), compared with CHF 183 million at the end of 2010.

The general meeting of the shareholders of Bank Leumi Switzerland at its meeting of 19 December 2011 resolved to distribute a gross dividend amounting to CHF 70.0 million, and approved the merger of Bank Leumi Switzerland with Banque Safdié and the change of name of the merged bank to Leumi Private Bank S.A.

On 20 December 2011, a total of CHF 66.2 million was paid to Leumi as a dividend.

The total value of assets managed and/or held for customers, which are not included in the balance sheet, totaled CHF 3.6 billion at the end of 2011, and compared with CHF 4.2 billion at the end of 2010.

On 10 February 2011, an agreement (hereinafter: "the purchase agreement") was signed between Bank Leumi Le-Israel Ltd. (hereinafter: "Leumi"), directly or through a company under its control, and Island Tower Foundation, Helena S. Safdié Levy, Edmundo Safdié, and G.RS. Participations S.à.r.l., the owners of Banque Safdié SA in Switzerland (hereinafter: "Banque Safdié"), according to which Leumi will purchase all of the share capital in the acquired bank, subject to conditions precedent specified in the agreement.

According to the purchase agreement, the basic consideration amount, before adjustments, will be based on the net asset value of the acquired bank, with the addition of a premium on the assets under management of the acquired bank on the date of the transaction's closing, and it will be adjusted in accordance with the execution of a due diligence examination.

On 30 November 2011, after the conditions precedent set forth in the agreement, the purchase agreement was completed and Leumi purchased the entire share capital of Banque Safdié. Pursuant to purchase agreement, the total consideration paid at the closing date of the transaction was CHF 143 million, of which CHF 110 million was paid to the sellers and the balance of CHF 33 million deposited on trust to secure adjustments in the consideration derived from changes in the assets managed by Banque Safdié in the 24 months following the date of completing the transaction, and other adjustments in accordance with the wordings agreed between the parties. The purchase significantly increased the scope of activity of the Group in Switzerland.

The percentage shareholding of Bank Leumi in Leumi Switzerland stands at 94.6%, as a result of the purchase of 6,917 Class B shares from the minority stakeholders in 2011.

On 3 January 2012, the merger was formally completed and pursuant thereto, the activity of Banque Safdié was merged with that of Bank Leumi (Switzerland).

The merged bank operates through three branches in Switzerland – Zurich, Geneva and Lugarno and a representative office in Israel.

Bank Leumi Luxembourg

Bank Leumi Luxembourg. was established in 1994 and opened to the public in May 1995. Bank Leumi Luxembourg provides its customers with a variety of private banking services, including deposits and investments in securities.

In September 2011, after 8 years of service, the general manager, Mr. Yoram Moskovitz, resigned and was replaced by Mr. Gil Karni.

Total assets at the end of 2011 amounted to some € 611 million, compared with some € 515 million at the end of 2010.

At the end of 2011, deposits of the public totaled some € 413 million compared with some € 453 million at the end of 2010. Trust deposits and securities held by customers of the bank, and are not included in the balance sheet, totaled € 663 million at the end of 2011, compared with € 705 million in 2010.

Bank Leumi Luxembourg ended 2011 with a profit of € 5.0 million, compared with a loss of € 5.0 million in 2010.

The capital means of Bank Leumi Luxembourg totaled some € 39 million, compared with € 33 million at the end of 2010.

A plan for the enhancement of the infrastructure system in Leumi Luxembourg was approved for execution in 2012.

Leumi International Investments N.V. ("L.I.I.")

The purpose of the company was to serve as a vehicle through which the Bank Leumi Group issues notes to the public overseas. The proceeds from past issues were intended for the use of the Group.

Since 2005, no issues have been made by the company.

Bank Leumi Romania

In August 2006, the Bank acquired over 99% of the issued and paid-up share capital of Eurom Bank S.A. from S.C. Kolal B.V, for a consideration of some US$ 46 million. The name of the company was changed to Bank Leumi Romania in August 2006.

Since the acquisition, the Bank increased Bank Leumi Romania's shareholders' equity by some US$83 million.

Leumi Romania is a banking corporation in Romania, and operates 20 branches and 3 agencies, and engages in varied financial activity that includes the accepting of deposits, the extension of credit, international trade and foreign currency activities.

In May 2010, the bank closed two branches and three agencies in view of the economic situation in Romania and after an examination of their future potential. In May 2011, the bank closed a further branch and merged a second branch with another. In February 2012, the bank shut six branches and one agency.

Leumi Romania ended 2011 with a loss of some 24 million Romanian ron (some US$ 7.2 million), compared with a loss of some 53.0 million Romanian ron (some US$ 16.5 million) at the end of 2010.

The reduction in loss derives mainly from a decrease in provisions for doubtful debts in the amount of some 26 million Romanian ron.

The bank's condition is significantly negatively influenced by the economic situation in Romania. During 2011 the deterioration in the overseas unit's credit portfolio continued, and was expressed as a growth of loans in arrears and an increase in the extent of legal proceedings used against costumers for debt collection.

Romania has been suffering in the past two years from the most severe recession in 20 years, which led to a sharp decrease of 7.2% in GDP, and a harsh impact on the construction and commercial sectors. In particular, the decline in the activities of the construction sectors were caused by a sharp decline in bank credit to the sector due to the liquidity problems of the banks and their desire to reduce their exposure to the sector, a decline in demand from household for rentals and a weakening in commercial real estate due to the canceling of construction plans and expansion by foreign companies.

In 2008, the Bank made available to Leumi Romania a line of credit in the amount of US$ 100 million, through a deposit without a repayment date, with the possibility of repayment after two years from the date on which a request for payment is made. As at the end of 2011, the balance of the deposit stands at some US$ 59 million.

In addition, the Bank was asked to provide Leumi Romania with a liquidity line in the amount of US $50 million, to be used in the event of a liquidity crisis in the bank. This request resulted from a letter in January 2009 from the Romanian central bank, according to which all Romanian banks were asked to submit a plan for emergency situations in which they were asked to present, *inter alia*, alternate sources of financing that they would be able to raise in the event of distress. The request was approved by the Board of Directors and by the Bank of Israel. In April 2010, a new regulation of the central bank came into force regarding changes in the parameters for calculating liquidity. In addition, the central bank is examining regulation which is likely to restrict even further the ability of foreign banks to withdraw the finance extended to subsidiaries in Romania.

The total assets of Bank Leumi Romania amounted to 1,128 million Romanian ron (US$ 337 million) at the end of 2011, compared with 1,150 million Romanian ron (some US$ 358 million) at the end of 2010. Deposits of the public amounted to 633 million Romanian ron (some US$ 189 million) at the end of 2011, compared with some 625 million Romanian ron (some US$ 195 million) at the end of 2010, and credit to the public amounted to 713 million Romanian ron (some US$ 213 million), compared with some 818 million Romanian ron (some US$ 255 million) at the end of 2010.

The capital, reserves and surplus amounted to some 196 million Romanian ron (some US$ 59 million) at the end of 2011, compared with 220 million Romanian ron (some US$ 69 million) at the end of 2010.

1 Romanian ron = US$ 0.299 (at the end of 2010 - US$ 0.311).

Leumi (Latin America)

Leumi (Latin America) S.A. was established in 1980 and operates through a head office in Montevideo and a branch in Punta del Este. Leumi (Latin America) provides general banking services.

In order to continue providing customers in the Group with optimal service and expanding the range of activity in Latin America, and relying on a legal opinion, a new department was established during the first half of 2011 in order to take advantage of the existence of a local bank under the Group's ownership. The unit will act as an extension of the subsidiaries for providing its customers with services, (pursuant to service agreements with subsidiaries of the Group), and will serve as a professional anchor in the area of private banking in the Bank. The unit will be headed by an experienced emissary from Israel.

Total assets of Leumi (Latin America) were US$ 43 million at the end of 2011, compared with US$ 46 million at the end of 2010.

Capital, reserves and surplus totaled some US$ 10 million on 31 December 2011, similar to 2010.

2011 ended with a loss of some US$ 117 thousand compared with a loss of some US$ 40 thousand in 2010. The balance of off-balance sheet activity totaled some US$ 274 million in 2011, compared with US$ 264 million at the end of 2010.

Leumi Re

In June 2002, the Bank established Leumi Re Ltd. in the Island of Guernsey. The company is wholly owned by the Bank and serves as a reinsurer for insurance companies that insure the Leumi Group. The company’s issued capital is US$ 30 million, of which US$ 6 million is fully paid. Furthermore, the Bank undertook in a guarantee to make additional amounts available to Leumi Re, up to an amount of US$ 9 million.

The Bank has also given an unlimited guarantee to the insurer, New Hampshire Insurance Company, to secure payment of the insurer’s claims with respect to Leumi Re Ltd.

The company was established with the approval of the Bank of Israel, which determined that:

- The Bank shall hold 100% of the means of control of the company;
- The company shall engage in banking insurance, insuring liabilities and insuring property;
- The company shall only engage in insurance for the Bank Leumi Group.

The company’s total assets at the end of 2011 amounted to US$ 36.7 million, compared with US$ 37.7 million at the end of 2010, and the insurance reserves amounted to some US$ 21.5 million at the end of 2011, compared with some US$ 24.6 million at the end of 2010. Shareholders’ equity amounted to some US$ 9.9 million as of 31 December 2011. Profit for 2011 amounted to US$ 7.5 million, compared with a loss of US$ 4.9 million in 2010.

Since 2003, the financial statements of the company have been prepared on the basis of the revised accounting rules of the Association of British Insurers. In accordance with these rules, the company's financial statements are prepared on an annual basis, according to which the insurance reserves are calculated on the basis of an assessment of the estimated cost of settling the claims that have been reported, as at the date of the statements.

Capital Market and Financial Services Activities

Leumi Global Managers Funds

Leumi Global Managers ("LGM") manages funds overseas through the manager-of-managers system. The funds are marketed through the Leumi Group overseas, subject to the laws applicable to the operations. The company was established in 2004 and is registered in Luxembourg.

LGM funds are the result of cooperation between the Leumi Group and SEI Investments Company ("SEI"), a leading international company in the field of asset management solutions, investment process management and handling institutional and private customers' investments. At the end of December 2011, the company managed assets amounting to US$ 162 billion.

SEI specializes in managing funds through the manager-of-managers system. SEI's funds are managed by portfolio managers who are specialists in the specific market in which each fund invests. SEI specializes in active management of the funds, while operating risk control and monitoring measures that allows it to use a combination of investment managers and to replace investment managers with others, when in SEI's opinion the others have a greater potential to achieve a yield over time.

The LGM funds include seven funds with varying characteristics relating to yield, risk, currency and investment amounts, which are suited to the needs of the customers of the Leumi Group.

As at 31 December 2011, the LGM funds had accumulated some US$ 142- million.

For further details regarding income from capital market activity, see page 182.

Activities of companies included on equity basis

Total investments of the Group in companies included on equity basis amounted to NIS 2,270 million as at 31 December 2011, compared with NIS 1,924 million as at 31 December 2010. The contribution to net operating profit of the companies included on the equity basis amounted to NIS 148 million in 2011, compared with NIS 420 million in 2010.

For further details, see pages 180.

Exposure to Risks and Methods of Risk Management

Risk management

The Bank is engaged in a wide spectrum of financial activities that involve the taking of risks, primarily credit risks and market risks and liquidity. These risks are accompanied by operational risks and legal risks inherent in business activity. Risk management in Leumi is considered an essential condition for fulfilling the Group's long-term goals. The main goal of risk management in Leumi is maintaining the stability of the Bank and the Group, and complying with the risk appetite established by the Board of Directors. This includes minimizing material losses and events that may significantly impair the Bank's reputation. In addition, the goal of risk management is to support the achievement of business goals, with continued activity to upgrade the risk management infrastructure and analysis of the risk picture enabling more educated decision-making and expansion of activity.

Risk management framework

Risk management in Leumi is led by the Chief Risk Officer, who is a member of management in the Bank, and Head of the Risk Management Division. The Division was established during 2011 and responsibility for management of the main risks in the Bank and in the Group was transferred to the Chief Risk Officer, with the legal risk management under the authority of the Bank's Chief Legal Advisor. In the risk management structure which was established, the Risk Management Division is an independent overseeing entity, which is involved real-time in the decision-making process. Subject to the Chief Risk Officer are the heads of the departments for managing credit risks, market risks, operating risks and Overall Risk-Return Manager, and the professional lines of reporting of those responsible for risk management and control in the Group's business divisions have been defined.

In accordance with changes in the risk management structure in Leumi, a new division of duties among the business divisions and the Risk Management Division has been defined. It was determined that the leadership of the management and control of risks at the level of the single transaction and specific project would be under the responsibility of the business divisions that are close to the customer and to the ground, and with the partnership of the Risk Management Division in real-time, in large transactions and projects at the Bank and Group level. The leadership of risk management at portfolio level, in particular, with assistance to the Board of Directors in defining risk appetite, and the leadership of Leumi's risk policy, is the responsibility of the Risk Management Division in conjunction with the business divisions.

Control and inspection of risk management are conducted by the management committees for the management of the various risks, as well as the Risk Management Committee of the Board of Directors, as set forth below:

- The Risk Management Committee of the Board of Directors
- The Upper Risk Management Committee headed by the President and CEO, of which all of the members of the management are members.
- Risk management committees according to various topics headed by the Chief Risk Officer and with the participation of factors from the various divisions: credit, market, operational, overall risk.

The committees outlined above discuss aspects of exposures to the various risks and determine internal restrictions in accordance with the conditions of the market and the Bank's risk appetite.

Risk management in the subsidiaries is conducted in accordance with the principles prescribed at the Group level. The main subsidiaries in Israel and abroad have policy documents relating to the management of the principal types of risk, which are derived from the Group policy in each of the areas of risk. The risk appetite, limits and authorities are determined, and there are also control systems and periodic management reports examining the limits against the actual position. The risk managers in the subsidiaries are subject administratively to the CEO of the subsidiary and professionally to the Chief Risk Officer of the Group.

Main risks and tools used in risk management

Methods and procedures for working in the area of risk management in Israel and abroad are examined and revised on an ongoing basis, taking into account the policy of the Bank, changes occurring in the business environment, and the directives and requirements of the Bank of Israel, as well as other relevant regulatory authorities in Israel and abroad. Set forth below is a condensed review of the principal tools used for estimating the risks and the basis for making decisions.

The quantitative risk management tools include varied and diverse statistical models for assessing the extent of the risk at various probabilities, such a model for rating borrowers and the VaR (Value at Risk) model for assessing market risk.

Nevertheless, the quantitative models are insufficient for assessing losses that could arise under extreme market conditions. Since shocks on global and local markets are sometimes reflected in a deviation of parameters from normal behavior, with a breaking of historical coefficients between risk factors. Therefore, an examination of varied scenarios is made in Leumi, including a combined materialization of the various risks, for the purpose of estimating the potential losses under extreme conditions, separately from the statistical models, and the examination of the adequacy of the activity and potential losses to the risk appetite. In these scenarios, the material risk factors to which the Group is exposed are examined, and they represent an important tool for examining the extent of compliance with the risk appetite, decision making on changes in exposures to risk, and the preparation of contingency plans for situations in which the risk may materialize.

Stress tests at Leumi are designed by the Risk Management Division in collaboration with the business factors and approved by the Chief Risk Officer within the framework of the committee she heads. The committee comprises representatives from the Risk Management Division, representatives of the business divisions, the Accounting Division, the Finance Division, the Operations and Administration Division and representatives of the subsidiaries in Israel, and it is responsible for periodically defining and updating the set of stress scenarios.

The main risk of the Group is credit risk, which includes credit to the public, banks, governments, securities, derivatives and the like. This risk is in accordance with the core business of the Group and expresses itself in activity with corporate, commercial and retail customers, as well as nostro activity. The Bank's policy in Israel is to be a dominant factor in all types of credit in order to create a spread of risk. The Bank's aim is that managing the credit portfolio, determining the level of working facilities with borrowers, limitations on the credit portfolio, and measuring concentrations, will be in terms of risk and not only in - terms of exposure. The allocation of dealing with customers between lines of business is carried out according to the level of indebtedness and the level of complexity/specialization of the type of transaction, in order to ensure the required level of expertise for dealing with each sector and type of activity.

Market risk, including liquidity risk, is the second most important risk that the Bank takes upon itself. The routine management of market risks is intended to support the achievement of business targets, while estimating the forecast profit from managing the risks against the damage likely to emanate from exposure to these risks. Exposures to market risk are managed dynamically at Group level. The system of limitations determined by the Board of Directors and the risk committees at different levels delineates the impact of exposure on the economic value, the accounting profit, capital reserve and liquidity position from unexpected changes in the various risk factors.

In the Bank's activity as a financial intermediary, there are operational risks that also include legal risks, compliance risks and the areas of business continuity and information security.

Operational risk management is conducted in accordance with the highest (best practice) standards in all parts of the Group.

Main changes in the risk environment

From August 2011, there was an increase in the overall risk level, in view of developments around the world, and notably, Europe, social unrest in Israel, the changes in the geo-political situation and changes in the regulatory environment in Israel and abroad. Business factors and the Risk Management Division are monitoring these developments and are taking focused steps to minimize the risks. Below is an outline of some of these risk areas in which a change was observed during 2011, and which could impact the Bank's activities in 2012:

1. **Development of the crisis in Europe**

   From the third quarter of 2011, there was a deterioration in economic activity and in the financial system in Europe, owing to the debt crisis in some of the countries. In the main scenario, a significant slowdown in Europe is expected in 2012, with growth likely to be even negative. Within Israel, the implications of the crisis were reflected, *inter alia*, in high volatility in the capital market and impairment in exporting companies exposed to the economic situation in Europe. A continuation of the situation could result in a more severe slowdown in all activity in the economy, and a broad deterioration in the situation of credit consumers, particularly those who are dependent on the raising of funds from the capital market. During the last quarter of 2011, several steps were taken to minimize the Bank’s risk of crisis in Europe, including increased liquidity of foreign currency, a decrease in exposure to banks in Europe in the nostro portfolio, and on the credit side - a measured tightening of credit policy in specific segments that could be harmed by the crisis. In the stress scenarios carried out with regard to Europe, it was found that Leumi complies with the risk appetite defined by the Board of Directors.

2. **Increase in the risk level in the activity of the domestic real estate market**

   The real estate sector has the largest rate of exposure to the overall real estate sector from the total credit portfolio Leumi. The decline in housing prices and the slowdown in activity in the Israeli economy will impact Leumi. The Bank has carried out a number of steps to reduce risk, both at the portfolio level and credit policy in general, and at the level of single transactions, which were intended to conserve the quality of the portfolio and enable the continuation of financing the business activities of borrowers in the real estate sector.

3. **Social protest**

   The social protest led to a decrease in income and profitability of some of the Bank’s borrowers and is likely to make their situation worse. Leumi continuously monitors the situation of borrowers in the sectors affected by this, particularly companies dealing in retail trade and food companies and in addition, evaluates the additional effects of the social protest on the Bank.

4. **Increase in risk from cyber attacks**

   Leumi invests several resources in the area of defending against data protection risks including cyber risks, both in specialist personnel, and in infrastructures, in order to reduce exposure to this risk. Cyber events that have occurred in Israel and around the world in the past year and, at the beginning of 2012, including the disclosure of thousands of credit card numbers of Israeli citizens, increase the materiality of the risk and the importance of preparations to minimize exposure to the risk and necessary courses of action required in the event of the occurrence, which, in certain cases, can cause substantial damage to the Bank's customers and its systems.

5. **Compliance risk**
   The severity of compliance risk increased during the last year due to the increased regulation in Israel and abroad, management enforcement and requirements of the U.S. authorities.

Severity of the risk factors

The methodology for classifying the degree of severity of exposures to the various risks, as outlined in the table of severity of risk factors, is based on estimating exposure to the various risks and the quantification of the impact of the scenarios materializing on the Group's capital, meaning its stability. The degrees of severity defined below are based on stress scenarios and present the level of exposure divided into three levels: low, medium and high. This is as a function of the extent of the impairment in the event of the risk materializing, in relation to the Group's capital. According to the methodology, a risk whose realization is likely to lead to a loss which will reduce the capital adequacy ratio of Leumi by up to 1%, is classified as a low risk; a risk whose realization will result in damage leading to a reduction in the capital adequacy ratio of more than 1%, is classified as medium; and a risk whose realization will result in damage leading to a reduction in the capital adequacy ratio of more than 2%, is classified as high. In addition, there is a fourth level of severity – critical, which describes a departure from the Group risk appetite as a result of a sudden variation in market conditions under the conditions of a serious crisis. In the event of such a departure, a program to reduce exposure will be initiated immediately.

The table of severity of risk factors presented below presents an assessment of the severity for each of the various risks derived from evaluating the effect of the realization of stress scenarios determined on the Bank's capital. It should be noted that none of the exposures to the risk factors is defined as high or critical, and the breakdown of the risks obtained corresponds with the Group's risk appetite and goals.

With regard to the financial statements of 2010, no change has taken place in risk classification according to risk level, and the increase in the risk environment described above, given the steps taken by management to reduce the risks, has not led to any significant change in the assessment of the effect of each risk factor on the Bank's capital and its stability.

Some of the information included in this chapter is "forward-looking information". For an explanation of this term, see "**Description of the Banking Corporation's Business and Forward-Looking Information**" on page 61 above

Table of severity of risk factors

	Risk	Definition	Degree of severity
1	**Overall credit risk[1]**	**Negative results that coincide with a failure or dishonoring contracts in loan instruments or participation as a result of a deterioration in the credit quality of the counterparty.**	**Medium**
1.1	Single borrower risk and securities	Amount of risk described by the likelihood of failure, the loss given a failure and the exposure at a time of failure of individual borrowers	Medium
1.2	Concentration risk	Credit risk arising from exposure to group of business entities with a common denominator	Medium
1.2.1	Large borrower credit risk - and group of borrowers	Credit risk arising from the relative size of borrowers in the credit portfolio.	Low
1.2.2	Industry and sector concentration risk	Credit risk arising from concentration of credit to borrowers in certain sectors and segments of the economy	Medium
2.	**Overall market risk**	**Risk arising from a change in the fair value of a financial instrument, cash flow and risk assets as a result of changes in market conditions**	**Medium**
2.1	Market risk – general	Financial negotiable market risks	Medium
2.1.1	Options risk	Unique risks relating to normal options	Low
2.1.2	Base risk	Risk due to fluctuation of the exchange rate, including inflation (trading portfolio and banking portfolio).	Low
2.1.3	Interest risk	Risk due to fluctuation in interest rates	Low
2.1.4	Margin and share prices risk	Risk as a result of fluctuations in share and bond prices in the commercial portfolio and in the banking portfolio for assets remeasured at market price	Low
2.2	Liquidity risk	The risk of inability to withstand the uncertainty in relation to the possibility of raising funds and/or realizing assets, in an unexpectedly manner and with a short time-frame, without incurring a material loss.	Low
3.	**Operating risk**	**Risk of loss arising from weaknesses or failures in processes, people or internal systems, or external events. This risk includes legal risk, but does include strategic risk or reputational risk.**	**Low**
3.1	Legal risk	The risk arising from activity which does not correspond with legislation (civil), legal errors and class actions conducted against the Bank.	Low
4.	**Strategic risk**	**Risk arising from strategic decisions, including inaction or lack of suitability to varying conditions**	**Low**
5.	**Reputational risk**	**The risk that a negative publication would cause a fall in the customer base, a fall in revenues or high legal costs**	**Low**
6.	**Compliance and Regulatory risk**	**The risk that can arise from non-compliance with requirements of the authorities**	**Low**
7.	**Holistic systemic risks**	**Risks caused as a result of external events that could lead to the materialization of a number of risks simultaneously**	**Medium**

1 Including credit to the public, bank deposits, bonds, activity in derivatives, etc.

Definitions of risks in the above table:

1. Credit risk

The risk of loss resulting from the possibility that a borrower may not meet its obligations. This refers to credit to the public, derivatives, deposits in banks, investments in debentures, and holdings in equity. The severity of overall credit risk is medium (see further details on risk management on page 218). Details of sub-risks included in the definition of credit risk according the Group map are as follows:

1.1 Risk in respect of single borrowers and collateral: The risk of the entry of a counterparty into default, leading to failure to meet contractual monetary obligations. The risk includes:

- Entry into default of counterparty in derivatives.
- Residual risk in respect of inability to realize collateral when a counterparty defaults.
- Country risk deriving from the exposure of borrowers operating in foreign countries
- Credit risk in shares deriving from the exposure to default in respect of a holding of shares for investment purposes.

The level of severity is defined as medium.

1.2 Concentration risk: Credit risk in a significant exposure to counterparties with similar economic characteristics or who are engaged in similar activities, which may lead, in a situation of change in the economic situation, to a similar effect on the ability to meet debt repayments of those counterparties. Below are details of sub-risks included in the definition according to the Group mapping:

1.2.1 Significant exposure to a large borrower or group of borrowers. The severity of the risk level is defined as low;

1.2.2 Sectoral and segmental exposure. The severity of the risk is defined as medium;

The severity of the overall risk and sub-risks was examined in the framework of stress scenarios which reviewed what damage there was in respect of concentrations of credit in the portfolio as a result of a serious crisis occurring. The severity of overall concentration risk is assessed as medium.

2. Market risk

Market risk is defined as a risk of exposure of Group assets because of uncertainty of changes in exchange rates, interest, inflation and shares, the correlation between them and their level of volatility. The severity of overall market risk is medium (see further details on risk management on page 244).

2.1 Market risks – general: risk of exposure of the Group's assets to uncertainty of changes in market factors. This **definition** includes:

2.1.1 Risk of activities in options. The severity of the risk is defined as low;

2.1.2 Basis risk. The severity of the risk is defined as low;

2.1.3 Interest risk. The severity of the risk is defined as low;

2.1.4 Bond margin and share prices. The severity of the risk is defined as low.

The severity of the general risk and sub-risks were evaluated in accordance with the most severe stress scenario in the set of scenarios for these risks. The severity of overall market risk is defined as medium.

2.2. Liquidity risk: Uncertainty with regard to the possibility of raising funds and/or realizing assets, unexpectedly within a short timeframe, without causing material loss. This risk has been determined as low, since the Bank complies with the liquidity ratios that it sets for itself, including probability indices, and the **subsidiaries** also comply with the indices that they have set for themselves. Monetary damage in a very severe liquidity scenario is also low.

3. Operational risk

Operational risk is the risk of a loss resulting from inadequate or failed internal processes, people or systems, or resulting from external events. This risk includes legal risk, but excludes strategic and reputational risks. Evaluation of the level of severity was based on allocation of the regulatory capital attributed to damages at a high level of severity and a review of historical events. The level of severity of the risk is defined as low. (See page 256 for more information on risk management).

3.1 Legal risk:

The risk of loss resulting from the inability to legally enforce the performance of an agreement or contingent liability. The definition includes risks deriving from legislation, regulations, case law and regulatory directives, risks deriving from operations not backed by adequate agreements or without legal counseling or according to deficient legal counseling. A plan for managing legal risks is implemented in the Group whose objective is to identify, prevent, manage and minimize legal risks. In view of the results of an analysis of the legal consulting division for a potential stress scenario, the Group's legal risk is categorized as low. (For further details on risk management, see page 261.)

4. Strategic risk

The risk of deviating from expected profitability when deciding to enter into new lines of business, less credit and market risks. The risk includes:

- Remote external environment: The risk deriving from changes in the political, economic, social, technological or regulatory environment.
- Close external environment: The risk deriving from changes in the competitive environment in which the Bank operates.
- Internal environment: The risk deriving from decisions/processes/actions taken or not taken by the Bank that have a significant effect of the Bank’s results.

- The damage in a strategic stress scenario is estimated as low.

5. Reputational risk

The risk that the publication or public disclosure of a transaction, a party to a transaction or customer-related business practice, as well as business results and events pertaining to the Group, may have an adverse impact on the public's confidence in the Group. The Group's reputational risk is managed by maintaining high levels of compliance with the various regulatory provisions, maintaining high levels of control, and orderly work procedures by the Management and the Board of Directors and their ability to monitor the current operations. Leumi Group has a code of ethics governing conduct *vis-à-vis* employees, suppliers and the environment. Leumi Group ensures that the products and services it supplies are of the highest quality. The treatment of employees and customers is reflected in the minimal number of complaints. In addition, there are detailed contingency plans for dealing with reputational events. The Group's reputational risk is categorized as low.

6. Compliance and regulatory risk

The risk that may derive from non-compliance with regulatory requirements and laws of the various authorities in Israel and abroad, new regulatory limits and reforms which may cause the Bank financial damage.

7. Holistic systemic risks

Risks deriving from economic, political, and geopolitical events in Israel or abroad that may endanger the stability of the Group, such as a war or a global economic crisis. The assessment of the risk is based on the total loss in a very severe stress scenario in the Group set of scenarios including the occurrence of a number of risks together. The degree of severity is classified as medium.

Basel Directives and Assessments in Leumi

The data in Leumi's financial statements, the calculation of the risk assets and the capital adequacy ratio as at 31 December 2011 are calculated and presented in accordance with the directives according to the standard approach in Basel II. The capital adequacy ratio amounting to 14.34% which Leumi presents at 31 December 2011 according to assessments of the Group covers the required capital in respect of the First Pillar and the Second Pillar, including the stress scenarios used by the Group in its internal assessments.

ICAAP (Internal Capital Adequacy Assessment Process)

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

The process in the Group is divided into two main components:

1. A continuous process of risk management in the Group, examining compliance by risk management with standards required by the Basel II directives and with Leumi's risk appetite, the identification of strengths and weaknesses and the construction of work programs to improve and update the risk management processes, also, *inter alia*, in light of economic reviews and update of economic forecasts. The assessment of risk management processes is closely linked to capital adequacy assessment, and the allocation of capital is carried out in accordance with the severity of the risks and the quality of their management.

2. Assessment of the Group’s capital adequacy and an examination of the capacity to bear losses in accordance with the risk appetite and the risk profile. When assessing capital adequacy, the Bank takes into account the Group’s strategic plans and its future capital needs, as reflected in the three-year plan, in the light of economic forecasts.

   The results of the process are formally collated in the ICAAP document submitted to the Supervisor of Banks at the end of May 2011. On the basis of this document, a dialogue takes place with the Supervisor of Banks with the aim of approving the capital adequacy determined by the Bank as a target in accordance with Basel II principles. This process is examined by the Supervisor of Banks as part of the Supervisory Review Process (SRP). The updated document for this year is currently being prepared.

Basel III – Trends and Forward-looking Information

In June 2011, the Basel III directives (published in December 2010) "Increasing the Resilience of the Banking System" were updated by the Bank for International Settlements (BIS). These directives rely on the Basel II directives and come to update several aspects as learned from the lessons of the recent financial crisis.

These directives are due to come into force at the beginning of 2013.

On 30 November 2011, a draft translation by the Banking Supervision Department of the Basel III document was published. This draft is a literal translation of the original. On 14 March 2012, the Supervisor of Banks sent a draft directive relating to his intention to determine a minimal core capital ratio higher than that currently required for all banking corporations. According to this draft, all banking corporations will be required to comply with a minimum core capital equity ratio of 9%, effective 1 November 2015.

In addition, a large banking corporation, the total of whose balance sheet assets on a consolidated basis constitutes at least 20% of the total balance sheet assets of the Israeli banking system, will be required to comply with a minimum core capital ratio at the rate of 10%, by 1 January 2017. This additional directive applies to the Bank.

Core capital ratio is to be calculated in accordance with the Basel III provisions and adjustments determined by the Supervisor of Banks.

The Bank of Israel has set up working teams which include the representatives of the banks and has transferred work files for conducting a quantitative impact study (QIS) for assessing the effect of the transition to the Basel III regulations on the capital adequacy ratios of Israeli banks.

Leumi Group is studying the impact of the aforesaid recommendations, if and when they are implemented in Israel, on the capital adequacy and liquidity ratios required from it. The capital planning process for 2012 is based on the rules in Basel II and, from 2013, on Basel III.

The aim of the directives proposed by the BIS is to enhance the stability of the banking system in times of crisis, in view of the lessons of the 2008-2009 crisis, while adding improvements in the area of risk management and emphasis on:

- Improving the quality and growth of capital.
- Improving liquidity ratios and fixing uniform standards for measuring liquidity.
- Reducing the pro-cyclical effect of the economic situation on the capital requirements.
- Increasing the transparency of methods of the risk management systems.
- Reducing the risks resulting from the realization of counterparty risks

Below are a number of points for emphasis in the Basel III directives:

1. A definition of the higher minimal capital ratio requirement for the core capital (including capital buffers for Tier 1 capital and total capital components*. Banks shall be required to meet these ratios gradually until 2019.

As a percentage of risk assets	Core capital ratio	Tier 1 capital ratio	Total capital ratio
Minimum capital required ratio	4.5%	6.0%	8.0%
Capital preservation buffer	2.5%	2.5%	2.5%
Minimal capital ratio + capital preservation buffer	7.0%	8.5%	10.5%
Anti–cyclical buffer	0%-2.5%		

* The Banking Supervision Department in Israel has set a requirement of 7.5% for the core capital ratio in the banking system from 31 December 2010 and a requirement to increase the core equity ratio in coming years in accordance with the above draft dated 14 March 2012.

On 25 June 2011, the BIS published a recommendation to increase the core capital component in large banks with global systemic importance by a further 1-2.5%.

2. Focusing on strengthening the components of core capital, the component with the highest quality among the Bank's capital base components.

3. The capital instruments in Tier 1 capital and Tier 2 capital will be required to include a mechanism for absorbing losses in case of insolvency.

4. The distinction between Upper Tier 2 capital and Lower Tier 2 capital was abolished and Tier 3 was abolished.

5. A new capital conservation buffer was determined – aimed at ensuring sufficient capital for absorbing losses at times of crisis. The capital conservation buffer was set at 2.5% of total weighted risk assets, and includes core capital components. The buffer is constructed as an additional layer to the required core capital ratio of 4.5%. While the capital adequacy in the Bank is within the range of the capital conservation buffer, distributing surplus profits, repurchasing stock or paying bonuses should be limited rather than limiting the business activity of the Bank.

6. A new countercyclical capital buffer was determined, at the level of 0%-2.5%. The supervising authority of each country will determine when a "credit bubble" and a potential for material losses begin to form, and verify that the system has sufficient capital for absorbing these losses. This means that the local supervisory authorities will be able to moderate an increase in credit by controlling the level of the buffer required from the banking system.

7. A new limitation was set as an addition to the capital adequacy ratio, which will be called "the leverage ratio". One of the main components characterizing the last crisis was the considerable leverage of balance sheet and off-balance sheet assets in the banking system. At the peak of the crisis, the banking sector had to materially reduce its leverage, in a way which intensified the negative effect on the prices of assets, eroded capital ratios and led to a squeeze of credit in the economy. The regulation, in the first stage, mentions a required leverage ratio, which is not derived from risk assets at a ratio of 3.0%, but, in any case, during the transition period, the appropriate ratio will be examined for the banking reality, in light of the new capital adequacy requirements. This ratio will supplement existing capital adequacy ratios. The translation document did not include the recommendations themselves relating to the leverage ratio (and relating to global liquidity standards), but only the preamble was translated, with a notice that the Bank of Israel intends to refer to these recommendations at a later date.

8. In the Basel III proposal, gradual transition arrangements were set for implementing the directive from 2013-2019.

9. Liquidity ratios - Two new liquidity ratios were added, emphasizing the ability to manage medium and long-term liquidity risks, as, during the recent crisis, there was a relatively long period of time when it was not possible to raise capital or sell certain assets in the markets:

    1. A 30-day short-term liquidity coverage ratio (LCR).

    2. A net stable funding ratio (NSFR)

In this report, certain data required by Pillar 3 have been expanded and/or added in accordance with the instructions of the Banking Supervision Department, as detailed below:

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Credit Risk Qualitative Disclosure	4(a)	Pages 218-224	-
Credit Risk Exposures by Principal Types of Credit	4(b)	Page 224	
Exposures by Geographic Area to Foreign Countries	4(c)	Page 242	Exhibit F
Credit Risk Exposures by Third Party and Principal Types of Credit	4(d)	Page 224	
Credit Exposures by Repayment Period	4(e)	Page 225	
Problematic Credit Risk Exposures and Provision for Doubtful Debts by Economic Sector	4(f)	-	Exhibit E
Total Impaired Loans and Provisions by Geographic Area	4(g)	-	Exhibit F
Movement in Balances of Allowance for Credit Losses	4(h)	-	Note 4C
Credit Exposures by Risk Weighting	5	Pages 226-228	
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Operational Risk - Qualitative Disclosure	12	Page 256-259	-
Investment in Shares (Qualitative and Quantitative)	13(b)	Page 129	-
Investment in Shares of Companies Included on Equity Basis	13(b)	Page 180	-
Interest Risk	14	Pages 247-250	Exhibit D

Credit risks

Policy and general principles for the management of credit risk

Credit risk is the risk of the Bank incurring a loss as a result of the possibility that a borrower or counterparty of the banking corporation does not meet its liabilities vis-à-vis the balance sheet, as agreed.

The Bank's credit and credit risks policy represent one of the central pillars for the strategic expression of the Bank's credit risk. This is aside the existing procedures for identifying, measuring, monitoring supervising and controlling the credit risk. The credit policies and procedures currently in force relate to the credit risks in all of the Bank's activities, and apply both to the single credit and to the entire credit portfolio.

The Bank's commercial credit policy is derived from the Group credit policy, a "supra-document", representing a framework for the Bank's credit policy in Israel and for the Bank's subsidiaries in the United States, the United Kingdom and Romania. The Bank's credit policy, representing a recommendation and guideline for crystallizing the Bank's credit policy in each of the subsidiaries in Israel is also presented for the subsidiaries in Israel.

The Bank in Israel's credit policy and credit risks document is updated each year, discussed by the Bank management and approved by the Board of Directors of the Bank. The document outlines policy for the Bank's activity in Israel and gives expression to the state of the economy in world and in Israel and to the risk environment evaluated for the coming year. The credit policy for 2012 was approved by the Board of Directors in February 2012.

The principles guiding the Bank include:

- Focusing on exposures in activities where the Bank has the expertise required to assess and manage the inherent risks.
- Involvement with credit of varying types with the aim of achieving risk dispersal.
- For each credit risk, there should be segregation between the unit dealing with the credit risk and an independent unit exercising control over the credit risk and over the management of the credit risk.
- Preparing a risk analysis before starting new lines of business or launching new products.
- The segmentation principle: allocating the handling of customers along business lines is carried out according to the operating turnover of the customer and the size of the obligo facility available to him, and according to the complexity/specialization of the type of transaction.
- Every unit in the Bank that creates exposure to credit risk and its manager must be aware of the risks in the area of its operations and responsible for their routine management.
- Carrying out routine and periodic control of credit exposures, with the aim of identifying weaknesses as early as possible and taking the appropriate steps.
- Evaluating credit risk in a quantitative manner, and deciding on a risk rating for every customer. To achieve this aim, the Bank has models and automated systems for supporting the process of reviewing the risk level of the borrower, and evaluating the expected loss.
- Determining an outline operating plan that creates differentiation between three types of operations:
    - Activities the Bank is interested in financing and would like to increase;
    - Activities for selective financing;
    - Activities the Bank tends to avoid financing;

  Details of the outline operating plan are presented in the Credit Policy Document of the Bank.
- Determining internal quantitative limits, and managing and monitoring them. In addition, the distribution of risk ratings of borrowers in the Bank is monitored by various cross-sections.
- The Bank has been working for a number of years, to increase vigilance and general awareness among managers of the customers, the potential negative implications of the environmental aspects on projects it finances. The Bank takes steps to identify the sensitive industries and to integrate a component of this exposure when making credit decisions.

Control and management procedures

In the area of credit management, the procedures for the control and supervision of risks, *inter alia*, by the intensifying the "segmentation" of corporate customers in the appropriate lines of business and in the framework of specialist branches.

The examination of the credit frameworks of the Bank's large borrowers and the approval of the transactions or their transfer for discussion in the appropriate credit committee are carried out by the Credit Risk Management Unit in the Credit Branch in the Corporate Division, in the Construction and Real Estate Department and in the Commercial Banking Division. These units were set up with the aim of tightening credit controls, and improving the quality of the Bank's credit portfolio and service to customers.

For further details, see paragraph "Organizational structure and management responsibility for credit risks".

As part of the control and supervision over credit, there are directives and regulations relating to the type of credit, terms of financing, method of reliance on the various collaterals, type of transaction, and periods of credit, and in this context, the control and supervision over executing policy have been tightened. On the individual level, special emphasis has been placed on the examination of the business condition with customers in which the level of risk has risen. Control is exercised by the use of control tools and improvement in the efficiency of working procedures.

The Bank's credit policy relates to bank credit at normative risk levels as they are defined, and accordingly, general guidance is given to the desired and better risk level. Therefore, the credit authorities are valid only in respect of transactions in the "green channel" (corresponding to the Bank's up-to-date credit policy).

Managing the loan portfolio in the Bank requires, *inter alia*, having a quantitative assessment of the risk level of the borrowers. To achieve this aim, models and automatic systems have been assembled in the Bank to support the process of examining the risk level of the borrower, the expectancy of loss, and the return required for these risks.

The Bank is in the process of setting up an advance system for managing the loan portfolio, with the aim of upgrading its capability to control the various risks, and particularly different risks of concentration, maintaining the limits of risk factors in the area of credit, directing activities with the objective of improving the ratio of return on risk, and facilitating a more accurate pricing system of credit risks.

As stated, the Board of Directors of the Bank approves the Bank's credit and collateral policy, as well as sectoral and other limits.

Outline according to economic sector

Three categories of economic sectors are defined as part of a policy by the risk rating of each sector – the sectors at a low, medium and high level of risk plus a definition of what is included in the "green channel" and what is outside it. This outline plan is updated on a routine basis in accordance with periodic analyses of the various sectors and segments of the economy according to the risks and prospects inherent in each sector. The sector outline plan represents a further consideration in specific decision regarding the grant of credit, together with an individual examination of risk features of the borrower/transaction and its risk rating.

For further details on this subject, see the paragraph on "Credit concentration".

Credit policy in overseas subsidiaries

In each of the Bank’s overseas units, the subsidiary's credit policy is approved by the local board of directors. Periodically, each of the overseas units presents a summary description of credit in its area, and the main characteristics of its credit portfolio, to the Board of Directors of the Bank. As in Israel, the credit policy of overseas subsidiaries is based on spreading risks among the various branches of the economy, while setting limits for exposure in the various sectors of the economy and operating segments. In addition, collateral policy is prescribed within the scope of the credit policy, including principles and rules regarding the various types of collateral, the extent of reliance thereon, etc. This is done in accordance with and subject to all the banking regulations and directives of each country. Various levels of credit-granting authorities are set for each subsidiary. In addition, in those subsidiaries providing commercial credit, there is a process for rating borrowers according to levels of risk and in subsidiaries with a substantial credit volume, there is a loan review unit which performs routine examinations of the risk level of the Bank’s customers.

Reporting on credit risk

The Bank is meticulous in maintaining routine and up-to-date reporting to members of the Bank Management and the Banking Supervision Department. Reporting to the Banking Supervision Department includes reports on various credit matters, including credit risk by sectors of the economy, financial instruments, the structure of shareholders' equity and the minimum capital ratio, large individual borrowers and groups of borrowers, credit for financing the acquisition of means of control, problem loans, and supplementary provision, credit exposures of subsidiaries abroad, related persons, etc.

Reports to Bank Management and/or to the Board of Directors relate to the development of credit for exceptional or major transactions, the results of quarterly reviews of the risk rating of borrowers in particular, and of the overall credit portfolio in general, quarterly reports on concentrations of credit by sector of the economy, individual borrowers and groups of borrowers, loans for financing the acquisition of means of control, countries, Israeli and foreign banks in relation to the limits set by the Banking Supervision Department and internal limits, the distribution of problem credit among the various units of the Bank, and information on customers with special sensitivity, etc.

Organizational structure and management responsibility of credit risk

Credit risk management department in the Risk Management Division

In the Risk Management Division, which is subject to the Chief Risk Officer of the Group (CRO), the credit risk department operates with the a credit risk manager at its head. The department is responsible for credit risk management at the portfolio level, including the formulation of the credit and credit risks policy document, monitoring and analyzing risks in the entire credit portfolio, independently examining and controlling specific credit portfolios and developing quantitative models and tools for measuring and controlling credit risks.

Credit risk management in the Risk Management Division

In order to structure the decision-making process as a function of the risk entailed in financing borrowers, CRM units operate within the Corporate Division, the Construction and Real-Estate Department, and the diamond sector. The purpose of the CRM units is to optimize decision-making in credit portfolios. CRM units are responsible for the in-depth analysis of credit applications from business units, validating borrowers' risk ratings, systematic credit monitoring, making recommendations on classifications and provisions, developing methodologies and financing "formats", developing control processes and implementing working procedures and rules for granting credit at Bank level. The main work of the units focuses on making an independent examination of customer relationship managers' recommendations for determining credit facilities for financing customers under their care, and identifying customers whose situation has deteriorated, while indicating the main risks characterizing the credit portfolio and making recommendations for the continued treatment of the customers. As part of the rationale behind the establishment of the Credit Risk Management units, and with the aim of improving and simplifying the decision-making process and shorten timeframes for providing credit, a change was made in the hierarchy of credit authorities at the various levels so that some credit applications are approved by Credit Risk Management units. This allows the credit committees to devote more time to discussing borrowers characterized by a high level of exposure, and to complex transactions. Reporting to the Real Estate Credit Risk Management unit is an "Appraisals Department", whose duties, *inter alia*, are to examine and validate appraisals of real estate assets pledged to the Bank, carried out by certified appraisers, and to determine the maximum collateral value of the properties.

A unit operates in the Commercial Division with similar characteristics to the Corporate CRM Department described above, which reviews and analyses the bulk of the credit portfolio of the Division.

In the Banking Division, the Consumer Credit Risk Management department is under the responsibility of the retail CRM sector, which is responsible for the entire retail credit portfolio, and for preparing Leumi's consumer credit policy document.

The sector regularly provides the management of the Division with an overview, an analysis of trends and expectation, with regard to consumer credit risk in the divisional credit portfolio.

For this purpose, the sector uses, in addition to the vast knowledge accumulated in the area, various models it has developed and the data bases under its responsibility.

The sector carries out and manages designated activities in consumer credit vis-à-vis the branches and the districts, leads committees in this area and is responsible for the training and assimilation procedures of the CS model in the branches and districts and the Basel II directives.

Special Credit Department

The Special Credit Department operates under the responsibility of the Head of the Corporate Division. The department specializes in dealing with companies in difficulties, and consists of the following two sectors:

1. **ITSC (Intensive Treatment of Sensitive Customers) Sector** – a professional unit dealing with active customers presently in difficulties, under the assumption that the company can be brought back to normative operations if it is managed and financed correctly.

2. **Collections Sector** – deals with inactive customers or those whose operations are about to be shut down. The two sectors above are often aided by relevant external parties such as external lenders, CPA's, architects/engineers, lawyers, etc.

Tools for credit risk management

In managing credit risk, use is made of quantitative models for rating the risk of borrowers and evaluation and monitoring of risk at portfolio level.

Granting private credit up to a defined maximum sum is examined under a credit-scoring system based on the level of risk inherent in the account. Corporate and commercial credit and major private customers are rated under the credit rating system which operates at the Bank. This credit rating assists management in the decision-making process, in pricing the credit, and in monitoring its quality over time. Credit risk is dependent on the probability of default by the borrower with one year of the rating in a given period, or PD (probability of default), the extent of the exposure in respect of the borrower at the time of default, EAD (exposure at default), and the loss from the borrower in a given default, or LGD (loss given default). The borrower evaluation system, coupled with the system for measuring profitability from the customer, provides a basis for connecting the level of risk and the pricing for the customer and improving various routine management aspects.

At the portfolio level, the Bank is assisted by an economic capital model, which is based on the rating of the borrowers, in order to assess the credit risk at the portfolio level and at different cutoffs.

Proper Conduct of Banking Business Directive No. 339

The Bank has made preparations and is implementing the provisions of the Supervisor of Banks' Proper Conduct of Banking Business Directive No. 339, which addresses the management of the Bank's credit risks. The directive sets out fundamental principles for the management and control of risks, including the responsibilities of management entities, appropriate involvement by the Board of Directors in risk management, the definition of means of control, and the provision of tools for evaluating and measuring risks, and regulating the means of control and supervision of these risks.

Conclusion-drawing process

The Bank has a process for drawing conclusions on credit matters, with the participation of the managers of the various units of the Bank. Committees for drawing conclusions have been established in the various divisions for this purpose. These committees convene periodically in order to discuss incidents of default, analyze the implications and significance of the findings of the incident, and formulate recommendations for improving work processes and enhancing business efficiency. The recommendations accepted by the committees are implemented in revisions to credit and collateral policy, in amendments to working procedures at the Bank, and in updates of training programs.

Capital requirements in respect of credit risk

For information regarding the capital requirements in respect of credit risk pursuant the Basel II directives, the standard approach, see pages 29-31.

Review of central credit risk focus points during the year

Against the background of fluctuations and financial and political crises we have witnessed in the past year, the Bank is increasing its efforts to identify borrowers and segments of the population that are likely to be impacted as a result, including:

- Exporters and/or entities with a high dependence on proceeds in foreign currency.
- Manufacturers dealing with competition in imports.
- Firms operating in "luxury" sectors, which are the first to suffer from a decline in demand in periods of economic slowdown.
- Borrowers raising index-linked credit in Israeli currency with the proceeds intended for investments abroad (such as real estate companies operating overseas).
- Borrowers who have raised source of finance in recent years on the capital market, and intend to base their future sources of repayment on raising funds in the Stock Exchange and/or an exit from existing investments.
- Borrowers whose debts are based on shares that constitute a material part of their asset value and/or the collateral on which the Bank is relying, etc.
- Borrowers in the real estate sector who are exposed to a fall in property prices as a result of a fall in demand.
- Holding companies, the value of whose assets are likely to be impaired, and as a result, the ratio between the value of holdings and the scope of leverage is worsened, making it more difficult to raise and turnover credit for repayment of earlier debts.

The Bank maintains strict control on a continuous basis over the effects of erosion and exposures created for the relevant borrowers which also derive from the volatility described above; including in-depth discussion of customers it defines as sensitive.

In view of the current uncertainty, against the backdrop of financial difficulties prevailing in various countries, the Bank adopts a selective policy in expanding activity, differentiating between different levels of risk, and adjusting credit margins and terms accordingly.

Risk exposures according to main type of credit exposure (Table 4(B) – Basel II):

Type of credit exposure	**31 December 2011**	31 December 2010	**31 December 2011**	31 December 2010
	Gross credit risk exposures		Average gross credit risk exposures	
	NIS millions		NIS millions	
Credit	**296,643**	252,759	**278,944**	252,255
Debentures	**37,229**	45,448	**35,557**	42,935
Others	**14,199**	12,868	**13,795**	12,966
Guarantees and liabilities on account of customers	**113,112**	107,258	**111,531**	104,158
Transactions in derivative financial instruments	**7,592**	13,852	**13,503**	12,194
Total	**468,775**	432,185	**453,330**	424,508

Credit risk exposure by counterparty and by main type of credit exposure – (Table 4(d) – Basel II):

	31 December 2011					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Sovereign debts	**41,287**	**24,666**	**-**	**189**	**21**	**66,163**
Debts of public-sector entities	**3,299**	**1,398**	**-**	**180**	**-**	**4,877**
Debts of banking corporations	**10,485**	**5,331**	**-**	**1,939**	**2,381**	**20,136**
Debts of corporations	**123,502**	**4,683**	**-**	**74,603**	**5,146**	**207,934**
Debts collateralized by commercial real estate	**19,180**	**-**	**-**	**1,489**	**-**	**20,669**
Retail exposures to individuals	**27,688**	**-**	**-**	**26,702**	**44**	**54,434**
Loans to small businesses	**13,816**	**-**	**-**	**4,021**	**-**	**17,837**
Housing mortgages	**57,386**	**-**	**-**	**3,989**	**-**	**61,375**
Securitization	**-**	**1,151**	**-**	**-**	**-**	**1,151**
Other assets	**-**	**-**	**14,199**	**-**	**-**	**14,199**
Total credit risk	**296,643**	**37,229**	**14,199**	**113,112**	**7,592**	**468,775**

	31 December 2010					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Sovereign debts	20,079	28,655	-	2,462	-	51,196
Debts of public-sector entities	3,175	3,507	-	126	-	6,808
Debts of banking corporations	8,719	6,725	-	1,687	7,502	24,633
Debts of corporations	111,842	5,624	-	65,364	6,303	189,133
Debts collateralized by commercial real estate	18,406	-	-	1,510	-	19,916
Retail exposures to individuals	26,631	-	-	25,635	47	52,313
Loans to small businesses	12,637	-	-	3,608	-	16,245
Housing mortgages	51,270	-	-	6,866	-	58,136
Securitization	-	937	-	-	-	937
Other assets	-	-	12,868	-	-	12,868
Total credit risk	252,759	45,448	12,868	107,258	13,852	432,185

Distribution of portfolio by repayment period and by main type of credit exposure – (Table 4(e) – Basel II):

	31 December 2011					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Up to one year	**162,556**	**16,965**	**2,812**	**70,093**	**6,151**	**258,577**
From one to five years	**64,748**	**12,502**	**743**	**28,877**	**2,600**	**109,470**
More than five years	**69,184**	**77,762**	**2,345**	**14,142**	**7,012**	**100,445**
Non-monetary items	**155**	**-**	**8,299**	**-**	**1,653**	**10,107**
Benefits to be offset					**(9,824)**	**(9,824)**
Total	**296,643**	**37,229**	**14,199**	**113,112**	**7,592**	**468,775**

	31 December 2010					
	Credit	Bonds	Others	Guarantees and other obligations	Transactions in financial derivatives	Total
	NIS millions					
Up to one year	127,782	18,526	2,267	61,944	6,060	216,579
From one to five years	61,141	14,763	655	30,091	2,003	108,653
More than five years	63,816	12,159	1,355	15,223	3,714	96,267
Non-monetary items	20	-	8,591	-	2,075	10,686
Benefits to be offset					-	-
Total	252,759	45,448	12,868	107,258	13,852	432,185

Credit risk in accordance with the standardized approach (Table 5 – Basel II)*:

The tables below give details of credit exposure according to risk weighting, allocating the exposure by counterparty, before and after deduction of credit risk in respect of recognized collateral.

*See Tables 4(b) and 4(d) above for details

Amount of exposure before expenses in respect of credit losses, and before deduction of credit risk(2)

	31 December 2011									
	0%	20%	35%	50%	75%	100%	150%	350%	Deduction from equity	Gross credit exposures (1)
	NIS millions									
Sovereign debts	**63,065**	**2,480**	**-**	**315**	**-**	**303**	**-**	**-**	**-**	**66,163**
Debts of public-sector entities	**-**	**1,374**	**-**	**3,499**	**-**	**-**	**4**	**-**	**-**	**4,877**
Debts of banking corporations	**36**	**16,442**	**-**	**3,095**	**-**	**563**	**-**	**-**	**-**	**20,136**
Debts of corporations	**-**	**642**	**-**	**2,093**	**-**	**201,640**	**3,559**	**-**	**-**	**207,934**
Debts collateralized by commercial real estate	**-**	**-**	**-**	**-**	**-**	**20,243**	**426**	**-**	**-**	**20,669**
Retail exposures to individuals	**-**	**-**	**-**	**-**	**54,170**	**123**	**141**	**-**	**-**	**54,434**
Loans to small businesses	**-**	**-**	**-**	**-**	**17,443**	**259**	**135**	**-**	**-**	**17,837**
Housing mortgages	**-**	**-**	**38,837**	**-**	**17,741**	**4,600**	**197**	**-**	**-**	**61,375**
Securitization	**-**	**1,001**	**-**	**100**	**-**	**21**	**-**	**-**	**29**	**1,151**
Other assets	**2,380**	**-**	**-**	**-**	**-**	**11,397**	**422**	**-**	**-**	**14,199**
Total	**65,481**	**21,939**	**38,837**	**9,102**	**89,354**	**239,149**	**4,884**	**-**	**29**	**468,775**

(1) Before conversion to credit of off balance sheet components as required by the Basel II directives (e.g. weighting of unutilized facilities) and before deduction of credit risk as the result of certain activities (e.g. use of guarantees).
(2) The deduction of credit risk expresses classification of the final of risk weighting between the various rates.

The above comments relate to the tables below.

Amount of exposure after expenses in respect of credit losses, and before deduction of credit risk(2)

	31 December 2011									
	0%	20%	35%	50%	75%	100%	150%	350%	Deduction from equity	Gross credit exposures (1)
	NIS millions									
Sovereign debts	**63,064**	**2,480**	**-**	**315**	**-**	**303**	**-**	**-**	**-**	**66,162**
Debts of public-sector entities	**-**	**1,373**	**-**	**3,497**	**-**	**-**	**4**	**-**	**-**	**4,874**
Debts of banking corporations	**35**	**16,437**	**-**	**3,095**	**-**	**563**	**-**	**-**	**-**	**20,130**
Debts of corporations	**-**	**642**	**-**	**2,093**	**-**	**199,230**	**3,461**	**-**	**-**	**205,426**
Debts collateralized by commercial real estate	**-**	**-**	**-**	**-**	**-**	**20,056**	**391**	**-**	**-**	**20,447**
Retail exposures to individuals	**-**	**-**	**-**	**-**	**53,773**	**82**	**139**	**-**	**-**	**53,994**
Loans to small businesses	**-**	**-**	**-**	**-**	**17,273**	**113**	**134**	**-**	**-**	**17,520**
Housing mortgages	**-**	**-**	**38,753**	**-**	**17,687**	**4,229**	**185**	**-**	**-**	**60,584**
Securitization	**-**	**1,001**	**-**	**100**	**-**	**21**	**-**	**-**	**29**	**1,151**
Other assets	**2,381**	**-**	**-**	**-**	**-**	**11,396**	**422**	**-**	**-**	**14,199**
Total	**65,480**	**21,933**	**38,753**	**9,100**	**88,733**	**235,993**	**4,736**	**-**	**29**	**464,757**

Amount of exposure after expenses in respect of credit losses, and after deduction of credit risk(2)

	31 December 2011									
	0%	20%	35%	50%	75%	100%	150%	350%	Deduction from equity	Net credit exposures (1)
	NIS millions									
Sovereign debts	**63,563**	**2,452**	**-**	**315**	**-**	**303**	**-**	**-**	**-**	**66,633**
Debts of public-sector entities	**350**	**876**	**-**	**3,495**	**-**	**-**	**4**	**-**	**-**	**4,725**
Debts of banking corporations	**35**	**16,273**	**-**	**3,356**	**-**	**511**	**-**	**-**	**-**	**20,175**
Debts of corporations	**-**	**642**	**-**	**2,093**	**-**	**189,146**	**3,286**	**-**	**-**	**195,167**
Debts collateralized by commercial real estate	**-**	**-**	**-**	**-**	**-**	**19,208**	**391**	**-**	**-**	**19,599**
Retail exposures to individuals	**-**	**-**	**-**	**-**	**51,323**	**82**	**133**	**-**	**-**	**51,538**
Loans to small businesses	**-**	**-**	**-**	**-**	**15,234**	**112**	**127**	**-**	**-**	**15,473**
Housing mortgages	**-**	**-**	**38,747**	**-**	**17,587**	**4,220**	**185**	**-**	**-**	**60,739**
Securitization	**-**	**1,001**	**-**	**100**	**-**	**21**	**-**	**-**	**29**	**1,151**
Other assets	**2,381**	**-**	**-**	**-**	**-**	**11,396**	**422**	**-**	**-**	**14,199**
Total	**66,329**	**21,244**	**38,747**	**9,359**	**84,144**	**224,999**	**4,548**	**-**	**29**	**449,399**

Amount of exposure after expenses in respect of credit losses and before deduction of credit risk[(2)]

	31 December 2010									
	0%	20%	35%	50%	75%	100%	150%	350%	Deduction from equity	Gross credit exposures (1)
	NIS millions									
Sovereign debts	47,976	2,805	-	231	-	184	-	-	-	51,196
Debts of public-sector entities	-	3,481	-	3,307	-	-	20	-	-	6,808
Debts of banking corporations	-	20,095	-	3,973	-	554	11	-	-	24,633
Debts of corporations	-	848	-	6,286	-	172,485	9,514	-	-	189,133
Debts collateralized by commercial real estate	-	-	-	-	-	18,880	1,036	-	-	19,916
Retail exposures to individuals	-	-	-	-	51,284	124	905	-	-	52,313
Loans to small businesses	-	-	-	-	15,466	115	664	-	-	16,245
Housing mortgages	-	-	38,257	-	17,749	1,920	210	-	-	58,136
Securitization	-	502	-	110	-	111	-	-	214	937
Other assets	2,098	-	-	-	-	10,402	368	-	-	12,868
Total credit risk	50,074	27,731	38,257	13,907	84,499	204,775	12,728	-	214	432,185

Amount of exposure after expenses in respect of credit losses and after deduction of credit risk[(2)]

	31 December 2010									
	0%	20%	35%	50%	75%	100%	150%	350%	Deduction from equity	Net credit exposures (1)
	NIS millions									
Sovereign debts	50,271	2,816	-	230	-	184	-	-	-	53,501
Debts of public-sector entities	-	1,215	-	3,299	-	-	20	-	-	4,534
Debts of banking corporations	-	20,284	-	4,087	-	554	11	-	-	24,936
Debts of corporations	-	848	-	6,286	-	161,954	9,058	-	-	178,146
Debts collateralized by commercial real estate	-	-	-	-	-	17,794	1,021	-	-	18,815
Retail exposures to individuals	-	-	-	-	48,617	124	832	-	-	49,573
Loans to small businesses	-	-	-	-	13,802	113	585	-	-	14,500
Housing mortgages	-	-	38,250	-	17,642	1,910	207	-	-	58,009
Securitization	-	502	-	110	-	111	-	-	214	937
Other assets	2,098	-	-	-	-	10,402	368	-	-	12,868
Total credit risk	52,369	25,665	38,250	14,012	80,061	193,146	12,102	-	214	415,819

Credit risk reduction

Policy and Processes regarding Collateral Valuation and Management

As a policy, the Bank aims to give credit against collateral. The amount of collateral required from a borrower derives, *inter alia*, from the level of risk in the credit. Collaterals received is not the principal consideration in approving credit, but rather additional support, intended to minimize the loss to the Bank in the event of the business/financial failure of the borrower.

Within the context of the collateral policy for all sectors of the economy, the Bank has set principles and rules concerning types and amounts of collateral. Requirements and rates of collateral derive from the level of risk that the Bank is willing to assume when providing credit, but special attention is also given to borrowers' risk ratings and their repayment ability as criteria for granting the credit, as opposed to the weight attributed to the usual collateral.

Furthermore, business criteria have been determined for receiving collateral, the manner of determining the rate of reliance on the collateral, courses of action when receiving them, methods and timing for updating its value and means of follow up and control, and these are distributed through working procedures, circulars, and operating instructions.

Collateral is matched to the kind of credit that it secures, taking into account the length of the period, types of linkage, the nature of the credit and its purpose, as well as the time frame within which the collateral can be realized. The Bank customarily verifies the value of collateral by obtaining up-to-date appraisals/valuations. Appraisals must be independent and addressed to the Bank.

The Credit Risk Management Unit in the area of real-estate in the Corporate Division is responsible for the operation of the Appraisal Section whose function, *inter alia,* is appraisals of real estate assets pledged to the Bank.

In special transactions, and in cases when shares of a corporation serve as the main collateral and/or the main source of repayment of a loan, this requires an updated appraisal and an examination of the ability of the corporation as a source of debt repayment. The appraisal is carried out by one of several generally accepted methods in the Bank, taking into account the circumstances of the matter, such as the description of the corporation, and the economic sector and economic environment in which the acquired corporation operates. Appraisals can be carried out by an expert unit in the Bank or by an external appraiser from the list of appraisers authorized from time to time by the Bank. If the appraisal is carried out by an external appraiser, an audit review will be carried out on it by the business personnel and expert units in the Bank.

The Bank has a computerized system enabling information to be produced about types of collateral. Instructions have been issued concerning the various types of collateral, managing them, determining their value (using external appraisers, financial data, etc.), handling the receipt of collateral, and monitoring changes in collateral and in its value. Officers authorized to approve the credit operate in accordance with prescribed policy. Rates of collateral are calculated automatically by the computerized system according to prescribed policy.

The Bank's collateral procedures contain the business and legal principles on the basis of which the various types of collateral are to be received. These guidelines also include operational aspects regarding the procedure for receiving collateral (for example: requisite forms, registration with registrars - if needed), collateral reliance rates in respect of each type of collateral, control processes to be performed, etc.

The principles on which collateral reliance rates are determined derive from the degree of liquidity and negotiability of the collateral, ways of realizing the collateral and the speed of realization, the degree of volatility in the value of the collateral, the appraisal of the collateral (internal or external), the degree of control, monitoring and supervision the Bank has over the collateral, the suitability of the type of collateral to the type of financing, and the dependence of the value of the collateral on the condition of the client.

Special emphases regarding specific collaterals also appear in the Bank's Credit and Credit Risks Policy document.

Common types of collateral accepted by the Bank for the purpose of reducing risks deriving from the grant of credit

- pledge/offset of monies in accounts held at the Bank or with external entities (shekel/foreign currency deposits, savings, securities, provident funds);
- pledge of sources for repayment paid into an account with the Bank (deferred receivables, credit card vouchers, direct debits, open accounts);
- bank guarantees from banks in Israel and abroad/sovereign guarantees/retention of inter-branch collateral;
- third-party guarantees;
- foreign trade risk insurance policies;
- real estate;
- floating charges;
- movable property (vehicles, equipment);
- pledge and assignment of rights by way of charge (pledges of contract/factoring).

Reduction of credit risk (Table 7– Basel II):

	31 December 2011					
	Gross credit exposure before allowance for credit losses	Gross credit exposure after allowance for credit losses	Total exposure covered by guarantees deducted	Total amounts added	Total exposure covered by eligible financial collateral	Net credit exposure
	NIS millions					
Sovereign debts	**66,163**	**66,162**	**(28)**	**499**	**-**	**66,633**
Debts of public-sector entities	**4,877**	**4,874**	**(497)**	**349**	**(1)**	**4,725**
Debts of banking corporations	**20,136**	**20,130**	**(287)**	**376**	**(44)**	**20,175**
Debts of corporations	**207,934**	**205,426**	**(365)**	**-**	**(9,894)**	**195,167**
Debts collateralized by commercial real estate	**20,669**	**20,447**	**(29)**	**-**	**(819)**	**19,599**
Retail exposures to individuals	**54,434**	**53,994**	**(4)**	**-**	**(2,452)**	**51,538**
Loans to small businesses	**17,837**	**17,520**	**(11)**	**-**	**(2,036)**	**15,473**
Housing mortgages	**61,375**	**60,854**	**(3)**	**-**	**(112)**	**60,739**
Securitization	**1,151**	**1,151**	**-**	**-**	**-**	**1,151**
Other assets	**14,199**	**14,199**	**-**	**-**	**-**	**14,199**
Total	**468,775**	**464,757**	**(1,224)**	**1,224**	**(15,358)**	**449,399**

	31 December 2010				
	Gross credit exposure	Total exposure covered by guarantees and deducted	Total amounts added	Total exposure covered by eligible financial collateral	Net credit exposure
	NIS millions				
Sovereign debts	51,196	-	2,305	-	53,501
Debts of public-sector entities	6,808	(2,266)	-	(8)	4,534
Debts of banking corporations	24,633	-	303	-	24,936
Debts of corporations	189,133	(313)	-	(10,674)	178,146
Debts collateralized by commercial real estate	19,916	(2)	-	(1,099)	18,815
Retail exposures to individuals	52,313	(3)	-	(2,737)	49,573
Loans to small businesses	16,245	(22)	-	(1,723)	14,500
Housing mortgages	58,136	(2)	-	(125)	58,009
Securitization	937	-	-	-	937
Other assets	12,868	-	-	-	12,868
Total	432,185	(2,608)	2,608	(16,366)	415,819

Activity in Derivative Instruments for the purpose of reducing credit risks

Hedging and/or Risk Reduction Policy and Strategies and Processes for Monitoring the Continuing Efficacy of Risk-Reducing Hedging Activities

Developments in international foreign currency markets and the volatility of exchange rates of the various currencies, with their implications on those borrowers active in foreign currency, make it necessary to increase activity in monitoring, supervising and controlling customers' exposures to fluctuations in market prices (exchange rate, inflation, etc.). To this end, the Bank has updated instructions addressing the matching required between the basis currency of the credit and the currency of the cash flow that constitutes the source of repayment of the credit and awareness of the subject of exposure to currency risks has been increased and special attention has been drawn to borrower with the potential of a high degree of exposure. When necessary, the borrower's risk rating is revised and a requirement issued to strengthen shareholders' equity and collateral.

If it appears that a borrower faces exposure/sensitivity to changes in exchange rates, the relevant business function has to examine the degree of the borrower's sensitivity from an overall perspective. This examination takes into account all the criteria requiring the borrower to be added to the list of sensitive customers, and consideration and quantification of the borrower's sensitivity to changes in the relevant exchange rates and commodity prices.

For the purpose of hedging various credit risks, the Bank recommends its customers to make use of defensive mechanisms against macro-economic variables, such as the Consumer Price Index, exchange rates and commodity prices. In order to reduce the level of credit risk, the Bank suggests to the borrower to protect himself against sharp changes in exchange rates, *inter alia*, by the use of financial instruments. By using these instruments, it is possible to "hedge" financial exposure and, to a certain extent, real exposure as well, keep risk to a minimum.

When a solution is not found to fully cover exposure to changes in exchange rates, the Bank examines the need for taking other measures to reduce exposure, such as changing the terms of the loan, increasing collateral requirements, and reducing the borrower's *obligo*, as well as cancelling lines that have not yet been utilized.

Various escape clauses are included in the credit documents, which enable the Bank to discontinue providing credit in foreign currency and to replace it with credit in shekels.

Due to the high volatility of worldwide prices of commodities, special attention is also paid to sectors that are likely to be adversely affected by this trend.

Below are credit risk balances to counter parties (Table 8 – Basel II):

	31 December 2011	
	Par value balance	Net credit exposure of derivatives
	NIS millions	
Interest contracts	**230,713**	**8,308**
Foreign currency contracts	**206,179**	**7,236**
Contracts in respect of shares	**18,423**	**1,653**
Commodities and other contracts	**1,547**	**219**
Credit derivative transactions (1)	**-**	**-**
Offset benefits (2)	**-**	**(9,824)**
Eligible collateral	**-**	**(44)**
Total	**456,862**	**7,548**

	31 December 2010	
	Par value balance	Net credit exposure of derivatives
	NIS millions	
Interest contracts	172,027	4,039
Foreign currency contracts	227,274	7,534
Contracts in respect of shares	14,739	2,044
Commodities and other contracts	1,530	235
Credit derivative transactions (1)	2,334	-
Offset benefits (2)	-	-
Eligible collateral	-	-
Total	417,904	13,852

(1) At the date of this report, there are no credit risk exposures in respect of hedging sold or purchased (31 December 2010 – NIS 741 million nominal value).

(2) From 31 December 2011 credit risk in respect of derivatives is calculated in accordance with Proper Conduct of Banking Business Regulation No. 313. and offset against transactions for derivatives with offset agreements.

The par value of a transaction in derivatives does not reflect the credit risk of the transaction. Credit risk is measured by the amount of the maximum loss, according to scenarios that the Bank may incur if the counterparty to the transaction does not comply with the terms of the transaction, after deducting enforceable set-off agreements.

The credit risk at a specified date is defined as the total loss or profit that has arisen from the transaction as at that date, plus the potential risk of additional future loss, this potential being estimated according to the level of expected volatility of the underlying asset and the duration of the remaining period until final settlement of the transaction.

Customer activity in transactions in the various types of derivatives is monitored by the Derivatives Risk Management Department in the Bank's Capital Markets Division. This department is responsible for the models for calculating the collateral requirement, the parameters used in the models, the computer systems which measure compliance with the frameworks of the activity, work procedures at the branches, and the legal forms that customers sign. In addition, a control overview is carried out in relation to all the customers, while, with respect to a number of customers working according to complex strategies or in new types of activities not yet computerized, direct monitoring is performed of the collateral requirement with regard to the actual activity and collateral frameworks.

Application of the Financial Assets Agreements Act (Netting) Law enables all future transactions between the Bank and the customer to be considered as a single transaction. This law enables payments to be offset in respect of futures transactions by affixing a single sum, should the customer become subject to insolvency proceedings. Accordingly, the legal forms have been amended and most of the customers have signed the forms.

If a customer has additional indebtedness to the Bank, the credit risk deriving from derivatives is included in the customer's total indebtedness to the Bank.

The following table presents the exposures pertaining to counterparty credit risk, in NIS millions:

	31 December 2011	31 December 2010
Derivatives hedging a positive gross fair value	**9**	32
ALM derivatives with a positive gross fair value	**11,564**	8,679
Other derivatives with a positive gross fair value	**-**	1
Credit derivatives with a positive gross fair value	**-**	5
Total fair value	**11,573**	8,717
Total collateral held	**419**	522

The following table shows credit exposure with respect to the fair value of derivatives, according to counterparties to the contract (reported under other assets), as at 31 December 2011, in NIS millions:

	AAA to AA-	A+	A	A-	BBB to BBB-	BB+ to B-	Unrated	Total
Foreign banks	NIS millions							
Euro zone[1]	**1,119**	**781**	**135**	**-**	**-**	**-**	**2**	**2,037**
United Kingdom [2]	**771**	**14**	**448**	**-**	**7**	**-**	**3**	**1,234**
United States	**1,145**	**399**	**6**	**-**	**-**	**-**	**220**	**1,770**
Other	**337**	**-**	**15**	**-**	**-**	**-**	**5**	**357**
Total foreign banks	**3,372**	**1,194**	**604**	**-**	**7**	**-**	**230**	**5,407**
						-		
Israeli banks [3]	**-**		**1,223**	**613**	**-**	**-**	**15**	**1,851**

Corporate customers, according to sectors of the economy	
Financial services[4]	**2,230**
Industry[5]	**1,580**
Construction and real estate	**138**
Transportation and storage	**82**
Trade	**123**
Electricity and water	**6**
Business services	**9**
Private individuals	**26**
Communications and computer services	**103**
Others	**18**
Total corporate customers	**4,315**
Others*	**-**
Total exposure	**11,573**

The following table shows credit exposure with respect to the fair value of derivatives, according to counterparties to the contract (reported under other assets), as at 31 December 2010, in NIS millions:

	AAA to AA-	A+	A	A-	BBB to BBB-	BB+ to B-	Unrated	Total
Foreign banks	NIS millions							
Euro zone[(1)]	1,763	7	-	-	-	67	2	1,839
United Kingdom [(2)]	536	31	116	-	6	-	6	695
United States	747	62	143	9	-	-	5	966
Other	274	-	-	-	-	-	-	274
Total foreign banks	3,320	100	259	9	6	67	13	3,774
Israeli banks [(3)]	31	388	658	-	-	-	13	1,090

Corporate customers, according to sectors of the economy	
Financial services[(4)]	2,377
Industry[(5)]	808
Construction and real estate	86
Transportation and storage	30
Trade	100
Electricity and water	231
Business services	9
Private individuals	41
Communications and computer services	30
Others	13
Total corporate customers	3,725
Others*	128
Total exposure	8,717

*

* In 2010. reverse transactions carried out by the customers and offset for the purpose of risk according to the branches of the economy.

(1) This amount includes transactions in 5 countries (2010 – includes transactions in 5 countries).
(2) This amount includes transactions with 10 banks (2010 – includes transactions in 10 countries).
(3) This amount includes transactions with 10 banks (2010 – includes transactions in 11 countries).
(4) This amount includes transactions with 466 customers, where the highest amount for a single customer is NIS 349 million (in 2010 – includes transactions with 324 customers, with the customer with the highest amount being NIS 427 million).
(5) This amount includes transactions with 286 customers, where the highest amount for a single customer is NIS 1,078 million (in 2010 – includes transactions with 265 customers, with the customer with the highest amount being NIS 575 million).

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Credit concentration

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

Dispersal of the credit portfolio among the various sectors of the economy:

The Bank's credit portfolio is split among the various sectors of the economy with the aim of dispersing the risk inherent in the high state of concentration in one sector. In sectors of the economy characterized by a relatively low level of risk, we endeavor to reach a high state of financing from out share in the system.

In addition to the sector dispersal limitation, decided by the Bank of Israel with regard to the 20 most important sectors of the market, the Bank defines internal restrictions as a part of its risk policy to disperse the credit portfolio on the basis of the sectors of the economy and the sub-sectors, both as a percentage of the regulatory capital and as a percentage of the credit risk.

Activity and risk restrictions in the construction and real estate sector

Similar to all the sectors of the economy, restrictions at sector level and sub-sector level are defined for the real estate sector as part of the credit and credit risk policy, and the methodology and parameters for financing transactions are also defined.

In addition, the emphasis given by Leumi to financing real estate is reflected in the fact that a significant part of the Bank's activity in the sector is concentrated in a separate system within the framework of the activity of the Corporate Division. In this context, the examination of credit frameworks of the large borrowers in the area of construction and real estate, the approval of transactions or their transfer for discussion in the appropriate credit committee, are examined by the credit risk management (real estate) unit.

The financing of the real estate sector is effected strictly on a range of the credit portfolio, distinguishing between the various segments – initiation of housing construction, building contracting including performance contracting, infrastructure works, activities in non-housing real estate – income-yielding assets, building products industry, trade in building products, and geographical areas in which the projects are located according to the relevant demand.

A significant part of the financing of the construction is done in the "closed project" (construction loan) format, which is characterized by periodic examination and close monitoring, on the reliance and with the assistance of external building supervisors.

As a part of the Bank's strategy to finance its customers in all of the places in which they operate, and with a tendency to disperse risks, the Bank also regularly participates in the financing of real estate abroad. The financing is effected for selective customers, in a controlled fashion and after examining all of their activity in Israel and abroad, in preferred countries and taking into consideration the country's political and economic risk, with a meticulous examination of the projects, with the Bank's overseas subsidiaries or local bank overseeing the projects.

Group of borrowers[1]

The Bank monitors the exposure of groups of borrowers in all their components, using the mechanized system that serves the Bank for the purposes of regular reporting to the Bank of Israel and for internal monitoring and examination of compliance of the scope of obligation of groups of borrowers with the regulatory limitations. In addition, there is an internal process, in the framework of which a central official ("the Group head") is appointed for each of the large groups and there is coordination and information flow regarding the components of the group with the objective of reinforcing, as much as possible, the control on credit exposure and concentration risk deriving therefrom. This process occurs between the various units in Leumi and also includes the subsidiaries, and obliges the business entities involved with management of groups of borrowers to provide constant flow of information relating to the requests made for credit and the ratio of risk to Group items, exercising discretion regarding the scope of information and entities to whom it is transferred..

Moreover, regarding the largest 10 groups of borrowers, the head of the sector dealing with these groups, is required, once a year, to provide the Board of Directors of the Bank with a comprehensive review of the group.

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

- With effect from 31 December 2011 updated provisions of Proper Conduct of Banking Business Regulations No. 313 came into effect, bringing a number of changes into force:

1. The restriction on the six largest groups of borrowers was canceled. In place of this restriction, a limitation of 120% of the Bank's equity was integrated into the restriction on a scheme of debts of large borrowers, groups of borrowers, and groups of bank borrowers, whose indebtedness is more than 10% of the Bank's equity. The total indebtedness of the above groups amounts to 93.9% of the Bank's equity.

2 With regard to the above, the definition "group of bank borrowers" has been added for the first time.

3. The restriction on indebtedness of groups of borrowers – remains at the rate of 25% of the equity of the Bank and the restriction on indebtedness of the borrower – in the amount of 15% of the equity of the Bank. Thus, the restriction of indebtedness of a controlled group of borrowers remains at 50% of the Bank' capital.

For information regarding credit to groups of borrowers whose indebtedness exceeds 15% of the equity of the Bank, see page 111.

Exposure restrictions in transactions for financing the purchase of the means of control

Proper Conduct of Banking Business Directive 323 defines credit for the purchase of the means of control as credit extended to a borrower when the main source of repayment to it is the corporation whose purchase the Bank financed.

[1] A group of borrowers is all of these together: the borrower, a person controlling him or a person controlled by them. When a corporation is controlled by more than one individual, it is required to include in one group of borrowers those controllers for whom the controlled corporation is material (e.g., from a capital perspective), including the controlled corporation and anyone controlled by them.

The directive applies to transactions which fulfill the following conditions:

- The amount of the financing for the purchase is higher than 0.5% of the Bank's capital.
- Repayment of the credit is based on the corporation purchased.

The regulation prescribes quantitative restrictions on the credit for financing the transactions for purchasing the means of control in corporations, and the Bank is in compliance. One of these restrictions is that the total credit for all of the transactions to purchase the means of control in banking corporations which comply with the aforesaid conditions, with the rate of financing higher than 50% of the corporation's cost of purchase must not exceed 70% of the Bank's capital.

A further restriction on financing the purchase of the means of control in a banking corporation is that the amount of the credit for a financing transaction for purchasing the means of control in a banking corporation, when the rate of bank financing for this purchase exceeds 30% of the cost of purchase, must not exceed the lower of: 5% of the capital of the bank extending the capital or 5% of the capital of the bank being purchased.

The Bank augments the aforesaid restrictions, with internal limits relating both to transactions for purchasing the means of control according to the regulation and to financing transactions for any purpose against the means of control (without the right of recourse) on a quantitative and qualitative plain.

1. A quantitative limit on the number of transactions for purchasing the means of control, together with the transactions for any purpose against the means of control.
2. Exposure limits for a single transaction according to ranges of risk-rating.
3. An overall exposure limit on transactions according to ranges of risk-rating.
4. Exposure limit for economy sectors.
5. An overall exposure limit on transactions that are not on the "green channel" and are not in full compliance with the Bank's credit policy.
6. An aggregative "prominent" limit on each credit portfolio for financing the means of control.

As part of the Bank's credit policy, the Bank's requirements have been determined when financing the purchase of the means of control or in the financing against the means of control (without the right of recourse) with regard to the necessary shareholders' equity, collateral, etc., and the other additional conditions required for extending credit of this type.

There is a designated unit in the Bank which examines the transactions and designs the financing packages, including the possible inclusion of other financing entities.

Transactions to finance the purchase of the means of control according to the definition in Proper Conduct of Banking Business Directive 323

Below are the principal balances of credit provided in this area by sector of the economy, as of 31 December 2011 (in NIS millions):

Economic sector	Balance sheet and off-balance sheet credit*
	NIS millions
Industry	**3,510**
Trade	**-**
Real estate	**848**
Communications	**630**
Finance and holding companies	**665**
Total	**5,653**

* Less allowances for credit losses and deductible collateral.

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

Geographic dispersal

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

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

In 2009, questions relating to geographic exposure were added in the systems of borrower rating questionnaires. The reference is in the aspect of the mix of revenues and/or the mix of the firm's cash flows, the location of the material assets used and creating its activity (assets used for generating revenue, such as plant / logistical center / warehouse / head offices / rental property, etc.), as well as assets used as collateral for the company's debts.

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

Credit exposure to foreign financial institutions

The following table sets out the credit exposure to overseas financial institutions [(1)]:

	As at 31 December 2011			
	Balance sheet credit risk [(2)]	Securities [(3)]	Current off-balance sheet credit risk [(4)]	Current credit risk
	NIS millions			
External credit rating[(5)]				
AAA to AA-	**8,989**	**3,636**	**649**	**13,274**
A+ to A-	**4,300**	**3,869**	**123**	**8,292**
BBB+ to BBB-	**209**	**18**	**-**	**227**
BB+ to B-	**54**	**-**	**7**	**61**
Below B	**-**	**-**	**53**	**53**
Unrated	**1,564**	**697**	**123**	**2,384**
Total current credit exposure to overseas financial institutions	**15,116**	**8,220**	**955**	**24,291**
Problem debt balances	**7**	**316**	**-**	**323**

	As at 31 December 2010			
	Balance sheet credit risk [(2)]	Securities [(3)]	Current off-balance sheet credit risk [(4)]	Current credit exposure
	NIS millions			
External credit rating [(5)]				
AAA to AA–	8,504	4,717	591	13,812
A+ to A–	2,191	5,738	120	8,049
BBB+ to BBB-	16	316	1	333
BB+ to B–	190	79	18	287
Below B	-	-	-	-
Unrated	948	87	86	1,121
Total current credit exposure to foreign financial institutions	11,849	10,937	816	23,602
Problem loan balances	6	-	-	6

(1) Overseas financial institutions include banks, investment banks, insurance companies and institutional bodies.
(2) Deposits in banks, credit to the public, securities that were borrowed or purchased in the context of buy-back agreements and other assets in respect of derivatives (fair value of derivatives).
(3) Including bank debentures amounting to NIS 1,605 million as at 31 December 2011and NIS 2,000 million as at 31 December 2010.
(4) Mainly guarantees and undertakings for the provision of credit (excluding off-balance sheet derivatives.)
(5) With effect from 2010, only the rating of Moody's was used to rate the foreign financial institutions to which there is a credit exposure.
(6) Credit exposure is presented after deduction of the specific allowances for doubtful debts.

Notes:

a. Credit exposures do not include investments in asset-backed securities (see the details in the note on securities).
b. Some of the banks have received government support of various types, including direct investments in the bank's capital, government guarantees of certain asset portfolios of the banks, guarantees enabling the banks to raise sources of financing, etc.
c. For further information regarding the composition of the credit exposure in respect of derivatives vis-à-vis banks and broker/dealers (local and overseas), see Note 18 to the Financial Statements.

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

The exposure by country is divided as follows: United States 45%, Europe (Germany, France, Italy, Spain and the Benelux countries) 26%, United Kingdom 19%, and other countries 10%.

The exposure includes mainly deposits in overseas banks, some 99.0% of which are short-term deposits of up to one week, and debentures, usually for a period of up to five years. The Bank closely monitors the condition of banks worldwide, and makes frequent analyses of their financial stability. The Bank maintains a shortlist of quality banks with which the Bank and its overseas subsidiaries make deposits.

Additional details regarding investments in securities, mainly debentures of foreign banks, are shown on page 125.

Management of exposure to and credit lines of foreign financial institutions takes into consideration, *inter alia*:

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

Exposure to foreign countries[1]:

The exposure to foreign countries risk according to final risk is distributed among geographical regions and countries, the main exposure being to countries in Western Europe and in North America. The exposure to country risk is the exposure to customers who operate in these countries (Table 4(c) – Basel II):

	31 December 2011		
	Balance sheet credit risk	Off-balance sheet credit risk[2]	Total credit risk
	NIS millions		
USA	**24,541**	**6,282**	**30,823**
UK	**10,213**	**3,004**	**13,217**
France	**2,935**	**322**	**3,257**
Germany	**3,930**	**304**	**4,234**
Switzerland	**2,659**	**770**	**3,429**
Others	**10,359**	**1,392**	**11,751**
Total	**54,637**	**12,074**	**66,711**

	31 December 2010		
	Balance sheet credit risk	Off-balance sheet credit risk	Total credit risk
	NIS millions		
USA	23,677	11,743	35,420
UK	8,589	7,782	16,371
France	3,766	3,226	6,992
Germany	4,219	4,835	9,054
Switzerland	2,007	2,314	4,321
Others	12,819	2,850	15,669
Total	55,077	32,750	87,827

[1] In connection with exposure to foreign countries, see also Exhibit D.

[2] Effective 31 December 2011, credit risk in respect of derivatives is calculated according to Proper Conduct of Banking Business Regulations No. 313 with offset agreements.

The following table presents the exposure to countries according to the credit rating of the countries as rated by the World Bank, in NIS millions as at 31 December 2011:

Rating	Balance sheet exposure	Off-balance-sheet exposure	Total exposure	Percentage of exposure in relation to total	Of which, problem
OECD countries	**51,170**	**11,061**	**62,231**	**93.4**	**1,546**
High-income countries	**775**	**384**	**1,159**	**1.7**	**1**
Countries with mid-high income	**2,386**	**582**	**2,968**	**4.4**	**647**
Countries with mid-low income	**298**	**47**	**345**	**0.5**	**2**
Countries with low income	**8**	**-**	**8**	**-**	**-**
Total	**54,637**	**12,074**	**66,711**	**100.0**	**2,196**

The amount of exposure to countries with liquidity problems as defined by the Fitch liquidity index and by the Bank of Israel (a country receiving monetary assistance from the IMF or whose liabilities are rated with a credit rating of CCC or lower) totals NIS 1,106 million and relates to 13 countries.

The countries are rated according to national income per capita as follows:
High income - exceeding US$ 12,276 per capita.
Mid-high income - from US$ 3,976 to US$ 12,275 per capita.
Mid-low income - from US$ 1,006 to US$ 3,975 per capita.
Low income – up to US$ 1,005 per capita.

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

a. OECD countries:

USA, Italy, Australia, Austria, Ireland, Belgium, Canada, Czech Republic, Denmark, Finland, Israel, Hungary, France, United Kingdom, Japan, Spain, Switzerland, Luxembourg, Slovenia, the Netherlands, Sweden, Poland, Germany and South Korea

b. Countries with high income:

Cyprus, Hong Kong, Monaco, Singapore, Cayman Islands and Croatia

c. Countries with mid-high income:

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

d. Countries with mid-low income:

China, Ecuador, Egypt, India, Jordan, Paraguay, the Philippines, Thailand, the Ukraine

e. Countries with low income:

A large number of the African countries, Haiti, Nepal

Exposure to certain foreign countries:

Country	31 December 2011				
	Credit to the public	Bonds	Deposits	Other	Total
	NIS million				
Ireland	**80**	**359**(1)	**18**	**15**	**472**
Greece	**6**	**2**	**-**	**-**	**8**
Spain *	**6**	**-**	**-**	**-**	**6**
Portugal	**42**	**440**(2)	**18**	**10**	**510**
Total	**134**	**801**	**36**	**25**	**996**

Portugal – no exposure to the Group
(1) Of which NS 264 million in Bank Intessa
(2) Most of the exposure to Spain is to Santander Bank most of whose revenues come from outside Spain.

Problem debts – disclosure, assessment, classification and rules for all for credit losses

The Bank follows the instructions of the Supervisor of Banks, dated 1 January 2011, in respect of expenses in credit losses and problem debts

For more information, see page 62.

Market and Liquidity Risks

Market risk and nostro policy

Market risk is defined as risk of a loss in off-balance sheet positions arising from changes in the fair value of a financial instrument as a result of a change in market conditions (a change in price levels in various markets, fluctuations in interest rates, exchange rate, inflation, the prices of shares and commodities and other economic indices). Exposure to market risks is reflected in the business results, the fair value of assets and liabilities, shareholders' equity, cash flows and the value of the Bank.

Market risk, including liquidity risk, is the second ranking risk in importance to the Bank, which the Bank assumes.

The policy for managing market risks is intended on the one hand, to support the achievement of business goals by assessing the risks and the damage that can result from exposure to risks and their limitation, in comparison with the forecast profit from them, and on the other hand, to reduce the level of risk deriving from the Bank's ongoing activity, including maintaining a high liquidity level. All this is after taking into account the volume of activity, limitations, and the costs of hedging activity, the changes occurring in the business environment in Israel and throughout the world, directives and requirements of the Bank of Israel, and developments occurring worldwide with regard to measurements and methods of managing risks and adapting them to the needs of the Group and the Bank.

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

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

Policy for the management of market risk includes restrictions on financial exposure in accordance with the risk appetite (the economic value and the accounting profit). These restrictions are aimed at limiting the damage likely to be caused as a result of unexpected changes in the markets. The system of limits demarcates the impact of exposure of the economic value, the accounting profit and the liquidity position, to unexpected changes in the various risk factors, such as interest rates, inflation, exchange rates, etc. The restrictions prescribed at the Group level include all subsidiaries in Israel and overseas.

In relation to nostro in shekels and foreign currency, the policy does not define a target for the size of the nostro, but rather provides that its size will actually be a consequence of the difference between the sources which the Bank raises for its uses, in particular, credit and the liquidity requirements. The policy, in relation to the composition of the nostro in foreign currency, defines the set of restrictions which are active and the risk in the exposure to countries and financial institutions, with reference to the risk inherent in these exposures, and to the aspects of geographical concentration according to the extent of the exposure. The policy in relation to the composition of the nostro in shekels determines that most of its nostro activity in shekels will be in Israeli government bonds. The credit risks existing in shekel nostro activity are minimized relative to the size of the portfolio and defined via risk restrictions specified by the Board of Directors.

Structure and functions of market risk management

The Bank implements Proper Conduct of Banking Business Directive No. 339 of the Supervisor of Banks, in the matter of the management of the market risks of the Group. The directive sets out basic principles for the manner of managing and controlling risks, including the responsibility of Management and the Board of Directors, the definition of means of control and tools for measuring risk, and the means of control and supervision of these risks.

The Risk Management Division, headed by the Chief Risk Officer, independently examines and monitors the extent of the risk and the procedure for managing the risks and prescribes the risk management policy. A chief market risk manager, subject to the Chief Risk Officer, is appointed with the grade of branch head.

The Capital Markets Division deals with the Bank's management of nostro and the operation of all the dealing rooms in the Bank for the purpose of trading and brokering in currencies, interest, derivatives and in securities. In addition, the Division is engaged in the overall financial management of financial product development and investment products and the management of the Group's assets and liabilities. Further, the Division is responsible for maintaining the relationship with overseas financial institutions and for providing service to customers operating on financial and money markets, including institutional customers and in the day-to-day management of control of risks of all the abovementioned activities.

Management of market risk is discussed in the following committees:

- Risk Management Committee of the Board of Directors – Once a quarter, a detailed discussion takes place on exposures to market risks and the change in risk focus points, in the committee of the Board of Directors for risk management. The committee reports the position regarding compliance with the limits at Group level, and the damage that Bank could incur from stress scenarios. In addition, any new activity in financial instruments that is significantly different from the current activity in financial instruments is presented for discussion and the approval of the committee within the context of a "new product" procedure. The results of the Board of Directors Risk Management Committee, the policy, the restrictions on the extent of various types of exposure and the change therein are reported and approved by the Board of Directors in plenum.
- The Upper Risk Management Committee headed by the President and CEO of the Bank – The policy crystallized in the Market Risk Management Committee (below) are discussed and approved within the framework of the Upper Risk Management Committee headed by the President and CEO, the Chief Risk Manager and all members of the Bank's management. In addition, subjects on market risks that are on the agenda are discussed.
- The Management Committee for Current Matters headed by the President and CEO, which meets every week, reports on the financial exposure position to market and liquidity risks and compliance with the limits determined by the Board of Directors. Periodically (every four to six weeks), the President and Chief Executive Officer reports in the context of the CEO's Report to the Board of Directors on exposure to market risks.
- Once a month, and not less than nine times a year, the Market Risks Management Committee headed by the Chief Risk Officer, meets to examine events and market trends which could have repercussions for the Bank, to discuss and approve risk policy and restrictions, monitor compliance with the aforementioned restrictions, approve the methodology for measuring exposure and, periodically, to ensure and discuss market risks in the subsidiaries.
- The Assets, Liabilities and Financial Investments Committee (ALCO), headed by the Capital Markets Division, which meets once a month and not less than nine times a year, is responsible for managing the assets and liabilities and financial investments, giving emphasis to the structure of the balance sheet, transfer prices, the required liquidity and liquid reserve investments, capital structure and capital-raising policy.

Quantitative tools for risk management

Market risk are assessed using a wide array of tools, which complement each other and match the Bank's various exposures in the trading rooms, the nostro investment activity and the activity of managing assets and liabilities.

Value at Risk (VaR)

The Bank manages exposure to market risks by various means, as mentioned above, and also as by means of a probability model – the VaR model. The risk measured by the VaR refers to the potential loss from holding all balance-sheet and off-balance-sheet positions, including the positions in the trading portfolios, which are exposed to possible changes in market prices. VaR measures the expected fall in the present value of the assets less the liabilities in the given mix of the capital structure, with a 99% confidence level, and for a holding period of two weeks, according to a given statistical breakdown. The calculation is based on the economic value of the capital by discounting assets and liabilities at risk-free interest rates prevailing in the market. The VaR calculation is made once a month at Group level and more frequently at Bank level and on the shekel trading portfolio.

The measurement of the VaR is carried out on the overall risk and risk divided into segments (exposure risk on a basis according to currency, exposure on interest according to segments and according to various time periods, shares risk), with, as a result of the coefficients (the dispersal effect) between the various factors, the general VaR is lower than the VaR according to segments.

In order to test the validity of the VaR model, the Bank performs daily backtesting, in accordance with the Basel directives, on the theoretical change in the Bank's economic value assuming that the positions do not vary and the only changes are those in market prices, compared with the estimate of the change as derived from the VaR model. The examinations carried out till now approve the validity of the model.

Sensitivity analysis and stress scenarios

From time to time, global and domestic markets are subject to shocks, which manifest themselves in especially high volatility of parameters, deviating from normal historical behavior. The VaR or other models do not provide information regarding losses that may occur under extreme market conditions, or may exceed the predetermined confidence level. Thus, in addition to the VaR measurement, risk is also measured under various stress scenarios, and sensitivity analyses to changes in one of the risk factors. These include all the risk factors to which the Bank is exposed and represent a part of the ICAAP process. See details in the introductory chapter.

Model for estimating the (marketable) credit risk in the nostro foreign currency portfolio

The model calculates the expected loss in the foreign currency nostro portfolio in scenarios of varying degrees of severity, based on specific characteristics of the portfolio, taking into account the probability of a failure and change in the ratings of issuers. The measurement of the risk in the entire portfolio is performed taking into account the dispersal and concentrations in the portfolio. The model computes the expected shortfall, which reflects the potential average loss within a time-framework of a year and a probability of 1%.

Capital requirement in respect of market risk

The capital requirements in respect of market risks (Table 10 – Basel II), as required pursuant to the standard approach, *inter alia*, as follows. These requirements reflect only a small part of the capital held by Leumi against market risks (First Pillar of the Basel II framework). In addition to this capital, the Group holds additional equity against market risks and nostro activity, in the framework of the Second Pillar of Basel II.

The following table sets forth the capital requirements in respect of market risks (Table 10 – Basel II):

	31 December 2011	31 December 2010
	NIS millions	
Capital requirement in respect of:		
Interest risks	**583**	742
Share price risk	**1**	20
Exchange rate risk	**170**	97
Options	**57**	100
Total capital requirement in respect of market risks	**811**	959

Main focus points in market risks

1. Exposure to interest

Risk of a loss as a result of changes in risk-free interest rates of credit in the various currencies due to differences between the repayment date of the assets and liabilities in each of the linkage segments.

The interest exposure policy restricts the extent of exposure to possible changes in interest on the Bank's profits and on shareholders' equity. Accordingly, in each sector, the exposure to an unexpected change of 1% in interest in all the periods is measured, relating to the potential erosion of economic value[1] and of the accounting profit for the year resulting from a shift in the yield curves in each of the segments and also for all segments together. Exposure to profit is heavily influenced by the activity remeasured at market prices (derivative transactions and commercial portfolios).

There are structured interest risks arising from the uncertainty in the market factors that may be hedged, but are structured in the banking activity. The risk includes gross behavioral options in loans and deposits that may not be hedged (early repayment options, for example).

The interest risk is actually measured and managed on the basis of various behavioral assumptions with regard to the repayment times of the assets and liabilities. The principal assumptions are:

- In the index-linked sector, an estimate is taken into account with regard to breakages and withdrawals at exit points in savings plans. The estimate is derived from past customer behavior.
- In accordance with accumulated experience, there is a long-standing stable credit balance in non-interest bearing current accounts. Accordingly, for purposes of measuring and managing interest rate exposure, Bank policy is to regard part of the non-interest bearing current account balances as a long-term liability. Periodically, the change in the non-interest bearing current account balances is examined in order to decide how it should be spread.
- Leumi Mortgage Bank – The management of exposures takes account of assumptions with regard to early repayment of loans. Assumptions regarding CPI-linked loans at fixed rates of interest rely on a statistical model for predicting early repayments. This statistical model is checked regularly. At the same time, Leumi Mortgage Bank has developed a repayment model including all linkage segments. The model is expected to be assimilated in 2012.

The summary of exposures to unexpected changes in interest at Group level (before tax and millions of NIS)* is as follows:

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

Effect of immediate parallel change of 1% on the yield curve	Potential erosion in economic value		Potential erosion in annual profit	
	31 December 2011	31 December 2010	**31 December 2011**	31 December 2010
Actual	**676**	665	**271**	114
Limit	**1,100**	1,100	**500**	500

* In the direction that is damaging to the Bank.

In 2011, the potential erosion in the economic value ranged from NIS 882 million to NIS 665 million (and in annual profit, from NIS 335 million to NIS 90 million).

In 2011, the Group complied with all of the exposure restrictions for interest prescribed by the Board of Directors.

Sensitivity of the fair value of assets and liabilities to interest

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

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

	31 December 2011				
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency		
	Unlinked	CPI-linked	Dollar	Euro	Others
	NIS millions				
Financial assets	**191,767**	**62,776**	**61,472**	**12,608**	**14,032**
Amounts receivable in respect of derivative financial and off-balance sheet instruments	**227,619**	**5,641**	**161,654**	**37,432**	**41,543**
Financial liabilities	**159,044**	**54,294**	**82,937**	**18,298**	**10,830**
Amounts payable in respect of derivative financial and off-balance sheet instruments	**242,830**	**10,709**	**143,466**	**31,945**	**45,619**
Net fair value of financial instruments	**17,512**	**3,414**	**(3,277)**	**(203)**	**(874)**

	31 December 2010				
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency		
	Unlinked	CPI-linked	Dollar	Euro	Others
	NIS millions				
Financial assets	164,964	62,174	54,925	16,252	12,866
Amounts receivable in respect of derivative financial and off-balance sheet instruments	185,789	2,704	177,426	28,932	36,316
Financial liabilities	140,887	51,636	70,646	18,713	9,894
Amounts payable in respect of derivative financial and off-balance sheet instruments	192,488	9,776	163,983	26,275	40,186
Net fair value of financial instruments	17,378	3,466	(2,278)	196	(898)

The effect of changes in interest rates on the net fair value of financial instruments (Table 14 – Basel II):

	31 December 2011						
	Fair value, net, of financial instruments after the effect of changes in interest rates					Change in fair value	
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency				
	Unlinked	CPI-linked	Dollar	Euro	Others	Total	Total
	NIS millions					NIS millions	%
Immediate corresponding increase of 1%	**17,160**	**3,523**	**(3,279)**	**(191)**	**(887)**	**(246)**	**(1.48)**
Immediate corresponding increase of 0.1%	**17,477**	**3,425**	**(3,277)**	**(202)**	**(875)**	**(24)**	**(0.14)**
Immediate corresponding decrease of 1%	**17,869**	**3,282**	**(3,276)**	**(215)**	**(870)**	**218**	**1.32**

	31 December 2010						
	Fair value, net, of financial instruments after the effect of changes in interest rates					Change in fair value	
	Israeli currency		Foreign currency, including Israeli currency linked to foreign currency				
	Unlinked	Index linked	Dollar	Euro	Others	Total	Total
	NIS millions					NIS millions	%
Immediate corresponding increase of 1%	16,970	3,937	(2,409)	206	(917)	(77)	(0.43)
Immediate corresponding increase of 0.1%	17,337	3,513	(2,291)	197	(900)	(8)	(0.04)
Immediate corresponding decrease of 1%	17,705	2,986	(2,145)	213	(878)	17	0.10

* Not including estimate of the value of revenues in respect of commission for early repayment.

1.1 Exposure to interest rates and compliance with restrictions

The status of exposure to interest changes at the Group level, which is calculated according to accounting principles is set forth below. During 2011, the Group complied with all the exposure restrictions for interest set by the Board of Directors. For detailed data on exposure to interest, see below in Exhibit D in the Management Review.

	31 December 2011			31 December 2010		
	Unlinked	Index linked	Foreign currency and linked thereto	Unlinked	Index linked	Foreign currency and linked thereto
Average duration of assets (1)	**0.91**	**2.85**	**0.72**	0.76	2.93	0.75
Average duration of liabilities (1)	**0.87**	**3.25**	**0.71**	0.68	3.56	0.68
Duration gap in years	**0.04**	**(0.40)**	**0.01**	0.08	(0.63)	0.07
Internal rate of return (IRR) (%)	**0.42**	**0.56**	**2.45**	0.6	0.59	1.71

(1) Including future transactions and options, and based on fair value data on financial instruments.

From December 2009, there was a change in the method of calculating and presenting the report of exposure to changes in interest rates, following new regulations of the Bank of Israel on this subject. Instead of data aggregating to balance sheet balances, the data in Exhibit D present the fair value of the financial instruments which are stated in Note 18c regarding "balances and estimates of fair value of financial instruments". The internal rate of return was changed accordingly. Instead of an internal rate of return discounts the expected cash flows to the balance sheet balance, an internal rate of return is presented, discounting the expected cash flows to the fair value.

In addition, instead of presenting the average duration based on the forecast data of assets and liability, with effect from December 2010, an effective average duration is presented, based on a change in the fair value as a result of a change of 0.1% in the internal rate of return of the assets and liabilities.

In calculating the average duration of the liabilities in the index-linked segment, an estimate regarding early repayments and withdrawals at exit points in the savings programs is taken into account, in accordance with a model which estimates the expected early repayments on the basis of the savers' behavior. An average duration of the total liabilities according to the original cash flow of the savings programs is higher, reaching 3.28 years, and the internal rate of return gap (hereinafter "IRR") amounts to 1.68%.

Early repayments of index-linked mortgage loans are taken into account in the figures set forth above, in accordance with a statistical model, which estimates the expected repayments on the basis of the borrowers' behavior in the past.

The average duration of the assets at the end of 2011, according to the original cash flow, which does not take into account early repayments, is higher, reaching 3.94 years, and the IRR gap amounts to 1.68%.

Exhibit D in the Management Review presents current account balances according to the Bank of Israel directives in deposits with demand of up to a month. On the other hand, for the purpose of exposure to interest, a certain rate from the current account balances in shekels and foreign currency for repayment periods up to 10 years. This is in accordance with the model of behavior that its basic assumptions are regularly updated. Taking these assumptions into account, the average duration of the liability is higher, reaching in unlinked shekels, 0.92 years, and foreign currency, 0.76 years, and the difference in the IRR amounts to 0.38% and 2.39%, respectively.

2. Basis exposure

The exposure to basis risk is reflected in the loss which is likely to occur as a result of changes in the consumer price index and in exchange rates, as a result of the difference between the value of assets and liabilities, including the effect of futures transactions, in each of the linkage sectors.

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

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

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

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

Changes in the exchange rate affect the effective tax rate, since exchange rate differentials in respect of investments abroad are not taken into account in the income basis for calculating the provision for tax, unlike exchange rate differentials in respect of sources of financing, and thus, there is an asymmetry with respect to exchange rate differentials. Subject to the rates of the changes in exchange rates of the various currencies relative to the shekel, and considering the volume of the investments abroad, this may have a material effect on the provision for taxes. The Bank carries out hedging transactions for the tax exposure in respect of investments overseas.

The actual effect of the exchange rate differentials in 2010 is shown on page 197 under the contribution of consolidated companies abroad to Group profit. In addition, changes in exchange rates have an effect on current income in foreign currency. Hedging activity was carried out at the beginning of 2012 against the expected net income.

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

	Approved limits Maximum excess or (deficit)	Actual exposure	
		31 December 2011	31 December 2010
		%	
Unlinked	(45)% - 45%	**(17.9)**	(8.6)
CPI-linked	(30)% - 30%	**22.4**	8.2
Foreign currency	(15)% - 15%	**(4.5)**	0.4

(1) In addition, the Bank and subsidiaries have limits on the maximum position allowed for investment in each currency.

In 2011, the average capital invested in the linked segment over the year was low and not material. The amount of capital invested in the segment ranged during the year from a surplus of 22% to a deficit of 24% of the exposed capital. Capital was channeled to the foreign currency-linked sector at a relatively low rate, and therefore, the effect of the change in exchange rate on pre-tax profit was not material.

In 2011, the Group complied with all the basis exposure restrictions approved by the Board of Directors.

Sensitivity to changes in the exchange rate of the main foreign currencies as of 31 December 2011 is as follows: The measurement relates to the effect of the changes in the Bank's capital and includes activity in balance sheet and off-balance sheet instruments:

	Dollar	Euro	Pound sterling	Swiss franc	Yen
	NIS millions				
Increase of 5% in exchange rate	**(43)**	**(1)**	**9**	**(4)**	**2**
Increase of 10% in exchange rate	**(97)**	**(17)**	**21**	**(12)**	**4**
Decrease of 5% in exchange rate	**50**	**(7)**	**(4)**	**5**	**-**
Decrease of 10% in exchange rate	**99**	**(29)**	**(7)**	**13**	**1**

These data do not take into account the effect of a change in the exchange rate on the flow of income and expenses in foreign currency in respect of which full hedging was made in 2011.

3. Exposure in the trading rooms

The market risks in the trading portfolio arise as a result of the Bank's activity as a market-maker and as a manager of nostro positions:

- Market-making activity – The Bank is a leader in the extent of activity in the area of derivatives and provides immediate services to customers active in the instruments. In the foreign currency and derivatives room, market-making activity is carried out at the spot desk (in shekels and in foreign currency), at the options desk (in shekels in foreign currency) and at the interest desk (shekels and foreign currency). This activity exposes the Bank to market risk (exchange rate risk and interest risk) and accordingly, the activity is managed and monitored in accordance with the restrictions approved by the Market Risk Management Committee. Due to the dynamic nature of the activity, these restrictions are regularly monitored at least once a day by the Middle Office.

- Nostro trading activity – In the trading room, there is initiated activity whereby initiated exposures are taken for bonds in shekels. This activity is routinely managed and monitored at least once a week, in accordance with the restrictions approved and validated by the Risk Management Division.

Risk management framework and methodology

As stated, marketable market risks are routinely monitored, with the frequency being determined in accordance with the nature of the activity being conducted. An estimate of the risks is made using a known and recognized methodology. The main points are as follows:

1. Interest exposures are measured and managed in terms of a change in the market value of the instruments as a result of corresponding changes in the interest curves in which exposures were taken.
2. The exposures at the option desk are measured and managed on the basis of generally accepted sensitivity ("Greek") indices.
3. Stress scenarios:
   - 3.1 Analysis of the sensitivity of the portfolio to the various risk factors (each risk factor separately) and an examination of the change in the value of the portfolio as a consequence:
   - 3.2 Stress scenario – macroeconomic scenarios based on history (for example, a scenario based on the 2008 crisis), as well as scenarios developed in collaboration between the Risk Management Division and the Economics Branch.

The table below shows the open transactions as at 31 December 2011 compared to the previous year (amounts in NIS millions):

	31 December 2011	31 December 2010
Full hedging transactions	**3,241**	2,563
ALM and other transactions:		
Interest contracts	**264,650**	187,064
Currency contracts	**244,878**	266,998
Contracts in respect of shares, share indices and commodities	**34,081**	32,635
Total	**546,850**	489,260

For details regarding the accounting policy for recording the balances, income and expenses of these types of instrument, see Note 1m –Significant Accounting Policies in the financial statements.

For further details, see Exhibit C to the Management Review and Note 20 to the financial statements.

4. Aggregate exposure to market risk – interest, basis, shares as reflected in the Value at Risk model

The VaR limits are determined, both on the economic value of the Group including overseas subsidiaries and the effects of the exposure in VaR terms, and on the components remeasured at market value (MtM) which affect the profit and loss of the Bank (including the Bank's commercial portfolios).

Below is the estimated VaR at Group level in NIS millions:

	VaR of economic value		VaR of mark-to-market portfolios	
	31 December 2011	31 December 2010	**31 December 2011**	31 December 2010
Actual	**161**	200	**79**	**51**
Limit	**500**	600	**400**	**500**

In 2011, VaR on the economic value ranged from a maximum of NIS 181 million and a minimum of NIS 125 million, and the VaR on the economic value ranged from a maximum of NIS 79 million and a minimum of NIS 44 million., respectively.

In 2011, the Group complied with all the VaR restrictions prescribed by the Board of Directors.

Marketable credit nostro risks

Leumi is exposed to credit and market risks of countries, banks and financial institutions in Israel and abroad. In addition, the Bank also invests to a limited extent in asset-backed instruments (CLO, MBS and ABS).

The Group exposure policy for foreign financial institutions is a part of the policy for managing market risks and marketable credit risks. This policy defines guidelines, risk limits on credit/counterparty exposures and authorities. The policy prescribes that most exposures will be to large banks that are systemically important to their country and to banks with a relatively high credit quality with an emphasis on dispersal of the portfolio.

Risk management in the exposure to financial institutions and to countries is effected through two credit committees headed by the Capital Market Division and in collaboration with the Risk Management Division.

- Limits Committee for activity vis-à-vis countries – which determines exposure limits for countries on the basis of economic analysis.\
- Marketable Credit Risk Committee – which determines the exposure limits for financial institutions in accordance with the prescribed policy and market conditions.

The quality of the portfolio is monitored by the Risk Management Division and risk analyses and scenarios for the examination of risk focal points which are discussed in the Upper Market Risk Committee and in the Risk Management Committee of the Board of Directors.

Exposures to liquidity risk

Liquidity risk
Liquidity risk is the risk created due to the uncertainty relating to the possibility of raising funds and/or realizing assets unexpectedly within a short period, without incurring any material loss.

Liquidity risk management policy

In accordance with Bank of Israel directives, the Bank implements an overall policy for managing liquidity risk, the purpose of which is to support the achievement of business goals, while evaluating and limiting losses that may arise from exposure to liquidity risks. The liquidity risk management policy is aimed at maintaining a high level of liquidity through investment in quality assets at a high level of liquidity and via policy directs the raising of stable and varied sources, with an emphasis on raising deposits from a large number of customers for various terms, including long terms.

Liquidity management policy at Group level is based on the following principles:

- Each subsidiary in Israel and abroad is responsible for the formulation and maintenance of an independent liquidity management policy, while maintaining strict compliance with the obligatory directives of the relevant regulatory authorities.
- The subsidiaries may rely on, amongst other sources, the use of credit lines from Leumi, subject to prior arrangement, and subject to regulatory limits.

In accordance with the abovementioned, the principles of the Bank's policy in the area of liquidity management were adopted by the overseas subsidiaries, subject to the local regulatory provisions in each subsidiary. In each of the Bank's overseas subsidiaries, the liquidity management policy is approved by the board of directors of the subsidiary. In the context of this policy, restrictions are prescribed, and compliance with the restrictions is examined with the Market and Liquidity Risk Management Committee both in the subsidiaries, and in Israel.

As part of the day-to-day management, liquidity risk is measured using an internal model whose purpose to examine and monitor the liquid resources at the Bank's disposal under various scenarios, including stress scenarios. In addition to the model outlined above, the Bank operates an additional system of indices for early warning of unusual and unexpected developments in the liquidity position.

As part of assessments for the crisis positions, a system of qualitative and quantitative indicators has been defined, indicating an unusual development or deterioration in the liquidity position and an updated contingency plan has been drawn up including the strategy for managing a liquidity crisis, including the appointment of a management team to be responsible for dealing with the crisis, and defining the procedures and steps required for contending therewith.

Sources of financing

The composition of the Bank's assets and liabilities continues to point to high liquidity, as a result of a policy of raising stable and varied sources and a policy of investing surplus liquid means in quality assets.

Surplus liquid means in Israeli currency are invested primarily in deposits in the Bank of Israel amounting to some NIS 3.6 billion and in securities, some NIS 28 billion, principally in government debentures. Surplus liquid means in foreign currency are invested primarily in debentures amounting to some NIS 18 billion, and bank deposits, some NIS 10 billion.

Most of Leumi's financing relies on raising deposits from the public.

The balance of public deposits in the Bank, not including subordinated notes, increased during 2011 by NIS 26 billion, 10.5%, and after canceling the effect of exchange rate differentials, the increase was NIS 18 billion (7.4%).

Most of the increase was in the unlinked shekel segment amounting to NIS 15 billion (9.6%), while. in the foreign currency and foreign currency linked segment, there was an increase of NIS 11 billion, (11.8%), after canceling the effect of exchange rate differentials, the increase was only 3.9%.

Monitoring liquidity risk

The Bank routinely monitors the liquidity position and the liquidity risk indices. Liquidity risk is measured and managed using an internal model whose purpose is to examine and monitor the liquid resources at the Bank's disposal under various scenarios. The scenarios relate to various market situations: normal course of business and extreme situations relating to the Bank and the entire banking system.

In each of the scenarios, the liquidity position is examined on the basis of two quantitative indices: the liquidity gap and the liquidity ratio. The model places the balance of the liquid assets (for example, cash, Bank of Israel deposits, realizable portfolio of bonds and credit forecast to be repaid) as a ratio of liabilities expected to materialize in the short term, in a way that examines the Bank's ability to meet all liquidity requirements.

The rate of change in the balance of deposits and credit for the whole payment period, under different scenarios, is determined in accordance with various parameters, depending on the level of severity of the scenario. Behavioral functions defined based on the judgment of business functions, assisted by historical data, take into consideration parameters such as the size and nature of the deposit for which expected cash flows are calculated.

It should be pointed out that the stress scenarios are more severe than anything the Bank has experienced in the past and the assumptions of these scenarios are therefore necessarily based more on the judgment of senior professional functions at the Bank than on any historical data.

The table below shows the liquidity gap and liquidity ratio in Israeli currency and foreign currency in each of the four types of scenario that have been defined, for a repayment period of one month, as at 31 December 2011 (regardless of interaction between the segments).

	In Israeli currency per month		In foreign currency per month	
	Gap	Ratio	Gap	Ratio
Scenario / period	NIS billions			
Ordinary	**48.8**	**12.7**	**13.3**	**3.5**
Statistical	**37.7**	**3.5**	**10.6**	**2.3**
Stress in Leumi	**28.5**	**1.7**	**7.0**	**1.3**
Systemic stress	**33.2**	**2.2**	**12.9**	**1.9**

* Leumi assumes that in extreme cases, the foreign currency segment supports the Israeli currency segment and *vice versa*.

With regard to the monetary steps taken by Bank of Israel to improve liquidity in the system, see page 267 below.

In addition to the model outlined above, other indices are measured to complement the liquidity position:

- In the foreign currency sector, the rate of long-term assets being financed by short-term liabilities, the "long/short" ratio, is also monitored.
- As part of the ongoing management of liquidity in Israeli currency and foreign currency, forecasts are made of the daily liquidity situation, using the Bank's existing information systems. At the end of each business day, the gap between the forecasted liquidity and the actual liquidity is measured. The gap distribution is used for updating the model, and improving the quality of forecasting of the liquidity position.
- In the Israeli currency and foreign currency sectors, trends in the liquidity position are examined (daily, monthly, etc.) over a protracted period, in order to monitor developments in deposits of the public, credit to the public, and liquidity in general, as well as for measuring margin risk.
- The Bank measures the risk of re-pricing in terms of cost as a result of unexpected changes in the terms of financing.

Draft amendment of Bank of Israel Directive No. 342 regarding Management of Liquidity Risks and Preparation for Basel III.

- In May 2011, the Bank of Israel published a first draft amendment to Regulation 342 regarding the management of liquidity risks, which has undergone a number of changes and its last version was transferred to the banks in September 2011. The draft represents a milestone in the adoption of the international regulatory directives regarding liquidity, which have been developed in light of the crisis in 2008 and 2009. The purpose in revising the regulation is to begin gradually to adopt the Basel III directives for managing liquidity risks, and at its center is the definition of minimum ratios between liquid assets and liabilities which is estimated will materialize within a specified time period. In particular, it involves the definition of minimum ratios between liquid assets and liabilities which, it is estimated, will materialize within a specified time interval. In particular, this involves the definition of a minimum liquidity ratio for a period of a month (a liquidity coverage ratio - LCR) and the definition of stable funding ratio for a period of a year (a net stable funding ratio - NSFR).

The Bank is examining the implications of this draft regulation and the type of preparations required for its implementation.

Fair value

In accordance with the directives of the Bank of Israel, the fair value of all financial instruments, i.e. all the monetary assets and liabilities of the Bank and of its subsidiaries, is shown in Note 18D to the Financial Statements. The fair value of a financial instrument is defined as the price paid by a buyer to a seller in an arm's length transaction.

When there is an active market, the market price constitutes the fair value. The price of certain securities is determined on the basis of assessments obtained from a third party, while, for derivatives, the value is determined on the basis of models. Market prices do not exist for a significant portion of the financial instruments of the Bank and its subsidiaries. In the absence of a market price, the fair value is an estimate, based on the present value of cash flows, as specified in Note 18D.

Fair-value estimates are based on the conditions existing on the date of the Financial Statements and do not necessarily represent future fair values.

In March 2007, the Board of Directors of the Bank prescribed a limit of US$ 1 billion for the total of transactions whose fair value is determined by the Bank on the basis of quotations received from the counterparty to the transaction. As a rule, these are financial institutions of high repute in the capital markets, who meet the criteria prescribed by the Bank Management.

The calculation of fair value is based, to a great extent, on a subjective assessment. Therefore, great care must be exercised when using this information, since it cannot indicate the economic value of the Bank and its subsidiaries, nor can it be used for comparisons between different banks.

It should be noted that data relating to fair value do not take into account the effect of taxes in the event of a positive or negative gap between the fair value and the book value of assets and/or liabilities shown on an accrual basis.

The data appearing in Note 18D to the Financial Statements show that the fair value of financial assets at the end of 2011 was NIS 555 million higher than the balance sheet value (in 2010, higher by NIS 2,295 million), while the fair value of financial liabilities was NIS 2,873 million higher than the balance-sheet value (in 2010, higher by NIS 3,812 million). The majority of the gap derives from the fact that the decrease in interest on liabilities was greater than the decrease in interest on loans, due to an increase in the risk margin.

The change in the fair value of monetary assets and liabilities beyond that recorded in the Financial Statements in 2010 derives mainly from the decrease in interest rates in the economy, and particularly, in the unlinked shekel segment, similar to the decrease in 2009.

Operational risks

Operational risk policy

Leumi Group operates in wide range of financial activities, and, accordingly, exposure to operational risk, including, *inter alia*, risk of embezzlement and fraud, legal risks, compliance risk, data technology risk, business continuity and data protection.

An operational risk is defined as "the risk of a loss resulting from inadequate or failed internal processes, people, systems, or external events. This definition includes legal risk, but not strategic risk and image risk."

Operational risks in Leumi Group are managed with systemic vision, using a consistent and systematic group methodology which delineates the Operational Risk Management Branch adapting to the nature, size and complexity of each organizational unit in the Group. Operational risk management relies on a proactive process of identifying, evaluating, measuring, monitoring, reporting and controlling/reducing material risks.

Operational risk management in Leumi Group relies on three lines of defense. Responsibility for operational risk management falls upon the managements of the divisions and subsidiaries (first line of defense) and includes: a decision between alternatives of accepting the risk, a change in controls, a change in the scope of activity or a transfer of risk. The Branch for Operational Risk Management and Compliance and the Prohibition of Money Laundering and SOX represent a second line of defense. The third line of defense is the Audit Division. The latter two lines of defense are independent and are not involved in business decision-making.

Operational risk management policy is on a group basis and is intended to support the business objectives and strategic goals of Leumi Group, prevent and minimize losses, taking into account risk tolerance and maintain long-term operating stability. Operational risk management is an integral part of the organizational culture and business and operational activity in the Group.

Risk appetite/tolerance in the Bank is defined for operational risk. Within this context, the term, risk tolerance, is defined in terms of operational risks and qualitative and quantitative risk appetite declarations are presented. In the quantitative aspects of risk tolerance, loss restrictions are determined at the Group level, at the business lines, and in material products/activities.

Operational risk management structure

Control and supervision of operational risk management in the Group is carried out through the Board of Directors and the senior management, the operational risk management function in the Risk Management Division, and the Operational Risk Committees and Controller system (Business Risk Controller), Risk Coordinators and officers in charge in the divisions.

The Upper Committee for Operational Risk Management, headed by the Chief Risk Manager, and in collaboration with the Chief Auditor, Operational; Risk Manager and representatives of the business divisions and main subsidiaries examine the implementation of the existing operational risk management policies and assessments, and those required for reducing material risks.

A conclusion-drawing forum meets on a quarterly basis, headed by the Operational Risk Manager, attended by representatives of all the business entities and subsidiaries (the controllers). The forum constitutes a platform for sharing knowledge, drawing lessons from events of failure inside and outside the organization and discussing strategies for reducing risk.

The independent function of operational risk management

The Operational Risk Management Branch is responsible for the Group's policy outline, planning and development of tools, methods and a working framework for operational risk management, the assimilation of an operational risk management culture, reporting to the Board of Directors and senior management, and supporting and professional guidance of the representatives of the first line of defense.

Methodologies, processes, methods and tools for operational risk management

The methods and tools for operational risk management in Leumi is examined and updated from time to time, leveraging professional knowledge from Israel and around the world, and as a result of regulatory directives of the Bank of Israel and other supervisory bodies.

The Group has defined an operational risk management policy document which forms a basis and working framework for risk management, and in the spirit of the document, procedures and methods have been determined. In addition, methodological tools have been assimilated for the management and control of operational risks.

Over three years, a risk assessment survey has been conducted on central work processes, at the end of which, reduction programs have been constructed. The next group survey is expected to begin in the second quarter of 2012.

An ordered risk assessment enables the Bank to understand its own risk profile, to designate resources and strategies for managing risks more effectively, and to assess the amount of capital in respect of operational risks. The risk assessment is a self-evaluation by content experts who are acquainted with the business activity in which the risk is inherent, and combines a qualitative and quantitative assessment. The quantitative assessment relates to potential monetary damage, and the qualitative assessment covers all direct and indirect damage that could occur when the risk materializes, with reference to the existing controls.

A further means of risk management is the analysis of stress scenarios, which are assessed and monitored, and for which evaluation and reduction programs are established and appropriate capital taken.

Regular monitoring of internal failure events is managed. The events are reported and analyzed, and a process of learning and sharing lessons is carried out. In addition, the Group is assisted by a database of external failure events, in order to validate the risk and damage assessment.

The Operational Risk Management Branch operates in order to establish an organizational culture which is laid down by the management of the risks with them, to advance the level of awareness among all employees and managers in the Group through education programs, training courses and an operational risk management portal.

The allocation of capital in respect of operational risks is intended to act as an absorption cushion for unexpected risks. The regulatory capital is calculated using the Basel basic indicator approach (total capital allocation in respect of operational risk appears on pages 29-30). At the same time, an assessment is made of the economic capital on the basis of a self-evaluation of operational risks, with the results of the calculation constituting a basis for challenging the regulatory capital. The assessment of the economic capital is made using an internal model of the loss distribution approach (LDA).

The operational risk is managed using a designated system enabling the documentation, identification, assessment, and measurement of risks and the determination of a recommended reduction program of controls. In addition, the system enables the gathering and analysis of internal failure events. The stored data supports the decision-making process with regard to the material risks and the prioritization of the reduction operations.

Data technology risk

Data technology is a central component in the proper operation and management of a banking corporation, inasmuch as the data, in all its aspects and implications, with decisive effect on the Bank's stability and development. Data technology risks apply to the operation of data systems in production, broad data technology processes and new activities (projects and systems).

An assessment of the operating risks in the systems operating on a routine basis is integrated into the risk management process Analysis of the results of risk assessments facilitates identification of high-risk systems, which must also be addressed to ensure compliance with Proper Conduct of Banking Business Directive No. 357.

In accordance with the risk assessment, a multi-year work program is built up to carry out data protection surveys and controlled penetration attempts, and a reduction program is determined accordingly.

In addition, a method for assessing risks in data systems development projects is implemented, the findings are analyzed, and recommendations for reducing the level of exposure is determined.

Data protection risk

Data protection risk management in Leumi is executed on the basis of the Group's data protection policy.

The management of data protection risks supports the solution to threats and risks in maintaining data assets and Leumi's data assets and data technology systems.

Data protection contends with challenges emanating from threats inherent in developing technologies, including new media, for example, social networks.

Data protection is made ready, *inter alia*, vis-à-vis the increase in threats and attacks, including cyber-attacks, using an international mapping and risk management model.

Business continuity risks

Bank of Israel directives require banks to take action to ensure business continuity in an emergency. The Bank's computer system relies on two computer centers. The main center is located in Kiryat Hamachshavim in Lod – underground and protected against rockets, earthquakes and biological and chemical attack, and a secondary underground center in Tel Aviv. In addition, Leumi has set up an underground emergency location for the Bank's trading room in the Hamachshavim Compound in Lod.

The Bank prepares itself for disaster recovery and continuity of its business activity. Activity is comprised of three layers:

- technological infrastructure;
- action plans and procedures;
- periodic emergency drills.

The main activities in the area of business continuity carried out during 2011 were as follows:

- Writing and revising policy documents and procedures (business continuity policies, outsourcing policies, emergency procedures for designated teams, etc.)
- Business Impact Analysis (BIA) project – continuation of analysis of business effects in divisions in accordance with the work plan.
- A technological and unit exercise drill were carried out.
- BS25999 testing (a British standard in the field of business continuity) of the Standards Institute) was successfully carried out.

Compliance, Prohibition of Money-Laundering and Prohibition of the Financing of Terrorism

In 2001, the Compliance Department (today the Compliance and Enforcement Division) commenced operations in the Group, pursuant to the requirements of the authorities and a chief compliance officer was appointed to be responsible for implementing the statutory provisions relating to the prohibition of money laundering and the prohibition of the financing of terrorism.

The complexity and development of banking activities require the Bank to comply strictly with all obligations applicable to a banking corporation in its relations with its customers, by virtue of primary legislation, regulations, orders, permits and Bank of Israel directives.

Proper Conduct of Banking Business Directive No. 308 obligates banks to enforce consumer directives, i.e. the laws, regulations, and directives governing banking activities regarding the Bank's relations with its customers, including the prohibition of money laundering and the prohibition of financing of terrorism.

In accordance with this Directive, a review of infrastructure is carried out every five years, in which consumer directives and the risks of the occurrence of events deviating from the directives are mapped out, and controls are defined to prevent their occurrence.

Following discussions of the 2006 work plan, the President and Chief Executive Officer appointed a committee which formulated an operating plan for the Compliance Department and compliance officers in the Group, adapted to international standards and the Basel Committee requirements. In the committee, laws, regulations and additional permits relevant to the Bank's operations were mapped and prioritized, along with the formulation of work processes, the means of control, procedures and training which are regularly maintained.

A decentralized compliance model and automated tools and systems required for the compliance function has been implemented in Leumi.

For the effective management of the subject, a compliance community has been set up in Leumi, comprising divisional compliance managers, full-time compliance trustees at branch level (70 as at March 2012) and part-time compliance trustees, for focused handling and controlling the areas of compliance, the prohibition on money-laundering and prohibition on the financing of terrorism.

The Compliance and Enforcement Department is in regular contact with the Bank's subsidiaries in Israel and overseas, for the purpose of monitoring the implementation of compliance in general, and the prohibition of money laundering and the prohibition of financing terrorism, in particular, as also expressed in the Group policy document, prepared in accordance with a risk-based approach, and approved by the Board of Directors in August 2010.

In 2011, the Bank continued activities required for the implementation of the statutory provisions pertaining to the prohibition of money laundering and the prohibition of the financing of terrorism, including: steps for improving data, the dissemination of publications and lessons learnt to the various units, developing and improving computer systems, and participation in training activities, to heighten awareness of this subject and the assimilation thereof amongst employees of the Bank.

On 8 April 2008, the Law for the Prohibition of Investment in Corporations Maintaining Business Contact with Iran, 2008 (hereinafter the Law) was passed. The Law's purpose is to prevent investment by Israeli institutional bodies in declared companies that maintain significant business contact contributing directly or indirectly to Iran.

According to the Law, the Implementation Committee will publish a list of companies and corporations that trade with Iran in the fields of energy, the nuclear project and the development of non-conventional weapons, as well as other companies on which foreign states have imposed restrictions regarding investment or trade with Iran. Lists pursuant to the Law have not yet been published.

On 15 June 2011, a proposal for amendment to the Law for the Prohibition of Investment in Corporations Maintaining Business Contact with Iran (Prohibition on Contracting), 2011, was approved in its preliminary reading. The amendment proposed adding to the Law a prohibition on public and private bodies and private persons to entering into contracts with corporations maintaining business contact with Iran.

On 26 December 2011, the Supervisor of Banks published a circular on the subject of the "Prohibition of Money Laundering and the Financing of Terrorism and the Identification of Customers (Proper Conduct of Banking Business, Regulation no 411"). The circular directs banking corporations and credit card companies to be alert to the risks inherent in entering into contracts with declared parties in international lists published by the United Nations Security Council, the European Union and OFAC, as parties involved in and assisting Iran's nuclear program and plans related thereto. These lists include around 1,200 entities (companies and individuals.)

Leumi is currently preparing for conducting a preliminary survey for examining the level of exposure to parties included in the lists noted in the circular.

Enforcement

On 17 January 2011, the Efficiency of Enforcement Procedures in the Securities Authority Law (Legislative Amendments), 2011 was passed in the Knesset. The object of the law, which is detailed in the explanatory notes, is the improvement of efficiency of enforcement over the legislative provisions in the area of securities laws. In context of this legislation, it will be possible to impose various sanctions on a corporation that breaches the relevant provisions, and on employees of the corporation, including officers.

On 15 August 2011, the Securities Authority published a document of criteria for recognition of an internal enforcement program in the field of securities and investment management (hereinafter: "document of criteria").

In the document of criteria, the Security Authority instructs the corporation to appointment an officer to be in charge of enforcement. His function, according to the document of criteria, is to be responsible for the implementation of the enforcement program.

The Chief Compliance Officer of the Group was also appointed by President and Chief Executive Officer to serve as head of Compliance and Enforcement and has the authority and means to implement the legislative provisions relevant to this area.

In a comprehensive process, including, *inter alia*, conducting surveys of compliance with the relevant legislative provisions including mapping of the gaps in this area, an internal enforcement program is currently being formulated. This program will relate to subjects detailed in the document of criteria.

Legal risks

The Bank of Israel defines legal risk as the risk of loss resulting from the inability to enforce legally the performance of an agreement. The legal risks are part of the operational risks.

Legal risks derive from the three main areas -

- Risks attributable to the Bank's activity, if it does not comply with a primary or secondary legislative directive, a regulation of the Bank of Israel or a directive of other qualified authorities, and judgments (legislative risks).
- Risks attributable to the Bank's activity with customers, suppliers and other factors with whom the Bank contracts in various agreements, if it is not backed by an agreement fully

regulating the Bank's rights, or that the agreement is not fully enforceable (legal commitment risks).

- Risks attributable to legal proceedings conducted against the Bank.

The Group also implements a program for managing legal risks, which aims to detect, prevent, manage and minimize the legal risks. The program includes policy documents and an interface between the Legal Division and units of the Bank, as well as internal procedures applicable to the Legal Division, the purpose of which is to ensure that legal counseling provided in the Bank is professional and up-to-date.

With regard to the Bank’s subsidiaries in Israel and abroad operate a general policy to manage risks in the framework of designated policy documents has been determined. Each subsidiary is required to prepare an internal procedure for managing legal risks that correspond with its activity and the Group policy on the subject. The internal procedures prepared by the subsidiaries as aforesaid, have been approved by the Legal Division and in the boards of the subsidiaries. According to the policy documents, the subsidiaries are required to refer certain subjects for appropriate legal advice. In addition, the companies send six-monthly reports to the Legal Risk Officer at the end of the second and fourth quarters each year, as well as immediate reports, as required in the policy documents. The reports are sent in a consistent format prepared in the Legal Division.

The program places emphasis on:

- preventing legal risks;
- identifying sources of material legal risks and how to deal with them;
- preparing appropriate agreements, guidelines and procedures;
- examining statutory provisions (including case law) and regulatory directives, and their implications on the work of the Bank.
- drawing conclusions on various matters and implementing of the conclusions drawn in legal documents used in the Bank, as well as disseminating opinions on these subjects to the relevant units in the Bank.

In order to conduct the legal risk management program, various officials and committees operate in the Legal Division, whose function is to locate and examine new legislation and legal rulings that have repercussions for the work of the Bank and coordinate the way in which they will be dealt with. New regulatory directives (primary legislation, secondary legislation, directives from authorities) are identified and, if necessary, dealt with, even at the stage of being a proposed law.

The activity of each of the abovementioned officials and committees is organized in an internal work procedure of the Legal Division. The procedures stipulate, *inter alia*, the information flow among each of the abovementioned officials and the management of the Division and the Legal Risk team which operates in Division.

Linkage Status, Repayment Periods and Liquidity Status

A. Linkage Status

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

A summary of the linkage basis position as it appears in Note 16 to the Financial Statements is as follows:

	As of 31 December 2011			As of 31 December 2010		
	Unlinked	CPI-linked	Foreign currency (2)	Unlinked	CPI-linked	Foreign currency (2)
	NIS millions					
Total assets (1)	**199,656**	**61,163**	**121,590**	170,963	59,655	105,567
Total liabilities (1)	**180,099**	**60,966**	**126,136**	153,808	58,773	108,469
Total exposure in the segment	**19,557**	**197**	**(4,546)** (3)	17,155	882	(2,902)(3)

(1) Includes future transactions and options.
(2) Includes foreign currency linked
(3) The short position in foreign currency derives mainly from a hedging transaction in respect of investments in foreign subsidiaries.

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

In 2011, there was an increase of some NIS 32.9 billion in total deposits from the public (including subordinated notes and capital notes), in total credit to the public there was a decrease of NIS 17.3 billion, in investments in securities and debentures a decrease of some NIS 7.3 billion, and in credit to banks an increase of some NIS 20.5 billion.

The main changes that occurred in 2011 in the main activity divided into linkage segments were as follows:

The unlinked shekel segment

The ratio of the assets in the shekel segment to total assets is some 55%.

Most of the activity in the segment is for short periods, up to one year.

Total credit to the public increased by some NIS 11.9 billion, some 9.8%.
Total deposits in banks, net increased by NIS 19.4 billion, and the total investment in securities decreased by some NIS 3.6 billion.

In 2011, total shekel deposits increased by NIS 18.5 billion, 14.0%. This increase includes the issue of capital notes and subordinated notes amounting to NIS 0.3 billion.

Total net balance of derivative transactions in the segment as at 31 December 2011, was NIS (15.3) billion, an increase of NIS (8.5) billion compared to December 2010.

The CPI-linked segment

The main activity in the linked segment is carried out for periods longer than a year.

Total credit to the public increased by some NIS 0.8 billion, some 1.5%.
Total investment in securities increased by NIS 0.6 billion.

In 2011, subordinated notes amounting to NIS 3.1 billion were issued through Leumi Finance.

The net balance of derivative transactions in the segment as at 31 December 2011, amount to some NIS (4.5) billion, a decrease of NIS 1.4 billion compared to December 2010.

Foreign currency and foreign currency linked segment

Credit to the public, which constitutes only some 51% of the total deposits of the public in the segment, increased by NIS 4.6 billion or 9.0% and after canceling the effect of exchange rate changes, increased by 2.3%.

Investments in securities in foreign currency amounted to NIS 17.6 billion, a reduction of NIS 4.3 billion, compared with December 2010.

Deposits in banks rose by some NIS 3.5 billion.

From the beginning of 2011, there was an increase of some NIS 11.4 billion (11.8%) in total deposits of the public in foreign currency. After canceling the effect of changes in exchange rates, the reduction was only 5.1%.

According to past experience, a large part of deposits in the foreign currency segment, which are deposited for periods shorter than one year, including deposits on demand, are re-deposited in the Bank in a continuous and constant process.

Activity in future transactions has a material impact on liquidity in the foreign currency segment. Total net future transactions in which foreign currency was given against shekels, amounted to some NIS 19.8 billion as of 31 December 2011, an increase of some NIS 7.1 billion, compared with December 2010.

B. Repayment periods

During 2011, as in recent years, the Bank was characterized by a high level of liquidity in shekels. This was partially as the result of a policy directed by the Bank to raise stable and varied sources of funds, by means of public and private offers and raising deposits from a large number of customers for various periods including long-term. In addition, the high liquidity reflects also the expansive monetary policy adopted by the Bank of Israel.

Some 26% of the Bank's total assets are deposited for short periods in banks and invested in marketable securities, mainly in government debentures.

Total liquid assets in 2011 were significantly higher than total short-term liabilities and the Bank complied with all liquidity limits for the various scenarios. This was in accordance with the policy whose aim is to ensure stability also in extreme theoretical stress scenarios.

The following table shows a future cash flow of the assets and liabilities according to repayment periods and according to index base (including derivative instruments and not including non-monetary items) (for further information, see Note 17 to the Financial Statements).

Pursuant to directives of the Bank of Israel from 2010, cash flows in respect of liabilities with a number of repayment dates will be classified in accordance with the intention of Management, and in the event that Management has no discretion, the cash flows will be classified in accordance with the earliest forecast repayment date.

	As at 31 December 2011			
Surplus of assets over liabilities*	Unlinked Israeli currency	CPI-Linked	Foreign currency including foreign currency linked	Total
Period remaining to maturity:	NIS millions			
Up to 1 month	**(49,417)**	**(5,285)**	**(23,955)**	**(78,657)**
From 1 month to 1 year	**22,422**	**(3,486)**	**(5,619)**	**13,317**
From 1- 5 years	**30,962**	**(2,096)**	**22,687**	**51,553**
From 5 - 10 years	**17,723**	**4,108**	**3,542**	**25,373**
More than 10 years	**18,545**	**13,308**	**2,349**	**34,202**
Without maturity date	**1,268**	**(1,185)**	**92**	**175**
Total	**41,503**	**5,364**	**(904)**	**45,963**

	As at 31 December 2010			
Surplus of assets over liabilities*	Unlinked Israeli currency	CPI-Linked	Foreign currency including foreign currency linked	Total
Period remaining to maturity:	NIS millions			
Up to 1 month	(53,685)	(868)	(31,444)	(85,977)
From 1 month to 1 year	28,727	(4,937)	(2,756)	21,034
From 1- 5 years	30,499	(2,750)	28,719	56,463
From 5 - 10 years	17,118	4,837	4,407	26,362
More than 10 years	13,836	9,645	1,599	25,080
Without maturity date	1,343	(860)	332	1,815
Total	37,833	5,067	857	43,757

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

A description of the key points of the policy, the means of monitoring and implementing the policy, and the limits used in the management of market risks, including basis and liquidity risks, are presented in the chapter "Exposure to Risks and Methods of Risk Management" on pages 244-.

Excess assets over liabilities for periods of 10 years and more in the unlinked shekel and CPI-linked segments increased in 2011 by some NIS 8.3 billion, mainly as the result of an increase in the volume of credit for mortgages. In the shekel segment, the excess of assets over liabilities for a period of up to one month increased by some NIS 4.3 billion. At the same time, a decrease of some NIS 6.3 million was recorded for a period of a month to one year. This change derived from the realization of the securities portfolio and an increase of deposits at banks.

In the index-linked segment, the excess of liabilities over assets for the period up to one month increased by some NIS 4.4 billion, mainly as the result of shortening of debentures issued by Leumi Mortgage and which were repaid in the first quarter of 2012. The effect of the raising of capital notes and subordinated notes in the linkage sector was offset by the shortening of the inventory of deposits of the public and subordinated notes.

In the foreign currency segment, an increase of the deposits in banks, a decrease in the volume of the securities portfolio, and the net increase in activities in derivatives for short periods (assets) led to an increase in the excess of liabilities for the period of one month to five years, in parallel with the excess of assets for a period of up to one month.

C. Liquidity Position and Funding

The liquidity position of the banking system

Total balances of the banking system (current accounts and monetary deposits) with the Bank of Israel at the end of December 2011 were some NIS 130 billion, compared with some NIS 100 billion at the end of December 2010.

The average volume of these balances was at a level of some NIS 124 billion in the last quarter of the year and at an average of some NIS 118 billion for the whole of 2011.

In 2011, holdings of *Makam* held by the public fell by NIS 21 billion to a level of NIS 113.8 billion at the end of December 2011. Foreign currency purchs of the Bank of Israel from the system in 2011 amounted to NIS 4.6 billion.

Total balances of Leumi (current accounts and monetary deposits) with the Bank of Israel at the end of December 2011 amounted to some NIS 36 billion, compared with some NIS 17 billion at the end of 2010.

The average volume of Leumi's balances with the Bank of Israel was some NIS 32 billion in the last quarter of the year and some NIS 27 billion for the whole of 2011.

On 20 January 2011, the Bank of Israel published changes in liquidity regulations, which came into force on 27 January 2011. According to the announcement, banking corporations are required to hold liquid assets in shekels at a rate of 10% in respect of shekel-foreign currency swap transactions and shekel-foreign currency futures transactions, executed with foreign residents (including foreign banks). The obligation to hold liquidity is from the date the transactions are executed until the end of the life of the transaction. In particular, for swap transactions, it is from the execution of the transaction until settlement date of the final part of the transaction.

Liquidity position and raising funds by the Bank

The structure of the Bank's assets and liabilities continues to indicate a high level of liquidity. This is the result of a deliberate policy of raising stable and diversified sources, while placing importance on the raising of deposits from a large number of customers, for varying periods, including for the long term.

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

See also page 254 of the Report.

At 31 December 2011, the balance of cash and deposits with banks (excluding Leumi) amounted to some NIS 50.4 billion, compared with NIS 30 billion at the end of 2010, an increase of some 67%. (Most of the increase was recorded in the first half of the year.)

In addition, the Bank has a securities portfolio of some NIS 41 billion, invested mainly in Israeli government debentures, foreign government debentures, and debentures of banks overseas.

Approximately 38% of the financial assets in the Bank are deposited in banks, net and invested in securities, a rate similar to 31 December 2010.

The percentage of credit to the public (including the deposit in Leumi Mortgage Bank for credit financing) out of deposits by the public as at 31 December 2011 is 75.8%, compared with 78.2% at 31 December 2010.

The balance of credit to the public as at 31 December 2011 amounted to NIS 151.6 billion, compared with NIS 143.4 billion at the end of 2010, an increase of some 5.7%. The increase was mainly in the unlinked shekel segment. After canceling the effect of exchange rate differentials, the credit increased by NIS 6.5 billion, an increase of some 4.5%.

At the end of December 2011, the balance of public deposits, including subordinated notes and capital notes, amounted to some NIS 265.2 billion, compared with NIS 239.8 billion at the end of 2010, an increase of 10.6%. After canceling the effect of exchange rate differentials, the increase was NIS 20.5 billion, or 8.5%. The increase in the balance includes subordinated notes of NIS 3.4 billion which was raised in September and November 2011 through Leumi Finance. Shekel deposits increased by NIS 21.6 billion or 13.4%. Foreign currency deposits increased by NIS 3.8 billion, or some 5.3% (in dollar terms, a decrease of US$ 0.4 billion was recorded).

In addition, in January 2012, NIS 2.3 billion was raised in subordinated notes through Leumi Finance.

During the period under review, the volume of off-balance sheet monetary assets of customers fell by NIS 35 billion. After deducting the effect of the impairment in market value, a positive accumulation of NIS 2 billion was recorded.

Legal Proceedings

1. Civil Proceedings

1.1 The Bank is a party to legal proceedings, including petitions for leave to approve class actions, brought against it by customers and former customers of the Bank, and various third parties considering themselves prejudiced or harmed by the Bank's activity during the ordinary course of its business.

In the opinion of the Management of the Bank, based on legal opinions, appropriate provisions have been included in the Financial Statements to cover possible damages in respect of all the claims.

The grounds for claims against the Bank are different and varied, including assertions as to the non-execution of instructions or their late execution, petitions for approval of attachments imposed by third parties on assets of debtors that according to them, are held by the Bank, assertions that interest charged is in accordance with the interest rates agreed upon between the Bank and the customer, interest rates deviating from those permitted by law, errors in the dates of debiting and crediting accounts in respect of checks drawn on them, assertions in connection with the charging of commissions, assertions relating to securities, labor relations, drawing checks without cover, and failure to honor checks.

For details regarding claims and petitions for leave to approve class actions filed against the Bank, see Note 18 to the Financial Statements.

Claims in an amount exceeding 1% of the shareholders' equity of the Bank on 31 December 2011, of about NIS 234 million, are detailed in Note 18 to the Financial Statements.

1.2 As part of measures taken to recover debts during the ordinary course of its business, the Bank, *inter alia,* initiates various legal proceedings against debtors and guarantors, and proceedings to realize collateral. The Financial Statements contain allowances for credit losses that were made by the Bank on the basis of an assessment of all the risks involved in the credit to the various sectors of the economy and taking into account the extent of the information concerning the relevant debtor/guarantor with regard to his financial strength and the collateral given to the Bank to secure repayment of the debt.

1.3 On 9 October 2011, an appeal that had been submitted on the verdict handed down by the Jerusalem District Court on 27 March 2011 determining that the proceeds of the sale of control and management of the provident funds and mutual funds belonged entirely to the managing companies and the banks, was dismissed, rejecting the three demands and petitions for recognition of the claim as a class action and companies under its control that engaged in the management of provident funds and mutual funds.

2. Other Proceedings

2.1 On 26 April 2009, a ruling of the Antitrust Commissioner was received at the Bank, pursuant to section 43(a)(1) of the Antitrust Law, 1988, according to which restrictive trade agreements, relating to the transfer of information regarding commissions, had existed between the Bank, Bank Hapoalim B.M., Israel Discount Bank Ltd., Mizrahi-Tefahot Bank Ltd. and the First International Bank of Israel Ltd., during the period from the beginning of the 1990's until the commencement of the Antitrust Authority's investigation into the matter in November 2004. This is a civil ruling, which constitutes *prima facie* evidence of the matters therein determined in any legal proceedings. The Bank submitted an appeal against this ruling. On 22 February 2011, the Commissioner's response to the appeal was submitted. A conciliation process between the parties took place, but it did not succeed. At this stage, the implications of the ruling cannot be assessed.

2.2 As has been published, authorities in the United States ("the authorities") are conducting investigations into foreign banks in connection with the banks' activities with customers who are assessed for tax in the United States ("American customers"), suspecting a violation of American law. As part of their investigations, as aforesaid, which are also being conducted against the Group, various demands have been made by the authorities to companies included among the Group's customers in connection with customers who have been identified by the authorities and banking services received from the Group, and the Group is cooperating with the authorities in furnishing the information that it is permitted to furnish under the law. At this stage, the results and implications of the said investigation cannot be predicted, and the possible damage to the Bank Group cannot be estimated or assessed.

2.3 In recent weeks, the Israel Securities Authority has been conducting administrative arbitration procedures pursuant to Section 52qq(a)(2) to the Securities Law, in connection with the publication of a profit warning by the Bank on 14 November 2011, and in connection with the issue of deferred notes by Leumi Finance pursuant to a shelf offer published 9 November 2011.

For further details regarding contingent liabilities, see Note 18 to the Financial Statements.

Restrictions and Supervision of Activities of the Banking Corporation

1. Pursuant to legal provisions, the Bank is subject to the supervision of various authorities with regard to its various activities, and especially with regard to its overall activities, to the supervision of the Bank of Israel, specifically the Governor of the Bank of Israel and the Supervisor of Banks.

By virtue of the powers granted to the Governor of the Bank of Israel and the Supervisor of Banks, various permits and approvals are issued by them from time to time, for activities and/or holdings in corporations.

2. The Governor of the Bank of Israel has permitted the Bank, by virtue of his authority under section 31 of the Banking (Licensing) Law, 1981, to hold the means of control of overseas corporations (hereinafter: "the overseas corporations"), and by virtue of this permit, the Supervisor of Banks has approved holdings by the overseas corporations in other corporations (the "sub-subsidiaries"). In addition, there are specific approvals relating to sub-subsidiaries. The permit for the holdings in the overseas corporations was issued on 23 February 2006 in lieu of previous permits, and such permit was given subject to the Bank acting to implement the requirements of the Supervisor regarding supervision and control of the overseas corporations and the sub-subsidiaries. The permit of the Supervisor to hold the means of control in overseas corporations and the Supervisor's approval to hold overseas corporations in sub-subsidiaries were amended in November 2011, enabling the Bank to hold 100% of the means of control of Banque Safdié and its subsidiaries, for the purpose of its merger into Leumi Switzerland (which thereafter changed its name to Leumi Private Bank).

The corporations included in the Governor's permit are: Bank Leumi USA, Bank Leumi (Switzerland), Bank Leumi (UK), Leumi (Latin America), Bank Leumi (Luxembourg), Bank Leumi (Jersey) and Bank Leumi Romania.

The permit is subject to a number of conditions regarding levels of holdings; supervision, control and monitoring of the management of the overseas corporations and sub-subsidiaries; the requirement for approval, a report, or notification to the Supervisor regarding various events, such as: investments in corporations, significant new activities, the opening of a branch or representative office; and the giving of information and documents to the Supervisor.

3. With regard to restrictions imposed on the depositing of monies between Group companies, see page 12.

Material Contracts

1. An agreement dated December 1995 between the Bank and the Assessing Officer for Large Enterprises regarding the manner of recognition for tax purposes of provisions for doubtful debts, based, *inter alia*, on the principal recommendations of the committee for the examination of tax aspects regarding doubtful debts.

The following are the principal rules determined in discussions with the Assessing Officer for the recognition of provisions for doubtful debts for tax purposes and the method of dealing with cancelled provisions. The basis of the rules is the recommendations of the committee appointed by the Income Tax Commissioner for the examination of tax aspects regarding doubtful debts of banks ("the Givoli Committee"), which were published in 1992, and which have yet to be incorporated into legislative amendments:

1.1 Specific provisions for doubtful debts are to be recognized as a tax expense in the year in which they are recorded, subject to paragraph 1.3 below.

1.2 Provisions for doubtful debts in relation to which specific monitoring is carried out – a mechanism has been determined to compensate the tax authorities, in real values together with interest, in cases where it becomes clear that past provisions were larger than the actual loss.

1.3 In respect of specific provisions for doubtful debts regarding debts in Israel in relation to which specific monitoring is not carried out, as of 1990, 20% of the nominal increase in the balance of the provision for doubtful debts in respect of such debts will be added every year for the purpose of calculating profits for income tax purposes, and if the provision decreases, 20% of the decrease will be considered by the Bank as cancellation of an unrecognized expense.

The Bank has reserved the right to carry out specific monitoring regarding all provisions for doubtful debts. As at 31 December 2007, specific monitoring was carried out for provisions for doubtful debts amounting to more than NIS 50,000.

1.4 If, at a certain point in the future, the balance of provisions for doubtful debts in respect of which specific monitoring is not carried out falls below the nominal balance as of 1 January 1990, in the amount of NIS 307,671 thousand, the Bank will not demand this decrease as an expense for tax purposes, since this amount was recognized in the past as a tax expense.

Following publication of the circular by the Supervisor of Banks regarding measurement and disclosure of impaired debts, credit, and the allowance for credit losses, (hereinafter "Directive of the Bank of Israel"), the banks, including the Bank, reached an agreement with the Tax Authority regarding recognition of allowances for credit losses for tax purposes. The agreement was signed on 19 March 2012. This agreement replaces the earlier agreement described above, and is effective for impaired debts that were recorded from 1 January 2011onwards.

The main points of the new agreement are as follows:

Large impaired debts on an individual basis:

The allowance is recognized as tax deductible in the same year it is recorded as an expense in the financial statements. In the tax year in which the balance of the allowance for credit losses was reduced (not as a result of an "accounting write-off" or a "waiver"), an "additional tax" will be added to the Bank's tax liability, with the addition of interest and linkage differentials, which will result in a tax charge which would have been collected if the allowance permitted to be deducted had been recognized at the outset.

For this purpose – a "large debt" is a debt of NIS 1 million or more, or a lower amount as notified by the Bank to the assessing officer and in accordance with the Bank's characteristics.

Impaired debts that are not large:

The expenses in respect of a net "accounting write-off" (after offsetting tax payment for the same year) – half are recognized for tax purposes in the first tax year following the year in which the expense was recorded, and half are recognized in the subsequent tax year in which the expense was recorded.

Allowances in respect of "retail debts" recorded up to 31 December 2010:

These will be recognized as tax deductible in five annual equal installments, beginning in 2011, providing they were not recognized as an expense for tax purposes in previous years.

Implications of the initial implementation of the Bank of Israel's directive on 1 January 2011:

Differences deducted from shareholders' equity as a result of the initial implementation of the Bank of Israel's directive will be recognized as tax deductible in five annual equal payments, beginning tax year 2011, subject to their being recognized for tax purposes in accordance with the terms of the arrangement, and on condition that they are not collective, general or supplementary provisions.

Collective allowance:

This is not recognized for tax purposes.

Because the Tax Authority signed the agreement on 19 March 2012, as stated above, the impact of the agreement has not yet been included in the 2011 financial statements. Nevertheless, it should be noted that implementation of the agreement has no significant impact on the Bank's 2011 annual financial statements.

2. A compromise agreement for the regulation of tax payments in Israel in respect of profits of subsidiaries of the Bank overseas, between the Bank and the Assessing Officer for Large Enterprises of August 1987, which was extended in October 1991 until the end of 1993, and again in March 1994, when its term was extended until such time as one of the parties gives a year's notice of its intention to propose changes to the agreement.

For further details regarding this agreement, see page 273.

3. An agreement from April 2005 between the Bank and the Tax Authority in connection with an offset in respect of the profits of a foreign subsidiary.

For further details, see Note 26.L

4. A special collective agreement dated February 2011between the Bank and the managers' committee and authorized signatories and the Histadrut, regarding the new scale for the administrative staff and the professional staff in the Bank.

5. A special collective agreement dated November 2011 between the Bank and the Joint National Employee's Committee of Bank Employees and the Histadrut regarding the terms of transition to centers of expertise.

6. An agreement between the Bank and Union Bank Ltd. ("Union Bank") for providing comprehensive computing and operational services, including development work and new and special projects as well as relevant training, by the Bank to Union Bank and its associates, signed in September 2001 and effective retroactively from September 1998 for a period of 11 years with an extension option. In December 2007, an addition to the agreement was signed by Leumi and Union

Bank, concerning an extension of the relationship, with changes in the business terms. The new relationship term is ten years, starting from 1 January 2007, during which a gradually increasing annual consideration will be paid to the Bank, starting at some NIS 40 million in the first two years and up to some NIS 45 million starting from the sixth year (the sums are linked to the December 2006 CPI, and are contingent upon Union Bank's volume of activity). The addition was approved by the Supervisor of Banks and the Antitrust Commissioner.

7. Letters of Indemnity as detailed in Note 18J to the Financial Statements.

8. Agreement from February 2011 regarding the purchase of Banque Safdié, Switzerland, see page 202.

Description of the Taxation Position

1. **(a)** On 13 August 1987, a compromise agreement was signed between the Bank and the Assessing Officer for Large Enterprises, which regulates tax payments in Israel in respect of profits of overseas subsidiaries of the Bank, pursuant to which from 1978 and thereafter the Bank's share of the profits of overseas subsidiaries on a consolidated basis will be included in the Bank's assessment. The agreement provides that it does not determine that the companies owe tax in Israel or that Israeli law applies to them and that the agreement does not constitute a precedent. The agreement was extended on 10 October 1991 with effect until the end of 1993, and again on 13 March 1994 and it will be in force until one of the parties gives a year's notice of its intention to propose changes to the agreement.

(b) Pursuant to an arrangement with the tax authorities dated 14 April 2005, as from 2004, the Bank may set off from its tax liability in Israel, in respect of the profits of an overseas subsidiary, an aggregate amount of up to US$ 67 million, but no more than the lower of US$ 3 million a year or the tax liability in Israel.

2. Amendment No. 11 to the Income Tax (Adjustments by Reason of Inflation) Law, 1985, provided that, *inter alia,* all the assessed parties to whom the amendment applies must pay tax on profits from securities traded on an exchange at the time of realization. The Amendment came into force in 1999. In the opinion of the tax authorities and the banks, taxing securities on a realization basis does not accord with the nature of the financial institutions' activity.

In light of this, on 6 June 1999, the tax authorities sent the banks a draft proposal to amend section 6 of the said Law, pursuant whereto the financial institutions would be taxed on the basis of the increase in the value of the securities, in accordance with the manner of presenting securities in the financial institutions' financial statements.

In co-ordination with the tax authorities, the Bank operates on the basis of the draft proposed law, and the tax provisions were made accordingly.

3. On 27 June 2006, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions), 2006, was published in the Official Gazette (*Reshumot*). The order determines that the rate of salary tax and profit tax applying to financial institutions will be 15.5%. The amendment came into effect on 1 July 2006.

On 1 July 2009, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) (Provisional Order), 2009, was published in the Official Gazette (*Reshumot*), raising the rates of salary tax and profit tax applying to financial institutions from 15.5% to 16.5%, from 1 July 2009 to 31 December 2010.

On 31 December 2009, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) (Provisional Order) (amendment), 2009, was published in the Official Gazette (*Reshumot*), reducing the rates of salary tax and profit tax applying to financial institutions from 16.5% to 16%, from 1 January 2010 to 31 December 2010.

On 24 February 2011, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) (Provisional Order), 2011, was published in the Official Gazette (*Reshumot*), fixing the rates of salary tax and profit tax applying to financial institutions at 16%, from 1 January 2011 to 31 December 2012.

The company tax rate in Israel in 2010 was 25% and in 2011, 24%. A body of persons is taxable on inflation-adjusted capital gains at the company tax rate with effect from the year of sale.

On 5 December 2011, a Law to Change the Tax Burden (Legislative Amendments), 2011 (hereinafter – the Law) was passed by the Knesset. Pursuant to the Law, with effect from 2012, *inter alia,* the plan to reduce company tax rates was canceled. The company tax rate was raised to 25% with effect from 2012 and the rate of tax on inflation-adjusted capital gains and the taxation on inflation-adjusted betterment were raised respectively.

The said change resulted in an increase in deferred tax balances of NIS 326 million, and, at the same time, to an increase in net profit in 2011, which was recorded in taxes on income.

4. The Bank, as a "financial institution" for the purposes of the Value Added Tax Law, pays profit tax. As mentioned above, the rate of profit tax in 2010, 2011 and 2012 is 16% and from 2013 and 15.5% thereafter. Profit tax constitutes an expense for company tax purposes and, therefore, the tax rate that applies to the Bank for the tax year 2010 was 35.34%, in tax year 2011 the tax rate was 34.48%, in tax year 2012 the rate will be 35.34%, and in tax year 2013 and thereafter, the tax rate will be 35.06%. See Note 1 to the Financial Statements for further details regarding the Bank's policy for recording deferred taxes.

5. The Bank has been issued with final assessments for the period up to and including the 2007 tax year. The principal consolidated companies have final assessments up to and including the 2007 tax year.

6. See Note 26 to the Financial Statements for further details with regard to the provision for tax of the Bank and subsidiaries, final assessments, accrued losses for tax purposes and differences between the statutory tax rate and the effective tax rate.

Human Resources

Number of Personnel

In 2011, the number of positions* in the Group increased by 143, a rise of some 1.1% in relation to the number of positions in 2010. With regard to the average for the year, the number of positions increased by 220, a rise of some 1.6% in relation to the average for 2010.

This rise derives from an increase in the number of positions in the Bank and the consolidated companies in Israel.

	Positions at year end		Average positions during the year	
	2011	2010	**2011**	2010
The Bank in Israel	**9,843**	9,725	**9,782**	9,643
Consolidated subsidiaries in Israel	**2,530**	2,471	**2,518**	2,403
Group total in Israel	**12,373**	12,196	**12,300**	12,046
Overseas: Bank branches and representative offices	**49**	56	**52**	58
Consolidated subsidiaries	**1,211**	1,238	**1,207**	1,235
Group total in Israel and overseas	**13,633**	13,490	**13,559**	13,339

*"Position" – means a full time position including specific overtime, working hours of employees from temporary employment agencies and employment of external consultants.

Within the framework of the cost saving and streamlining program, it was decided to reduce approximately 800 positions by the end of 2014. Of these, it is expected to reduce some 300 positions during 2012. The reduction in manpower is based on natural retirement, and reduction of recruitment of new employees, which is made possible, *inter alia*, by the "Advancing Together" project, which promotes the removal of "back office" activities from the branches to "centers of expertise".

Remuneration system and salary structure

In general, the salary and remuneration systems for the Bank's employees are based upon a correlation between the level of remuneration and the position of the employee, the contribution of the employee to the Bank and the evaluation of the employee's manager. Consequently, the remuneration granted to the employee is differential.

Collective agreements with the employees

a. On 13 February 2011, a special collective agreement was signed between the Bank and the managers' committee and authorized signatories and the Histadrut, regarding the new scale for the administrative staff and the professional staff in the Bank.

b. On 29 November 2011, a special collective agreement was signed between the Bank and the Joint National Employee's Committee of Bank Employees and the Histadrut regarding the terms of transition to centers of expertise.

See page 294 for details of salary of senior officers.

Labor and Salary Costs (for the Bank)

	2011	2010	2009
	NIS thousands		
Cost per employee position (excluding bonus)*	**316.7**	300.8	283.2
Cost per employee position (including bonus)*	**323.3**	327.5	303.7
Salary per employee position (excluding bonus)*	**211.8**	202.2	192.0
Salary per employee position (including bonus)	**217.2**	224.1	208.9

* Cost per employee position does not include pension expenses for pensioners and costs of voluntary retirement.

Training and Development

The Management of the Bank sets itself the goal of supporting the business units and the attainment of their business goals through study and training procedures, which focus on improving the professional and managerial ability of employees and managers. In this context, Leumi employees participated in 35,217 training days during 2011.

Training activities in 2011 focused on raising the level of professionalism of the employees with emphasis on core banking areas – credit, investment counseling, service and sales and management training, all according to the business objectives of the Bank, including comprehensive training and assimilation with regard to regulations and compliance for all the Bank's employees.

Organizational development and supporting units undergoing change and under construction

In 2011, activity was expanded in the area of organizational development and supporting units undergoing change or in the process of being established. Among the central processes in the area are: the establishment of a risk management division, "Advancing Together", the construction of centers of expertise, a change in the Procurement and Real Estate Division, etc.

Digital learning

In 2011, the increase in knowledge management activity in Leumi continued, with the adoption of new remote-learning (LM) technologies, and self-teaching activities at all the Bank’s units, with the object of making wider use of the existing knowledge in the organization, refining the ability of the employees to study in their units as part of the work routine, and increasing the number of those studying at the Bank.

Manager development

Implementation of the manager development program at Leumi continued in 2011, and during the year, more than 95% of managers participated in Bank-wide management courses, professional courses, and enrichment and skills development programs. Also, the scope of mentoring for new managers beginning their work at the Bank, for managers taking up new positions and for supporting processes of changing units, was expanded.

Education

The percentage of employees with university education at the Bank has been on a continuing upward trend. The percentage of university graduates at the Bank was 63.5% of all employees at the end of 2011, compared with 61.4% in 2010, 59.6% in 2009 and 57.5% in 2008. The percentage of graduates among the managerial staff reached 93% in 2011, in comparison with 92.6% in 2010, 92.4% in 2009 and 91.6% in 2008.

This increase in the percentage of university graduates is the result of the recruitment of employees with university education, the resignation of Bank employees who were not university graduates, and the acquisition of higher education by Bank employees.

Employee Rights

Labor relations between the Bank and its employees in Israel, save for those with personal employment contracts, are primarily based upon a basic collective labor agreement known as the "Labor Constitution" and supplementary and collective agreements. The terms of employment of members of the Bank's Management and certain other senior employees are regulated by personal employment contracts. For additional details see note 15 to the financial statements.

New Employees and Tenure

In 2011, the Bank recruited 361 employees, compared with 250 in 2010.
In 2011, tenure was granted to 405 employees, in comparison with 125 employees in 2010.

Organizational Culture - Leumi's Code of Ethics

In 2005, Leumi launched its code of ethics, "the Leumi Way".

During 2005-2011, comprehensive and varied processes continued for the assimilation of the Code of Ethics amongst all Leumi employees, with emphasis on making the promotion of the subject of ethics a part of the concept of the role of the manager at Leumi. In addition, there are some ethics functions operating – the officer responsible for ethics, an inter-divisional ethics committee, divisional ethics committees, an ethics call-center.

The ethical code, "the Leumi Way" was examined in the framework of the SOX controls and the *Ma'ala* rating, and is part of Leumi's Report on Corporate Responsibility which received international recognition from the international organization Global Reporting Initiative, the leading recognized body in the world in the field of formulating and promoting reports on social and environmental responsibility.

In 2011, an ethical code for investment consultants was launched and a social media accord was initiated.
During this year, an upper ethics committee was established, in addition to the existing ethics institutions. The committee, which is headed by the Head of the Human Resources Division, is responsible for formulating and supporting the process at strategic junctures. The committee convenes twice a year. The committee decided on a process of examining a revision of the ethical code.

The process of revising the code included 22 focus groups, in which 350 employees and managers from the entire Leumi Group participated.

The revised code will be launched and assimilated in the course of 2012.

Employee opinion survey

Leumi management conducts an opinion survey among all the employees of the Bank once every two years, as part of maintaining a continuous dialog with its employees. The survey is intended to reflect an up-to-date picture with regard to the perceptions and views of the employees regarding the various aspects of work and activity in Leumi, and to obtain recommendations for the processes of retaining employees and improving procedures in the Bank.

The findings of the survey conducted in 2011pointed to the fact that the level of satisfaction among Leumi employees is generally high (8.81 on a scale from 5-10). Leumi is perceived by its employees as a leading brand, geared to the benefit of its customers and directed towards business excellence and the achievement of its goals.

Involvement of employees in the community

The Management of Leumi views the involvement of its employees and managers in the community as a central goal in the area of social responsibility. Leumi encourages its employees to take an active part in volunteer projects and to become involved in community life, and provides them with frameworks for volunteering and a variety of opportunities to contribute and volunteer.

During the course of 2011, some 4,428 employees – from 230 units within the Bank - engaged in volunteering activity. The total hours of volunteer work by employees over the course of the year was 33,797.

The activities of the unit are based on a network of social leaders in all the divisions and functions of the Bank, numbering some 300 employees representing the various units of the Bank. Their purpose is to promote the subject of volunteer work among employees in their unit while building an infrastructure to support the activity.

Leumi has about 400 community partners, mainly in the area of children and young people. A total of some 50,000 people every year benefit from the direct influence of volunteer work by Leumi employees.

Employees from throughout the country are involved in a range of activities such as assisting children and youth at-risk in residential homes, clubs and community centers; tutoring, assisting with homework, collecting equipment for the needy, visiting hospitals, assisting in absorption centers for new immigrants, assisting the disabled and more.

Along with these many different activities, a decision was made to link with Leumi's vision of strengthening the future generation, by empowering those volunteering for a year of service through the "Leumi Movement" program in partnership with youth movements, and by deepening the connection with community partners of the "Leumi Tomorrow", and "Fair Chance for Children" organizations, as well as the "Adopt a Combat Soldier" project of the Friends of the Association for the Wellbeing of Israel's Soldiers.

Positions according to operational segments:

	Average positions in 2010		Average positions in 2009	
	Managerial Staff	**Clerical Staff**	Managerial Staff	Clerical Staff
Households	**1,372**	**5,779**	1,369	5,783
Small businesses	**466**	**1,400**	446	1,393
Corporate banking	**451**	**657**	452	625
Commercial banking	**787**	**1,194**	724	1,091
Private banking	**401**	**417**	401	453
Financial management – capital markets	**270**	**350**	232	250
Other	**3**	**12**	27	93
Total	**3,750**	**9,809**	3,651	9,688

The calculation of the number of positions according to operational segments is based on the management of personnel according to the Bank's main lines of business, with various adjustments and on the basis of assessments. In calculating the number of positions according to operational segments, employees of head office units, who serve all or part of the operational segments of the Bank, have also been taken into account.

Appointments and Retirement

Appointments:

1. **Ms. Rakefet Russak-Aminoach**, Head of the Corporate Division, will be appointed to the position of President and Chief Executive Officer of Leumi Group, as of 1 May 2012 (approved by the Bank of Israel). Since 1 July 2011, Ms. Russak-Aminoach has served as Senior Deputy Chief Executive Officer, Acting CEO in the absence of the President and CEO.

2. **Mr. Gideon Altman**, Head of Commercial Banking Division, was appointed a member of Bank Management, as of 1 January 2011.

3. **Mr. Yaron Bloch** was appointed CEO of Leumi Partners, as of 1 January 2011.

4. **Mr. Sasson Mordechay** was appointed Chief Internal Auditor and Head of the Internal Audit Division, as of 1 March 2011.

5. **Ms. Tamar Yassur** was appointed CEO of Leumi Card Co., as of 1 March 2011.

6. **Mr. Aviram Cohen** was appointed Head of Marketing Division, as of 20 March 2011.

7. In accordance with the approval of the Board of Directors, the following promotions were effected in the Bank, as of 1 April 2011:

   The following members of management were promoted to the rank of Deputy Chief Executive Officer: **Mr. Zvi Itskovitch** – Head of the Private and International Banking Division; **Mr. Baruch Lederman** – Head of the Banking Division; **Mr. Itzhak Malach** – Head of the Operations and Computer Division; **Professor Daniel Tsiddon** – Head of the Capital Markets Division; **Ms. Rakefet Russak-Aminoach** – Head of the Corporate Division.

   The following members of management were promoted to the rank of First Executive Vice-President: **Mr. Gideon Altman** – Head of the Commercial Banking Division; **Mr. Yaacov Haber** - Head of the Finance and Economics Division; **Mr. Dan Cohen** – Head of the Human Resources Division; **Mr. Menachem Schwartz –** Head of the Accounting Division.

8. **Mr. Dan Cohen** was appointed Head of Human Resources and a member of Bank Management, as of 1 April 2011.

9. **Adv. Nomi Sandhaus,** the Chief Legal Advisor and Head of the Legal Division was appointed a member of Bank Management, as of 1 April 2011.

10. **Mr. Steve Levin** was appointed chairman of the board of directors of Bank Leumi USA, as of 30 June 2011.

11. **Mr. Gil Karni** was appointed CEO of Bank Leumi Luxembourg, as of 16 August 2011.

12. **Mr. Yoel Mintz,** Head of the Building and Real Estate Department, was promoted to the rank of Deputy CEO, as of 1 September 2011.

13. **Ms. Einat Skornik** was appointed Head of the Investment Consulting Department, as of 1 January 2012.

14. **Ms. Meira Karni**, Head of the Compliance and Enforcement Department, was promoted to the rank of Deputy CEO, as of 1 April 2012.

Retirements:

1. **Ms. Galia Maor,** the President and Chief Executive Officer of the Bank, announced her intention on 1 January 2012 to retire from her position. At the request of the Board of Directors, she will continue to act as President and Chief Executive Officer until the end of April 2012, and the advance notice will become effective in May 2012, for a period of 9 months, after cessation of work.

2. **Mr. Joseph Horwitz,** Chief Internal Auditor and Head of the Internal Audit Division, ceased to serve in his position on 28 February 2011, and retired after 41 years in the Bank.

3. **Mr. David Bar-Lev,** Head of the Human Resources Division and member of the Bank Management, ceased to serve in his position on 31 March 2011, and retired after 46 years in the Bank**.** Mr. Bar-Lev was appointed Chairman of Leumi Mortgage Bank, as of 1 January 2011.

4. **Mr. Zeev Nahari,** Senior Deputy Chief Executive Officer and Assistant Chief Executive Officer, Senior Member of Management for Finance Accounting and Capital Markets, ceased to serve in this position on 30 June 2011, and retired after 46 years in the Bank. Mr. Nahari will continue to act as Chairman of the Board of Directors of Leumi Partners until 31 March 2012 and will be appointed Chairman of the Board of Directors of Arab-Israel Bank, as of 1 April 2012.

5. **Mr. Shmuel Zelotnik,** Head of the Investment Consulting Division, ceased to serve in this position on 31 December 2011, and retired after 35 years in the Bank.

6. **Mr. Shmuel Zussman**, Chairman of the Board of Directors of Arab Israel Bank, will cease to serve in this position on 31 March 2012, after seven years in office.

7. **Mr. Zvi Itskovich,** Head of the International and Private Banking Division, will cease to serve in this position on 30 June 2012, and will retire after 33 years in the Bank.

Organizational Structure

The Leumi Group's organizational structure, according to lines of business and head-office services, as described below, combines the activity of companies in the fields of banking, finance, the capital market and financial services.

Lines of Business

Leumi is organized into five lines of business that focus on different market sectors, and each business line specializes in the provision of service to a group of customers. This form of organization enables the customers to enjoy a high standard of professional service, varied distribution channels, products that are adapted to their requirements and fast and flexible decision-making processes.

Following is a description of the responsibility for Leumi's five lines of business:

1. The **Corporate Division** manages the activity of Israel's large business customers on the basis of sectoral expertise and synergy between the sectors. This line of business also includes the Construction and Real Estate Division that is responsible for the activity of Israel's largest building and contracting companies, with specific expertise and skill in the sphere. In addition, the Division is responsible for the design of special transactions, such as the financing of projects in Israel and abroad, transactions for financing the means of control, the organization of syndicates, the examination of investment plans, trade and international finance.

2. The **Commercial Banking Division** manages the activity of middle-market commercial companies, through the main Tel Aviv branch and 24 commercial branches, which are organized on a geographic basis into 4 commercial districts. The Division's organizational structure is unique in the banking system, providing a "one stop shop" for its comprehensive and extensive services, while broadening its services to business customers through digital channels.

3. The **Banking Division** manages the activity of the private customers and small business customers, who receive the full range of services through 199 branches, which are organized in 8 districts on a geographic basis and by means of a variety of technological/direct distribution channels, including Leumi Call, which provides services to customers through the telephone, cellular phones and the Internet. The services and products are adapted to all the customer sectors differentially according to the nature of their banking activity, their characteristics and their needs. The customers of the Division are segmented into the following sectors: the retail segment, the premium segment, and the corporate banking segment. The Division coordinates the retail operations in the Group, including those of the Arab Israel Bank, Leumi Mortgage Bank and Leumi Card.

4. The **International and Private Banking Division** is responsible for the banking activity of the Group overseas, and for managing private banking in Israel and worldwide. The Division has 7 private banking centers in Israel for residents and non-residents and is also responsible for the activity of Bank Leumi le-Israel Trust Company Ltd. The Division's activities also include, *inter alia*, control and co-ordination between the Bank in Israel and the overseas units, and the provision of services, at international standards, to wealthy customers. The Division is also responsible for overseas mergers and acquisitions.

5. The **Capital Markets Division** is responsible for managing the Group's financial assets in Israeli currency and foreign exchange; management of the *nostro*; the activity of all the Bank's dealing rooms (Israeli currency, foreign exchange and Israeli and foreign securities); developing innovative financial products and investment products; management of the assets and liabilities of the Bank and management of market risks; formulation of the Bank's policy on prices and financial margins; relations with financial institutions abroad; co-ordination of the Bank's capital market operational services; and operational service for customers active in the capital and financial markets, including institutional customers.

As well as the division according to line of business, Leumi Group has the following head office units which provide services to the business units:

The **Finance and Economics Division** is responsible for coordinating and preparing the Bank's work-plan; managing profit centers and financial and managerial measurement; planning and managing the Group's capital; preparing the Bank's expenditure budget and monitoring its application, sharing in the determination of the order of priorities in the investment budget, coordination of commissions policy, managing the Bank's and the Group's tax matters and the Bank's and the Group's insurance, connections with investors and analysts, monitoring economic developments and preparation of sectoral reviews and economic forecasts.

The **Accounting Division** is responsible for managing, developing and determining the Bank's accounting guidelines, managing the Bank's books of account, preparing the financial statements of the Bank and the Group, preparing reports to the Bank of Israel, monitoring regulatory changes related to accounting and their implementation in the Bank and in the Group. In addition, the Accounting Division is responsible for assessing the effectiveness of the key controls of the SOX 404 working process, calculating capital adequacy and reporting to the public in accordance with Basel II directives under the standardized approach.

The **Human Resources Division** is responsible for the formulation and implementation of the Bank's human resources policy and, within this overall context, for selection and placement of employees, remuneration, salary structure, labor relations, development and advancement of employees, banking training – managerial and general, assimilation of the "Leumi Way" code of ethics, intra-organizational communications, internal information, care of the individual, organizational counseling and development, employee involvement in the community and employee welfare.

The **Operations, Information Systems and Administration Division (*Chatam*)** is responsible for the computerized and operational deployment of the Bank and the Group. As part of its task, the Division co-ordinates the formulation and determination of the strategy, policy and activity regarding technological development, computers, operations, data technology, communications, organization and methods, information security, operations of overseas units, operations of subsidiaries in Israel and security. The Division also provides a solution and technological infrastructure for the Bank's risk management.

The **Internal Audit Division** is responsible for the internal auditing of the Leumi Group.
The Audit Division operates by virtue of the Internal Audit Law – 1992, Proper Conduct of Banking Business Directives of the Bank of Israel and directives of the Board of Directors. In addition, the Division acts in accordance with professional standards of the Institute of Internal Auditors.

The division deals, in an independent, impartial manner, with the examination and assessment of the Group's internal control systems, including: examination of the work and control processes, examination of the method of managing various risks in the Group, maintenance of the Bank's implementation of the instructions of the Board of Directors, the Management and the Bank's guidelines, and examination of operational efficiency. In addition, the division conducts an independent review of the internal process for an assessment of capital adequacy of the Group (ICAAP). The Chief Internal Auditor is directly responsible to the Chairman of the Board of Directors.

The **Risk Management Division** was established in 2011 and headed by the Chief Risk Officer. It serves as Leumi's management company. The Chief Risk Officer is responsible for risk management in the Bank and in the Group and reports directly to the President and CEO and the Board of Directors.

The Risk Management Division was set up with an emphasis on the Division's independence in taking risks. The Division coordinates risk management at the Group level in all the main risk areas: credit, market and operations. Its aims are to maintain the stability of the Bank and the Group, and to create a strong infrastructure for managing and controlling risks that will support the achievement of business targets, in accordance with the defined risk appetite. The Division is responsible for assisting the Board of Directors in defining the risk appetite, leading risk policy, developing and defining tools for measuring and pricing risks in the various activities. In addition, the Division is responsible for identifying, measuring and controlling the major risk focal points in the Group, and the changes occurring in them, and examining the risks inherent in new activities. The procedure for accessing the capital required vis-à-vis the risks assumed by the lines of business in the Bank and in the Group (the Internal Capital Adequacy Assessment Process - ICAAP) is led by the Division, as well as the independent validation of models and preparations for the required regulatory changes in the areas of risk management, such as Basel II and Basel III.

The **Legal Division** is responsible for overall legal counsel to the Bank and its subsidiaries in Israel and the management of legal risks in the Bank and the Group.

The **Investment Counseling Department** is responsible for the Bank's policy regarding counseling on investment in securities; financial instruments; pension products; carrying out research on capital and money markets; professional development of investment and pensions advisors; and specifying systems in the fields of consulting and the development of decision-supporting models; treatment of regulatory aspects in the field of investment and pensions counseling; and adapting processes and procedures in these areas to the directives of the regulator.

The **Marketing Department** is responsible for Bank and Group marketing and marketing communications, the spokesperson's office, regulation and public relations, conventions and events, marketing research, corporate responsibility, charitable donations, sponsorships and community relations.

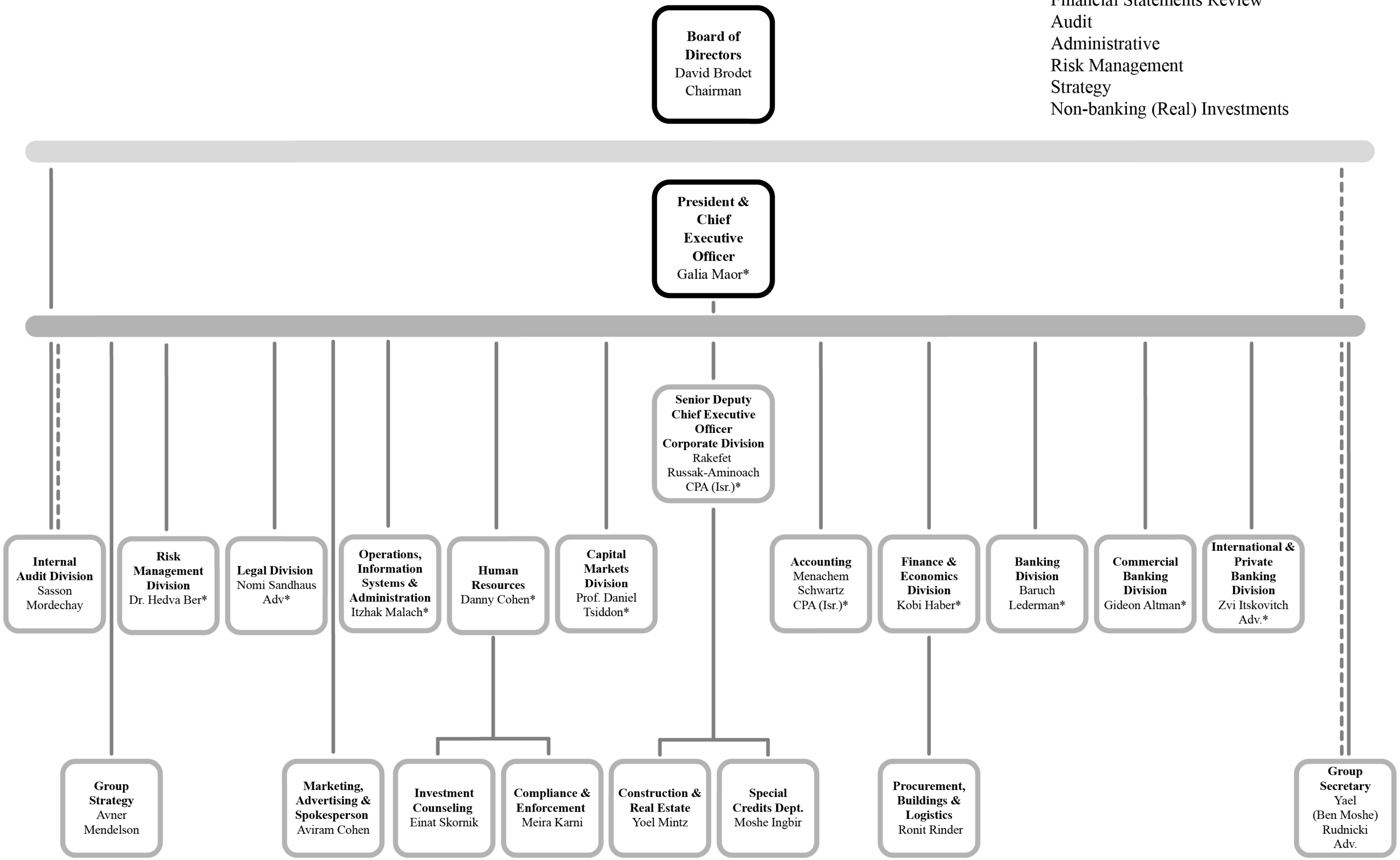
The **Procurement, Construction and Logistics Department** is part of the Finance and Economics Division and is responsible for the provision of services in the area of procurement (technological and general), construction and maintenance, the assets and various logistical services in the areas of consignment and a logistical center, in the Bank and in the subsidiaries in Israel.

The **Compliance and Enforcement Department** is responsible for implementing the Bank's and the Group's compliance plan regarding consumer directives, including the implementation of the legislative provisions dealing with the prohibition of money laundering and of financing terrorism, administrative enforcement and American customers (in collaboration with the Finance and Economics Division and the Legal Division). The Compliance Department is also responsible for the Customer Relations Department. The Head of the Compliance Department reports to the Head of Human Resources.

The **Strategy Department** is responsible for assisting Group Management and the Board of Directors in defining and planning Bank and Group strategy and its validation, examining and analyzing subjects with strategic implications, and providing support and leadership of main projects in cooperation with the lines of business.

Bank Leumi le-Israel B.M.
Organizational Structure

Committees of the Board of Directors
Credit
Financial Statements Review
Audit
Administrative
Risk Management
Strategy
Non-banking (Real) Investments



* Member of Management

Leumi for the Community – Social Involvement

Corporate responsibility management

The area of corporate responsibility in Leumi is managed on a basis of overall perception, strategy and policy led by the Board of Directors, and through various committees operating to advance the various subjects: ethics, the environment, accessibility and community ties.

In 2011, Leumi Group published its third Corporate Responsibility Report for 2009-2010, including a report on the diverse activities, initiatives and achievements of Leumi Group in the area of social-environmental responsibility. The report was written in accordance with the directives of the Global Reporting Initiative (GRI) and was awarded the highest rating of A+, which testifies to the level of maximum transparency. A review of the propriety of the report was carried out by an external and independent expert who examined the manner of compliance with reporting according to the GRI, the veracity of the report and the way the organization has conducted itself.

The Corporate Responsibility Report appears in full on the Leumi website (http://plus.leumi.co.il).

In March 2011, Leumi joined the Global FTSE4Good Index, which examines the performance of companies in comparison to the global benchmarks in the realm of corporate responsibility. The index, which assesses companies traded on the FTSE All World Index, is intended to assist ethical investments according to criteria in the area of society, the environment and corporate governance. Leumi gained a rating according to the FTSE4Good Index rating of 98 (out of 100).

The *Ma'ala* rating of corporate responsibility for 2011 was published in July and Leumi was again placed in the highest group (Platinum).

Accessibility

Leumi's efforts to advance the topic of accessibility are carried out in three main channels: facilitating access in new and existing buildings, making services accessible and raising awareness among the employees.

Accessibility in new and existing buildings – through the end of 2011, around 175 existing branches at various levels of accessibility in accordance with needs and abilities.

Service accessibility – During 2011, a pilot scheme was held for use of a display screen which enables visually impaired customers view a larger display. Leumi invested in the independent development of a user-interface for the Caspomat teller machines, in accordance with international accessibility standards. The Internet marketing site is mostly accessible at Level A as required. The StepHear system, an orientation and navigation system intended for visually-impaired persons, which operates by means of voice direction, has been installed in 70 branches. To date, as part of the Leumi V service and the banking video service, several conversations have taken place with assisted by a sign language interpreter.

Raising awareness among employees – In 2011, the Bank began a process of training employees to serve as accessibility coordinators in branches of the Bank. The job of the branch accessibility coordinator will be to ensure implementation of accessibility standards, to assimilate the means of providing accessibility for people with disabilities and train other employees in the branch. In addition, computer software has been developed for assimilating the subject of service accessibility.

Management of community ties

Leumi's social commitment is reflected in its constant investment in tomorrow's generation and the provision of opportunities and tools for its success. Leumi has chosen to focus on advancing education, culture and the arts, as well as activities to help close the gaps between the center of the country and the periphery. Leumi's social involvement is implemented via three main channels: "Leumi Tomorrow - The

Centennial Fund for Endowing Israel's Future Generation" (R.A), donations and financial sponsorships of social causes and employees' volunteering activities.

"Leumi Tomorrow - The Centennial Fund for Endowing Israel's Future Generation"

The association invests in the advancement of youth by supporting various educational programs, operated by 10 social bodies and associations, among a range of population sectors throughout Israel. In 2011, the association donated NIS 11 million to various educational programs throughout Israel, in which more than 20,000 youth participated.

Alongside the monetary support, the social bodies and associations are able to participate in organizational workshops and financial conduct workshops given by Leumi employees on a voluntary basis, to assist in the Bank's infrastructures and to take part in a forum of social partners, intended to develop the organizations' professional abilities.

In December 2011, the Leumi Board of Directors approved a three-year budget framework for the "Leumi Tomorrow" Association, amounting to at least NIS 11.7 million per annum, such that it would be able to sign long-term agreements with the voluntary associations and organizations that it supports, with the aim of giving them much greater stability. Within this framework, the contribution to the "Youth Leading Change" Association was expanded by NIS 0.5 million per annum. The total contribution to this association in the next three years will be NIS 14.6 million.

Other programs to which Leumi contributes

"Young Israeli Entrepreneurs" organization

Leumi is an involved partner in the "Young Israeli Entrepreneurs" organization, in which youth experience setting up a start-up company which advances a business idea of product development. Leumi's contribution to the organization focuses on assisting in the operation of the program in the social and geographic outlying areas, together with the adoption of the program by branches of the Bank throughout Israel, and recruiting volunteer mentors from among employees of the Group.

The "Turning-Point" Program in cooperation with the Buchmann-Mehta School of Music at Tel Aviv University, and the Israel Philharmonic Orchestra.

In 2011, Leumi continued its support of the program, together with the Arab Israeli Bank of the Leumi Group. The program promotes artistic musical activity within Arab society, as well as joint activities with students on the campus of the Buchmann-Mehta School of Music**.** Reciprocal relations with the students at Tel Aviv University will create opportunities for connecting the center of the country with the outlying areas, as well as bringing Jews and Arabs together.

The Leumi Center for Robotics

In order to encourage and promote excellence in science, and as part of its support of the future generation, Leumi contributed to the establishment of the Center for Robotics, and has sponsored the center's activities since 2009. The center's aim is to nurture motivation among the youth to engage in the fields of science, mathematics and technology.

Promotion of Israeli Creation

As part of its responsibility for promoting and cultivating tomorrow's generation, Leumi initiates and supports ventures which allow young artists to exhibit their creations to the wider public. In addition, Leumi sponsors various exhibitions and cultural events.

In 2011, Mani House, Leumi's Visitors and Arts Center, which is open to the public, hosted four exhibitions displaying works by a number of Israeli artists.

Summary of Leumi's Donations and Sponsorships in 2011

In 2011, the Leumi Group made donations and provided sponsorships for social and community purposes in the amount of some NIS 32.4 million, of which donations amounted to some NIS 24.5 million.

Set out below is a breakdown by category of total donations and sponsorships in 2011:

Education, children and youth	- NIS 14.4 million
Culture and art	- NIS 5.3 million
Community and society	- NIS 10.6 million
Health	- NIS 2.1 million

Decisions regarding the designation and amount of donations are made, as appropriate, by the Bank’s Donations Committee, the members of which are appointed by the President and Chief Executive Officer, and the "Leumi Tomorrow" voluntary association. Applications for donations are given careful and thorough consideration in accordance with criteria determined in the Bank’s donation guidelines and approved by the Board of Directors. Large donations (exceeding NIS 100,000) are referred to the Board of Directors for approval.

Management of the environment

The subject of the environment has been managed in Leumi in an organized manner since 2007, following the appointment of an officer in charge of the environment, who is experienced in managing direct environmental effects. The committee for the management of environmental credit risks in Leumi is responsible for the management of indirect effects, including the management of credit risks and the financing of environmental infrastructure ventures.

Leumi has formulated an internal quality standard – the "Green Branch" standard – with the aim of encouraging branches and units to manage and measure their environmental effects in order to bring about a reduction in the consumption of environmental resources. The development of the standard was completed in 2011, and a pilot scheme has been carried out, in which the central branch in Tel Aviv and the Direct Banking Division earned the title "Leumi's Green Branch".

In 2011, Leumi completed the process of certification of the ISO 14001 Standards for the management of an environmental system, and is the first bank to comply with this standard. In addition, Leumi is the only financial organization in Israel and one of only four business organizations certified by the Israel Standard Institute for the ISO 50001 Standard for energy management.

In 2011, Leumi offset 4% of its 2010 carbon footprint, through the "Kol Dodi" project, a socio-environmental project, in conjunction with the "Good Energy Initiative". As part of the project, assistance is given to a small number of underprivileged families to replace their water boilers with economy solar-powered water tanks. This activity is intended to help in the reduction of energy consumption, and, in turn, the families' monetary outgoings, as well as contributing to a reduction in greenhouse gas emissions. Leumi's support is carried out both through the transfer of a monetary donation to the "Good Energy Initiative", which is directed to assisting these families, and through favorable loan terms.

In November 2011, Leumi was awarded "the Environment Minister's Badge" in recognition of its joining the registration and reporting system for greenhouse gas emissions and carbon footprint.

Internal Auditor

The Chief Internal Auditor, Sasson Mordechay, who has served as the Chief Internal Auditor since 1 March 2011, has considerable experience in internal auditing. His appointment was approved by the Bank's Audit Committee on 13 December 2010 and by the Board of Directors on 14 December 2010.

Adv. Joseph Horwitz served as the Group's Chief Internal Auditor until 28 February 2011, the date of his retirement.

The Chief Internal Auditor meets the criteria of section 146(b) of the Companies Law, 1999 and the provisions of section 8 of the Internal Audit Law, 1992 (hereinafter "the Internal Audit Law") and the internal audit employees meet the criteria of section 8 of the Banking Rules (Internal Audit), 1992 ("the Banking Rules").

We would point out that on 25 December 2011, the Supervisor of Banks published Proper Conduct of Banking Business Director no. 307 "Internal Control Function", which set out, *inter alia*, the features of the internal audit function, its role, the extent of its activity, its work and reporting methods. It also organizes the status and duties of the internal auditor.

The Chief Internal Auditor is a full-time employee of the Bank, with the status of a member of management. This is his sole employment and he is organizationally responsible to the Chairman of the Board of Directors.

The Internal Audit Division has an annual work plan and a multi-year work plan for a period of up to three years. The multi-year plan covers most of the subjects audited, other than a relatively small number of low-risk subjects which are audited every four years. The annual work plan and the multi-year work plan are derived from a mapping of audit subjects which are based, *inter alia*, on the documents detailed in section 3(b) of the Banking Rules. The work plans are derived from a systematic methodology of estimating risks and controls, according to which the frequency of the audit for each subject is established. Thus, regarding subjects with a higher level of risk, audits will be carried out once a year. With respect to subjects that involve a lower level of risk, audits will be carried out every two or three years. The proposed annual work plan and multi-year work plan are submitted by the Internal Audit Division and are approved by the Chairman of the Board of Directors, the Audit Committee and the plenum of the Board of Directors.

The Internal Audit Division's annual work plan and the multi-year work plan allow the Chief Internal Auditor to exercise discretion in deciding to deviate from the plan.

In the context of the audit work, a sample of material transactions carried out by the Bank – including the procedures through which they were approved – are examined. For this purpose, material transactions include a material purchase or sale of activity, "transactions" as defined in section 270 of the Companies Law and an "extraordinary transaction" – as defined in the Companies Law.

The Internal Audit Division's annual work plan and the multi-year work plan each include a chapter dealing with the annual and multi-year work plans of the material consolidated subsidiaries in Israel (as set forth in Note 6.D to the Financial Statements). Employees of the Internal Audit Division serve as internal auditors of the Bank's consolidated subsidiaries in Israel. The process of structuring the consolidated companies' work plans is similar to the process of structuring the work plan of the Bank's Internal Audit Division. Generally, the financial statements of the companies included on equity basis include reference to the work plans of their internal auditors.

At the material foreign subsidiaries, local internal auditors are appointed. The Internal Audit Division supervises the work of the local auditor, as provided in section 1(a)(3) of the Banking Regulations. This is carried out, *inter alia*, through an examination of the local internal audit work plan of the overseas subsidiary before it is submitted for approval by the audit committee and the board of directors abroad.

The Bank's internal work plan includes targeted audits by the Internal Audit Division in Israel of the overseas subsidiaries, and the division of labor between the Israeli and overseas internal auditors is carried out through coordination of the audit subjects between the Israeli and overseas auditors. The internal auditors of the material overseas subsidiaries report to their local audit committee.

The Chief Internal Auditor and his team of employees in the Leumi Group in Israel comprise, on average, 117 positions for 2011, as described below:

	Average positions of auditors in the Leumi Group in Israel, including outsourcing
The Bank	97.6
Subsidiaries in Israel	14.8
Overseas subsidiaries	4.6
Total	117

In addition, local auditors are employed in overseas subsidiaries in 22 positions.

The number of positions is approved by the Audit Committee in Israel, based on the annual and the multi-year work plan.

The Chief Internal Auditor may, within the framework of the budget, use outsourcing for the execution of work that requires special knowledge or in the event of insufficient staff.

The table below shows details of the benefits and amounts which were paid or for which allowances were made for 2011 to the Chief Internal Auditor: (NIS thousands)

2011										
Holding in the capital of the Bank	Compensation for services				Other remuner-ation		Loans given on beneficial terms			
	Salary	Bonuses**	Social benefit provisions	Share-based payments	Value of the benefit	Total *	Balance as at 31 December 2010	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
	NIS thousands									
0.003	**931**	**-**	**2,227**	**7**	**102**	**3,267**	**47**	**3.42**	**1**	**-**

* Excluding salary tax.
** Estimate – see Note 15H of the financial statements.

The total payments to the Chief Internal Auditor and the components thereof are submitted to and approved by the Audit Committee.

The Board of Directors believes that the holding of securities by the Chief Internal Auditor and the compensation paid to him do not affect the exercise of his professional discretion.

The Chief Internal Auditor prepares the annual and the multi-year work plan in accordance with the professional standards of the Institute of Internal Auditors in Israel and the international Institute of Internal Auditors (IIA).

In addition, the Chief Internal Auditor operates in accordance with the directives and instructions of the Supervisor of Banks.

The Audit Committee and the Board of Directors have noted that in the Chief Internal Auditor's written declaration he complies with the requirements laid down in the abovementioned generally accepted professional standards, and he operates in accordance with the directives and instructions of the Supervisor of Banks. On the basis of this declaration, and on the basis of his role as expressed at the meeting of the audit committee of the Board of Directors, the Audit Committee and the Board of Directors are satisfied that the Chief Internal Auditor meets all the said requirements.

Generally, upon the issue of written audit reports by the Internal Audit Division, and as part of the ongoing work process, discussions are held with the audited entities (branch managers, district managers or managers of other organizational units) on the audit reports, and discussions are also held on material findings with the heads of the divisions and the President and Chief Executive Officer.

Before the meetings of the Audit Committee, the Chairman of the Audit Committee, in consultation with the Chief Internal Auditor, determines which audit reports will be presented in their entirety for discussion at the Audit Committee. Furthermore, lists of all the audit reports issued by the Internal Audit Division in the relevant period, together with a summary of the material findings, are submitted on an ongoing basis for the perusal of all the members of the Audit Committee. They may peruse any audit report they wish and make a request to the Chairman for it to be presented in its entirety for discussion by the Audit Committee.

Material audit reports are discussed at the Audit Committee each month, and on occasion twice a month.

At the end of the first and second halves of the year, the Internal Auditor submits reports summarizing the audit operations to the Chairman of the Board of Directors, the President and Chief Executive Officer and the Chairman of the Audit Committee. They include a summary of the material findings, the auditor's recommendations and the audited entity's replies for the relevant periods.

In addition, the Chief Internal Auditor submits an annual report that summarizes the audit operations during the course of the entire year to the Chairman of the Board of Directors, the President and Chief Executive Officer and the Chairman of the Audit Committee, which also includes monitoring the performance of the annual work plan.

The summary annual report for 2010 was submitted to the Audit Committee on 7 April 2011 and discussed in the Committee on 12 April 2011. Annual reports of the Israeli and overseas subsidiaries were submitted to the Audit Committee on 23 May 2011 and discussed in the Committee on 26 May 2011.

The Chief Internal Auditor's report for the first half of 2011 was submitted to the Audit Committee on 1 September 2011 and was discussed by the Committee on 27 October 2011.

The Chief Internal Auditor's report for the second half of 2011 was submitted to the Audit Committee on 19 March 2012 and was discussed by the Committee on 22 March 2012.

The Chief Internal Auditor has been provided with documents and information as specified in section 9 of the Internal Audit Law, and was given access to information, as specified in that section. He has continuous and direct access to the Bank's information systems, including access to financial data.

The internal auditors in Israel carrying out audits of the subsidiaries in Israel and abroad have been provided with documents and information as specified in section 9 of the Internal Audit Law, and were given access to information, as specified in that section. They have continuous and direct access to the information systems of the subsidiaries in Israel and abroad, including financial data.

The Board of Directors and the Audit Committee believe that the scope, nature and continuity of operations and the work plan of the Internal Auditor are reasonable under the circumstances, and that they enable the Internal Audit in the Group to achieve its goals.

Disclosure Controls and Procedures for the Financial Statements

The Supervisor of Banks has published a circular detailing provisions for the application of the requirements of Section 404 of the SOX Act. In Section 404, the SEC and the Public Company Accounting Oversight Board determined provisions as to management's responsibility for the internal control over financial reporting and as to the external auditors' opinion with regard to the audit of the internal control over financial reporting.

The Supervisor's directives in the said circular prescribe that:

- Banking corporations shall apply the requirements of Section 404 and also the SEC's directives that were published pursuant thereto.

- Proper internal control requires the existence of a control system in accordance with a defined and recognized framework, and the COSO (Committee of Sponsoring Organizations of the Treadway Commission) model meets with the requirements and can be used to assess the internal control.

The COSO model provides defined standards for the purpose of assessing the internal control system in the organization and the ways in which it can be improved, and defines internal control as a process which is influenced by the board of directors, the management and other persons within the company.
According to the COSO model, there are five components that need to be referred to:

1. The Control Environment: this component involves the examination of the management's conduct with reference to various subjects such as the existence of a code of ethics, management's aggressiveness in reports, etc.

2. Risk Assessment: this component involves the examination of the relevant risks regarding each of the processes and sub-processes that is checked, and which have an impact on the financial statements.

3. Control Activities: this component involves examining of the relevant controls regarding each of the risks that were identified at the risk assessment stage.

4. Information & Communication: this component involves checking that the information required for the Bank's activity is available, and that there is a mechanism that processes the information it received and transfers it to the appropriate parties at the Bank.

5. Monitoring: this component involves the examination of the existence of a mechanism that checks the monitoring of the correction of deficiencies. Proper supervision may be reflected in a periodic examination of the internal control system, continuous implementation of opportunities for improvements, the management's response to the internal control recommendations made by external auditors as well as the internal parties, rapid adaptation to new regulatory directives, etc.

Since 2009, the Bank has been taking steps to implement the directives in the Leumi Group on a routine basis, together with consultants engaged for the purpose of carrying out the project.

Management of the Bank, together with the President and Chief Executive Officer and the Chief Accounting Officer, have evaluated, as at the end of the period covered by this Report, the effectiveness of the disclosure controls and procedures of the Bank. On the basis of this evaluation, the President and Chief Executive Officer of the Bank and the Chief Accounting Officer have concluded that, as at the end of the said period, the disclosure controls and procedures of the Bank are effective for the recording, processing, summarizing and reporting of the information that the Bank is required to disclose in its annual financial statements, in accordance with the Directives of the Supervisor of Banks on reporting to the public and at the time required in these Directives.

During the quarter ended 31 December 2011, no material change to internal controls on financial reporting of the Bank occurred which had a material effect, or which could reasonably be expected to have a material effect on the Bank's internal controls of the financial reporting.

No material weaknesses were found.

Remuneration of Senior Office Holders

For the year ended 31 December 2011

Below are details of the benefits and amounts paid or in respect of which provisions were recorded in the years 2011 and 2010 to the Chairman of the Board of Directors and to the recipients of the five highest salaries among the senior office holders of the Group. The benefits described below do not include benefits in respect of banking services that are granted to all employees, such as benefits regarding interest on deposits of monies with the Bank, discounts or exemptions from commissions for banking services provided by the Bank, and interest rate benefits on mortgages granted by Leumi Mortgage Bank. The amounts of the benefits in respect of the banking services mentioned, regarding each recipient, are not material. Certain private banking customers, including customers who are included in arrangements between the Bank and employee groups, are occasionally given benefits that are similar to those granted to Bank employees and in some cases, even exceed them.

2011												
Details of party receiving compensation [1]			Compensation for services			Other compensation[2]			Loans given on beneficial terms [13]			
Name	Position	Holding in the capital of the Bank	Salary	Bonuses [8]	Social benefit provisions [3]	Share-based payment	Value of the benefit [4]	Total *	Balance as at 31 December 2011	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
		%	NIS thousands									
Mr. David Brodet [5]	Chairman of the Board of Directors	**0.001**	**2,007**	**-**	**929**	**20**	**160**	**3,116**	**-**	**-**	**-**	**-**
Ms. Galia Maor [6][13]	President and Chief Executive Officer	**0.021**	**2,922**	**(26)**	**2,975**	**27**	**138**	**6,036**	**175**	**3.42**	**5**	**-**
Mr. Itzhak Eyal [10]	Chief Executive Officer, Bank Leumi USA	**0.002**	**1,528**	**1,204**	**143**	**10**	**753**	**3,638**	**151**	**2.48**	**4**	**-**
Mr. Amnon Zaidenberg [9]	Chief Executive Officer, Bank Leumi (Switzerland)	**-**	**1,795**	**914**	**207**	**-**	**374**	**3,290**	**-**	**-**	**-**	**-**
Mr. Ofer Grinbaum [11]	Chief Executive Officer, Leumi Partners Underwriting	**-**	**556**	**2,092**	**175**	**-**	**28**	**2,851**	**-**	**-**	**-**	**-**
Mr. Gideon Altman	First Executive Vice President, Head of Commercial Banking Division	**0.001**	**1,185**	**(6)**	**1,410**	**11**	**120**	**2,720**	**39**	**1.80**	**1**	**327**
Mr. Menachem Schwartz	First Executive Vice President, Chief Accounting Officer, Head of Accounting Division	**0.006**	**1,165**	**(6)**	**1,445**	**11**	**101**	**2,716**	**128**	**4.73**	**4**	**-**
Mr. Zvi Itskovitch [13][8][7]	First Executive Vice President, Head of International and Private Banking Division	**0.000**	**1,391**	**(6)**	**1,125**	**13**	**127**	**2,650**	**276**	**5.29**	**8**	**128**

* Excluding salary tax.

1. Those receiving the compensation hold full-time positions.

2. Pursuant to agreements on the matter of the privatization of the Bank and pursuant to agreements with Accountant-General in the Finance Ministry and the Bank's employees, in the context of an outline prospectus dated 6 April 2011, the shares of the Bank were offered by the State of Israel to the Bank's employees (and other workers in the Group). The purchase of the shares by the participants was completed on 17 May 2011 (with regard to the Chairman of the Board of Directors, the purchase was completed on 29 May 2011), pursuant to and subject to the arrangements and conditions set forth in the outline prospectus. The shares are blocked for a period of four years and are deposited with a trustee. In addition, the Bank has extended loans to the participants (who have requested the same) for purchasing the shares offered in the outline prospectus. For details, see page 19.

3. Social benefit provisions include provisions for severance pay, provident funds, pension, supplementary training fund, vacations, jubilee benefits, and national insurance, as well as supplemental payments to the reserves for the above, due to salary changes during the accounting year.

4. The value of the benefit includes, *inter alia*, car and telephone expenses.

5. On 14 September 2010, the Audit Committee of the Board of Directors, the Board of Directors on 15 September 2010, and the General Meeting of the Bank on 4 November 2010, approved the terms of engagement between the Bank and the Chairman of the Board of Directors, Mr. David Brodet. The Chairman is employed on a full-time basis as an Executive Chairman. For details of the terms of employment of the Chairman, see Note 15(B)(4)(b) to the Financial Statements. The monthly salary of the Chairman of the Board of Directors (subject to the approval of the General Meeting) was increased by 3.7%, effective 1 January 2012. For further details, see para. 12 below.

6. On 1 January 2012, the President and Chief Executive Officer announced her intention to retire from her position. At the request of the Board of Directors, the President and Chief Executive Officer will continue working until the end of April 2012, and the advance notice period will begin in May 2012 and last for nine months without actually working. For further details regarding the terms of the employment contract of the President and Chief Executive Officer, see Note 15(B)(3)(a). In accordance with the decision of the Board of Directors, the gross monthly salary of the President and Chief Executive Officer was raised to NIS 210 thousand, as of 1 January 2011 (with the gross monthly salary of the President and Chief Executive Officer prior to this update being NIS 190,269) and by a further 3.7%, effective 1 January 2012.For further details, see para. 12 below.

7. Senior employees of the Bank have special personal employment contracts with the Bank. For further details regarding the retirement conditions of senior officers, and entitlement to notice on terminating employment, see Note 15(B)(3)(b) to the Financial Statements. For explanations regarding the annual bonus to senior employees pursuant to the Bank's bonus plan, see Note 8 below.
The amount of the maximum additional expense to the Bank, if the employment of all of the above employees were immediately terminated, would amount to NIS 379 million (NIS 350 million in 2010). These amounts are before tax and include salary tax on the pension obligation. Since it is unlikely that all the said employees will be dismissed immediately, a global provision of 25% of the above sum has been made, in the amount of NIS 90 million (NIS 89 million in 2010). These sums also relate to members of Management (with a full provision existing in regard to the CEO).

   Following the amendment of the personal contracts of the members of Management, as set forth in Note 15(B)(3)(b) to the Financial Statements, a specific attribution out of the said provision was made for members of Management, the balance of which amounted to NIS 14 million as of 31 December 2011; in 2010 – NIS 8 million.

8. The Board of Directors and the Audit Committee have approved a long-term bonus program for senior managers in the Bank: the Chairman of the Board of Directors (subject to the approval of the General Meeting), the Chief Executive Officer and the other members of the Management of the Bank, for 2009 onwards ("the Bonus Plan"). For details see Note 15g to the Financial Statements.

The Chairman of the Board of Directors, the President and CEO, and the members of the Bank management were not awarded bonuses for 2011.

The data in this section refer to adjustments of the bonuses for 2010.

9. Mr. Amnon Zaidenberg served as CEO of Bank Leumi (Switzerland) Ltd. ("**Leumi Switzerland**"), a wholly-owned subsidiary of the Bank, with effect from January 2008. According to the contract of employment between the parties, each party is entitled to terminate this agreement at any time with six months notice. On the termination of employment of Mr. Zaidenberg, due to resignation or dismissal, he will be entitled to all of the monies accrued in the pension fund being maintained for him.

The decision to grant a bonus to Mr. Zaidenberg, as stated in the table above, was approved in the Board of Directors of Leumi Switzerland on 6 February 2012, after receiving the recommendation of the company's salary and remuneration committee. Leumi Switzerland's decision to grant Mr. Zaidenberg a bonus was made further to and in accordance with the remuneration policy of the Leumi Group to Chief Executive Officers in Overseas Subsidiaries and this was accepted, *inter alia*, in light of his central role in leading and managing the merger and acquisition of Banque Safdié with Leumi Switzerland. The merger was completed on 3 January 2012 with the merged entity being called Leumi Private Bank AG.

On 6 February 2012, the board of directors of Leumi Switzerland further resolved to raise the salary of Mr. Zaidenberg by 5%, with effect from 1 March 2012.

10. Mr. Itzhak Eyal serves as Chief Executive Officer of Bank Leumi (USA) ("**Leumi USA**"), a fully owned and controlled subsidiary of the Bank, through Leumi Partners, since 1 October 2010. Mr. Eyal's salary, as set forth in the table above, was determined in accordance with generally accepted practice for the salary of chief executive officers in banks of similar size and activity in the United States. Mr. Eyal's salary also includes additional expenses of the Chief Executive Officer's rent in the United States. The decision to grant Mr. Eyal a bonus as stated in the table above was approved by the Board of Directors of Leumi USA on 8 March 2012. Leumi's decision to grant Mr. Eyal a bonus was made further to and in accordance with the remuneration policy of the Leumi Group to Chief Executive Officers in Overseas Subsidiaries and this was accepted, *inter alia*, against the background of the substantial improvement in the operating results achieved by Leumi USA in 2011 and in light of the improvement in the credit portfolio of Leumi USA.

For details regarding the terms of retirement of the senior officers in the Bank, including Mr. Eyal and his entitlement to advance notice on terminating his employment, see Note 15(B)(3)(a) to the financial statements.

11. Mr. Ofer Grinbaum has served as CEO of Bank Leumi Partners Underwriters Ltd. ("**Leumi Underwriters**"), a fully owned and controlled subsidiary of the Bank, through Leumi Partners, since 15 September 2008. According to the employment agreement between the parties, either party may terminate the agreement at any time, given prior notice of 3 months, where in the event of the termination of Mr. Grinbaum's employment resulting from the purchase of the company by a third party, prior notice of 12 months will be given. At the cessation of Mr. Grinbaum's employment, due to resignation or termination, he will be entitled to all monies that have accumulated in the managers insurance policy being administered on his behalf, including the amounts that have been accumulated in respect of severance compensation. In the event that employment relations between the parties are terminated under circumstances that entitle Mr. Grinbaum to severance compensation according to the law, he will be entitled to the amount of the difference between the severance compensation to which he is entitled by law and the amounts that have accumulated in his severance compensation account in the managers insurance policy, to the extent that a difference exists. In accordance with the terms of the employment agreement, Mr. Grinbaum is entitled to an annual bonus in the amount of 13.5% of the eligible profits (as defined in the agreement) provided that the amount of the annual bonus does not exceed NIS 4 million. In the event of the termination of his service in the middle of the year, for whatever reason, Mr. Grinbaum will be entitled to a bonus of the relative proportion of the year that he has worked.

The bonus to Mr. Grinbaum was approved by the Audit Committee and by the Board of Directors of Leumi Underwriters on 20 March 2011, after the Audit Committee and the Board had evaluated the employment agreement with Mr. Grinbaum, and the wording therein, and determined that the bonus to Mr. Grinbaum would be fair and reasonable in view of his experience and skills in managing the company, his considerable contribution to the company's profitability and in light of his importance in the company's activity, which has resulted in the company becoming the leader in its field.

12. Om 28 March 2012, after receiving the approval of the Audit Committee and after accepting the recommendation of the Executive Committee of the Board of Directors, the Board of Directors approved raising the monthly salary of the Chairman of the Board of Directors (subject to the approval of the General Meeting) and the President and CEO, by 3.7%, with effect from 1 January 2012. In addition, after the approval of the Audit Committee and accepting the recommendation of the Executive Committee, the Board of Directors approved various increases in the salary of members of Bank management. Background information relating to the salary of the President and CEO and other members of the Bank’s management from 2005 until that date, were presented to the Board, showing the amount of change in salaries in the Bank, by group of employees, from 2005 until that date, costs to the Bank in respect of salary adjustments, and data relating to the costs of the five highest paid employees of other banks.

13. Loans granted under usual conditions to all employees of the Bank, and their amounts were determined according to uniform criteria.

14. Directors and other officers have been insured by the Bank under directors' and other officers' liability insurance policies covering the Bank and its investee companies. The relative insurance premium paid is not included in the above tables, as it is insignificant. The total premium amounted to NIS 3,001 thousand and relates to all officers in the insured group.

15. The Board of Directors believes, having held discussions, received explanations and appropriate and relevant background material, and having examined the remuneration, taking into account the activities of the Bank and the Group and their results in 2011, and after noting the performance and activity of each senior officer mentioned above, that the payments to senior officers, as set out in the table and the explanations above, represent fair and reasonable compensation under the circumstances.

For further details see Note 15 to the Financial Statements.

2010											
Details of party receiving compensation			Compensation for services			Other compensation		Loans given on beneficial terms			
Name	Position	Holding in the capital of the Bank	Salary	Bonuses	Social benefit provisions	Value of the benefit	Total	Balance as at 31 December 2010	Average period until maturity (years)	Benefit provided over the year	Loans granted on regular terms
		%	NIS thousands								
Mr. David Brodet	Chairman of the Board of Directors	0.00	787	650	2,468	54	3,959	-	-	-	-
Ms. Galia Maor	President and Chief Executive Officer	0.020	2,351	4,416	1,645	112	8,524	-	-	15	4
Mr. Zeev Nahari	Senior Deputy Chief Executive Officer	0.014	1,617	2,388	751	122	4,878	-	-	10	1,312
Mr. Avi Zaldman	Chief Executive Officer, Leumi Partners	0.005	1,285	1,000	3,180	96	5,561	140	1.29	14	667
Mr. Uzi Rozen	Chief Executive Officer, Bank Leumi USA	0.009	2,312	710	1,707	11	4,740	-	-	-	65
Mr. Ofer Grinbaum	Chief Executive Officer, Leumi Partners Underwriting	-	533	3,980	153	-	4,666	-	-	-	-
Ms. Rakefet Russak-Aminoach	First Executive Senior Deputy, Chief Executive Officer, Head of Corporate Division	0.003	1,295	1,452	525	91	3,363	237	4.21	17	-
Mr. Itzhak Malach	First Executive Vice President, Head of Operation and Adminstration	0.008	1,332	990	801	95	3,218	203	2.91	16	719
Mr. Zvi Itskovitch	First Executive Vice President, Head of International and Private Banking	-	1,297	1,012	760	101	3,170	224	3.50	17	153
Mr. Eitan Raff	Former Chairman of the Board Of Bank Leumi	0.008	1,241	1,961	60	107	3,369	-	-	11	-

* Does not include salary tax.

Auditors' Fees (1)(2)(3)

	Consolidated		Bank	
	2011	2010	**2011**	2010
	NIS thousands			
For auditing activity: (4)				
Joint auditors	**29,315**	27,765	**12,646**	11,785
Other auditors	**3,080**	2,574	**294**	209
Total	**32,395**	30,339	**12,940**	11,994
For audit related services: (6)				
Joint auditors	**450**	223	**23**	115
Other auditors	**727**	841	**-**	92
For tax services: (5)				
Joint auditors	**1,977**	1,815	**510**	491
Other auditors	**600**	355	**-**	-
For other services:				
Joint auditors	**4,011**	1,679	**2,394**	1,046
Other auditors	**6,528**	567	**5,771**	-
Total	**14,293**	5,480	**8,698**	1,7774
Total auditors' fees	**46,688**	35,819	**21,638**	13,738
Joint auditors' fees from other engagements (7)	**-**	-	**-**	-

(1) Report of the Board of Directors to the Annual General Meeting on the auditors' fees in respect of audit and additional services, under sections 165 and 167 of the Companies Law, 1999.

(2) Auditors' fees include payments to partnerships and corporations under their control and also payments required by the VAT Law.

(3) Including fees paid and accumulated fees.

(4) Audit of annual financial statements and review of interim reports.

(5) Provided services related to continuous tax auditing.

(6) Audit related fees, mainly include: prospectuses, special certificates, comfort letters, tax consultancy, forms and reports to authorities to which the signature of the auditors is required and audit of businesses purchased during the year.

(7) As reported by the auditors, pursuant to section 4 of the directives relating to a conflict of interests and impairment of independence in consequence of the auditors' other engagements, and included above.

Board of Directors

Below are the names of the Directors, their principal occupations and their positions in the Bank Leumi Group and in other bodies:

Name of Director	
David Brodet **Jerusalem**	Chairman of the Board of Directors – Bank Leumi Le-Israel B.M. Owner of David Brodet Ltd. (in suspension) Chairman of the Executive Committee of the Jerusalem Foundation and the Hadassah Academic College Jerusalem. Member of the Managing Committee in the Jerusalem Institute for Israel Studies and in the Cameri Theater. Chairman of the Board of Trustees of the Fund for Treatment of Sheltered Persons. Chairman of the Public Council for Statistics. Lecturer at the National Security College (Haifa University) and President of the Union of Banks in Israel (R.A.)
David Avner **Nofit**	Chief Executive Officer and Owner of N.S.Y. Avner Ltd.
Reuven Adler, CPA (Isr.)*+ **Petach Tikva**	Business Consultant and Company Director. External Director on the Board of Directors of the Bank. Economic and Financial Consultant.
Zipora Gal Yam* **Maalot**	Economic Consultant, Company Director. External Director, Direct Insurance – Financial Investments Ltd. Member of the Board of Trustees of the Tel Hai Academic College.
Prof. Arieh Gans* **Ramat Gan**	Professor of Accounting, Tel Aviv University and Company Director. Director, Member of Finance and Audit Committee, Middle East Tubes Company Ltd. Member of Professional Committee in the Israeli Accounting Standards Board.
Moshe Dovrat **Tel Aviv**	Company Director. CEO, Director and Owner of Beit Meniv Funding Ltd. and Dovrat (M.H.) Investments and Business Initiatives Ltd. Director and Shareholder in Beit Meniv Israel Ltd. and Theracoat Ltd. Chairman of the Board of Directors of Kibbutz Kfar Blum Tourism. Member of Management of Kfar Blum Holdings – Agricultural Cooperative Society Ltd. Member of Executive Committee of the Ra'anana Symphonette Orchestra. Member of Management of the Center for Jewish-Arab Economic Development. Member of the Economic Assembly and one of the founders of the Macro Center for Political Economics and Sustainable Eco-Tourism in Israel, Member of the General Assembly of the Ramat Gan College and the College for Developing Teaching Programs in Israel Ltd. Member of the Public Council of the Batsheva Dance Company. Member of the Finance Committee for the Council for a Beautiful Israel.
Yehudah Drori **Tel-Aviv**	Company Director and Consultant on capital market issues. Deputy Chairman of the Committee for Members' Investments in Harel Insurance Co. Ltd. Capital Market Consultant to various entities.
Doron Cohen **Reut**	CEO, Co-Op Blue Square Services Cooperative Ltd .(in liquidation) Owner and Director, Trigger D.C. Ltd. and Trigger D.C. Holdings Ltd. and in Gamma Capital Ltd. Director, Harel Insurance Investments & Financial Services Ltd. and in the Consumer Cooperation Fund Ltd. Observer in the Nostro Investments Committee in Harel Insurance Co. Ltd. Member of the Council of Leumit Health Fund, Member of Public Committee for Reviewing the Terms of Employment of Senior Employees in the Histadrut Labor Federation. Economic and Financial Consultant.
Adv. Miriyam (Miri) Katz **Tel Aviv**	Attorney, Consulting, Management and Company Director. Shareholder and CEO, Miri Katz Projects Ltd. External Director, Itamar Medical Ltd. CEO, Ima fund, (registered association). Member of the Board of Trustees of the Hebrew University in Jerusalem, and the Technion Israel Technological Institute.
Yoav Nardi **Ramat Gan**	Company Manager and Business Consultant. Director and Owner of Nardi Consultants and Risk Management Ltd. Chairman of Investments Committee of the National Library Ltd. and Yad Sarah (R.A.)

Name of Director	
Zipporah Samet*+ **Jerusalem**	Owner, Chairman of the Board of Directors and CEO in Merav Yaniv Financial Consulting Ltd. Chairman and shareholder in Bio-Plasmar Ltd. External Director in Shahar Hadash Group Ltd. in Africa Israel Investments Ltd. Chairman of the Board of Directors in Capital Israel Company for Locating Funds Ltd.
Amos Sapir* **Tel Aviv**	Member of board of directors of companies and non-profit associations. Director and owner in Sixace Management Co. Ltd (1997) Ltd., and Sixace Holdings Ltd. Chairman of the Board of Directors of N. Feldman & Son Ltd., Israel Amlat Investments (1993) Ltd., External Director in Hot Communication Systems Ltd, and A. Drori Group Ltd, Director in Leumi Group Plastic Products (1993) Ltd. and Mifal HaPayis Pinhas Sapir Fund, Chairman of the Board of Trustees in the Pinhas Sapir Development Center, Member of Board of Trustees in Tel Aviv University and Bezalel Art and Design Academy, Jerusalem, Member of the Executive Committee in the Academic College of Tel-Aviv-Yafo, and in the Shoshana and Pinhas Sapir Fund, Chairman of the Executive Committee in Leap in Immigration, Leadership and Excellence in Employment for Ethiopian Academics, Member on Public Council – Midot – Reflection and Rating of Non-Profit Associations Ltd. (Halatz), Member of Council in Educational Technology Center.
Prof. Efraim Sadka* **Tel Aviv**	Professor of Economics and Holder of the Henry Kaufman Chair of International Capital Markets, Tel Aviv University. Economic Consultant, Company Director, and Executive Member of voluntary associations. Chairman of the Babylonian Jewry Heritage Center. Owner and Director of A.Z. Eretz Ratz Ltd. External Director of Paz Oil Co. Ltd. Chairman of Remuneration of Heads of Higher Education Institutions Committee. Chairman of the Executive Board, The Pinhas Sapir Center for Development, Tel Aviv University. Chairman of the Advisory Committee of Poalim Real Estate Fund, Member of the Executive Board of the Sapir Forum, Member of the Association and Chairman of the Audit Committee of the Israel Democracy Institute, Member of the Committee for Examining Ways of Maintaining Long-Term Financial Solidity of the National Insurance Institute, Member of the Steering Committee for Establishing a Medical School in Zefat and the Practical Research Institute in the Eastern Galil, Member of the Professional Committee of the Israel Accounting Standards Board. Editor, The Economic Quarterly. periodical of the Israel Economic Association, Sub-editor in international professional periodicals, Chairman of the Committee to Review Parameters for the actuarial reporting of the National Insurance Institute, Director in B. Gaon Holdings Ltd.
Prof. Gavriella Shalev*+ **Even Yehuda**	President of the Senior Academic Council and Senior Lecturer in the Ono Academic College. Shareholder in Din Publishing, Management and Services Ltd.

* External Director pursuant to Proper Conduct of Banking Business Directive No. 301 of the Banking Supervision Department.
+ External Director pursuant to the provisions of the Companies Law.

Pursuant to Proper Conduct of Banking Business Directive No. 301 of the Supervisor of Banks, at least one-third of the members of the Board of Directors shall be external directors who meet the eligibility requirements of an external director as defined in the Companies Law, 1999.

Accordingly, seven directors serve on the Board of Directors of the Bank, who are classified as external directors, whose eligibility is in accordance with the requirement with respect to an external director, pursuant to the Companies Law.

In addition, in light of the definition of an "independent director" in the Companies Law, which was added as part of Amendment 16 to the law and came into effect on 15 March 2011, the Audit Committee of the Board of Directors confirmed that the external directors according to the definition of Directive 301 are independent directors.

See the Bank's website (www.leumi.co.il) for further details about the committees of the Board of Directors and their composition.

Report on Directors with Accounting and Financial Expertise

Pursuant to the provisions of the Companies Law and its Regulations, the Board of Directors of the Bank has resolved that at least 3 directors with "accounting and financial expertise", will serve on the Board of Directors of the Bank at all times. This minimum number will allow the Board of Directors to comply with the requirements imposed upon it by law and the documents of incorporation, and in particular with regard to its responsibility for examination of the financial position of the Bank and the preparation of the Financial Statements.

In determining the said minimum number, the Board of Directors considered the size of the Bank, the complexity of its activities and the range of risks involved therein, and the systems and procedures in place at the Bank, such as control, risk management, compliance, internal audit, and the audit of the external auditors. It was also taken into account that all of the members of the Board of Directors comply with the qualification requirements to serve as a director of the Bank pursuant to the Bank Shares Law and Directive 301.

At least 3 directors who comply with the definition of a "director with accounting and financial expertise" will therefore participate in the discussions regarding the Financial Statements and their approval, such discussions being held in the Financial Statements Review Committee and in the plenum of the Board of Directors.

There are currently 14 directors serving on the Board of Directors, the legal quorum for its discussions being eight directors.

In addition, pursuant to the directives of the Bank of Israel, the Board of Directors has determined that at least two "directors with accounting and financial expertise" will serve on the Audit Committee of the Board of Directors at all times.

The legal quorum for discussion and the approval of resolutions in the Audit Committee and the Financial Statements Review Committee will be a majority of the members of the committee, providing the majority of those present are external directors pursuant to Directive 301. Seven directors currently serve on the Audit Committee, the legal quorum for its discussions being four directors. Seven directors currently serve on the Financial Statements Review Committee, the legal quorum for its discussions being four directors.

All of the directors serving on the Board of Directors comply with the definition of a director with accounting and financial expertise. All of the directors serving on the Audit Committee and the Financial Statements Review Committee comply with the aforementioned definition.

Name of Director	**Additional facts that qualify the Director as having accounting and financial expertise**
David Brodet	Chairman of the Board of Directors of the Bank since August 2010. B.A. in Economics and Political Science and M.A. in Economics, The Hebrew University of Jerusalem. VP Finance of Israel Aircraft Industries 1987-1991 Budgets Director in the Ministry of Finance 1991-1994 Director-General, Ministry of Finance 1995-1997 Served as Chairman of the Board of Directors of Mizrahi Bank and Tefahot Bank, and as Chairman of Karnit Government Insurance Corporation. Served as Director of Public Companies and as a Member of Finance and Financial Statements Committees of various Boards of Directors.
David Avner (1)	B.A. in Mathematics and Philosophy, Haifa University, and qualification in Business Administration, Haifa Technion, CEO and Deputy CFO in Partner Communication Ltd., a public company traded on the Tel Aviv Stock Exchange, 2005-2010. As part of his function as CEO of the company, he was heavily involved in the process of preparing financial statements.

Name of Director	Additional facts that qualify the Director as having accounting and financial expertise
Reuven Adler, CPA (Isr.) (1)(2)	External Director on the Board of Directors of the Bank B.A. in Economics and Accounting, Tel Aviv University. 32 years' experience until October 2004 in banking, Recent positions: Senior Deputy President and Chief Executive Officer, Deputy President and Chief Executive Officer, Manager of Finance Division and Risk Manager in Bank Mizrahi Tefahot Ltd., responsible *inter alia* for the capital markets trading sector, the financial management sector, Accounting and Financial Statements Department, and the Planning and Economics Department. In the framework of responsibility for the above sectors and departments, was responsible for monetary management, ALM, liquidity and exposures, the dealing rooms of the bank, preparation of financial statements of the Bank, prospectuses, budget, etc. In addition, served throughout the years as Comptroller of the Bank. Previously chairman of the board of directors, external director, and director of various companies.
Zipora Gal Yam	B.A. in Economics and Philosophy, The Hebrew University of Jerusalem. Held various economic positions with the Ministry of Finance, 1992-2001, including Head of the Economic and State Revenue Department and a member of management. Director and Chairman of the Finance Committee of Zim, 1993-1999. Senior economist in the Research Department of the Bank of Israel, 1974-1991. Director of various companies.
Prof. Arieh Gans (1)(2)	C.P.A. (Isr.), B.A. in Accounting, The Hebrew University of Jerusalem (Tel Aviv Branch), Professor of Accounting, Tel Aviv University. Held various accounting positions with Koor Industries Ltd., 1978-1998, including Vice President Accounting and Control and Head of the Accounting Division. Kesselman & Kesselman, Certified Public Accountants (Isr.), 1961-1977. Member of various committees of the Israeli Institute of Certified Public Accountants, the Israeli Accounting Standards Board and Senior Examiner of the Auditors' Council. Director of various companies.
Moshe Dovrat	B.A. in Economics and Political Science and M.B.A., The Hebrew University of Jerusalem. Held various economic positions with the Bank of Israel and Ministry of Finance, 1968-1975; Vice President of an industrial company, 1975-1980; Head of Foreign Currency Investments and Deposits Department of Bank Hapoalim, 1980-1985; held various economic positions with the Ministry of Economics and Planning, including Director-General of the Ministry, 1985-1989; Head of Economic Department of Clalit Health Services, 1989-1992; Head of the Investment Center of the Ministry of Industry, Trade and Labor, 1992-1996. Chairman of the Board of Directors, director and member of investment committees, and CEO of various companies.
Yehuda Drori	B.A. in Economics and History and M.B.A. (Finance), The Hebrew University of Jerusalem. Held various positions in the Ministry of Finance, 1968-1987, including Commissioner of the Capital Market, Savings and Insurance. Chairman of the Executive Board of Directors of Poalim Capital Markets 1988-1994. Served as Director of U-Bank of the First International Bank Group. In this position served as Chairman of the Financial Statements and Audit Committees, and as a Member of the Credit and Risk Management Committees. Served as Director in several companies, some of which as Member or Chairman of the Audit and Financial Statements Committees. Member and Chairman of investments committees in institutional entities. Consultant to various entities on capital market issues.
Doron Cohen (1)	B.A. in Economics and Business Administration and M.B.A. (Finance), Hebrew University of Jerusalem. Held various positions with the Budget Department of the Ministry of Finance, 1988-1993. Held various positions with the Government Corporations Authority, 1995-2000, including Director-General of the Authority. CEO of Co-Op Blue Square Services Cooperative Ltd. since 2000. Director, Harel Insurance Investments & Financial Services Ltd since 2006 and member of the balance sheet committees. Observer in the Nostro Investments Committee of Harel Insurance Co. Ltd in 2010. Director of Mercantile Discount Bank Ltd., 2000-2006. Director of various companies. Economic and Financial Consultant

Name of Director	Additional facts that qualify the Director as having accounting and financial expertise
Adv. Miriyam (Miri) Katz (2)	LL.B, The Hebrew University of Jerusalem Chairperson of the Israel Securities Authority, 1997-2002 Member of the Auditors' Council, 1997-2002 External Director and Chairperson of the Audit Committee, Bank of Jerusalem, 2003-2006 Managing Partner, Ophir Katz & Co., Law Offices 1989-1997; Advisor since 2003 External Director and director of various companies
Yoav Nardi (1) (2)	B.A. in Economics and M.B.A. (Finance), The Hebrew University in Jerusalem. Has wealth of diverse banking experience in the fields of credit, financial markets and asset and liability management. Served in a wide range of positions in the Banking Supervision Department of the Bank of Israel, and as a Chief Economist at the First International Bank. Served as Member of Management and Deputy President and Chief Executive Officer of the Jerusalem Bank and involved on an ongoing basis in monitoring the preparation of the Financial Statements of Bank Jerusalem, including the Directors Report.
Zipporah Samet (2)	B.A. in Economics and Mathematics and MBA (Economics), from the Hebrew University in Jerusalem. Senior Economist in the Bank Research Unit in the Bank of Israel, Head of Pricing Monitoring and Control Team, 1983-1995. Senior Deputy to the Supervisor of Capital Markets, Insurance and Saving in the Finance Ministry, 1995-1998 Supervisor of Capital Markets, Insurance and Saving in the Finance Ministry, 1998-2002. External Director in Israel Discount Bank Ltd., including term as Chairman of the Audit Committee, 2003-2009.
Amos Sapir (1)	B.A. in Social Sciences (Economics and International Relations), Hebrew University in Jerusalem. MBA (Finance) and Doctoral Studies (specializing in Banking Finance), University of Columbia, New York. Economist and Investment Company Manager, Israel Industrial Development Bank Ltd. 1967-1968. Economist, Clal (Israel) Ltd. 1968-1969, CEO – Member of Founders' Group and Shareholders in Technologies, Tadeh Technology Development and Automation Ltd, 1969-1973. Assistant to CEO – in charge of establishment team of new investment company owned by European investors, International Israel Development Company Ltd. 1974-1975. Executive Deputy Chairman of the Board of Directors and representative of the shareholders, Israeli Food Produce Ltd., 1975-1978. CEO – in charge of establishment of television installation, Talanit Ltd., 1978-1979. Finance Officer, Chief and Financial and Management Officer, Assistant to the CEO and CEO of Clal Real Estate Investments Ltd., Assistant to the CEO, Head of Staff, Chairman of the Board of Directors of A.B.N. Health and Leisure Sites Ltd. (Tourist Division of Clal Group). From 1/96, CEO of Clal Capital Markets and in charge of the Group's capital market activity, Member of many directorial boards of companies in the Clal Israel Ltd., Clal (Israel) Ltd. 4.1980-5.1997 Chairman of the Board of Directors, Maalot, The Israel Securities Rating Company Ltd. 11-1999-1.2008. Chairman of the Board of Directors, Standard and Poor's Maalot Ltd. 1.2008-10.2009. Chairman of the Board of Directors, N. Feldman & Son Ltd. 1.2003-to date. Director (Chairman of the Board of Directors from January 2011), Ishal Amlat Investment (1993) Ltd. 12.2001-to date. External Director, Hot Communication Systems Ltd, 6.2007-to date External Director, Log Plastic Products Ltd, 11.2007-to date. External Director, A. Dori Group Ltd., 12.2010-to date.
Prof. Efraim Sadka (1) (2)	B.A. in Economics and Statistics, Tel Aviv University. Ph.D. in Economics, Massachusetts Institute of Technology. Professor of Economics, Tel Aviv University. Member of various professional and public committees, Committee for Examination of a Corporate Governance Code (the Goshen Committee), the Rabinowitz Committee for Income Tax Reform, the Fogel Committee for Pension Reform and the Steinberg Committee for Direct Tax Reform in the Presence of Inflation. Member of the Professional Board of the Israeli Accounting Standards Board. Chairman of the Board of Directors of Housing and Construction Holdings Ltd., 1989-2005; Chairman of the Board of Directors of K.G.M. Pension Fund, 1996-2000. Previously, member and chairman of various boards of directors.

Name of Director	Additional facts that qualify the Director as having accounting and financial expertise
Prof. Gavriella Shalev (2)	B.A. in Law, The Hebrew University of Jerusalem, M.A. in Law, The Hebrew University of Jerusalem, Doctor of Law, The Hebrew University of Jerusalem. Served for lengthy periods on Boards of Directors of public companies and banks. In some of these companies, served as external director. Served as Director and Head of Audit Committee in Bank Hapoalim.

(1) Member of the Financial Statements Review Committee
(2) Member of the Audit Committee

Board of Directors

During 2011 and until the publication of the Report, the following changes took place in the composition of the Board of Directors:

At the Special General Meeting of the Bank that took place on 28 December 2010, Prof. Gabriela Shalev was elected as external director on the Board of Directors of the Bank, pursuant to section 239 of the Companies Law, 1999, for a period of three years beginning on 1 February 2011, in place of Prof. Israel Gilad, who completed two terms of service of three years each as an external director of the Bank. Confirmation by the Banking Supervision Department in the Bank of Israel of their having no objection to the appointment of Prof. Shalev was received on 12 January 2011.

At the Annual General Meeting of the Bank held on 24 May 2011, Adv. Miriyam (Miri) Katz was reelected as a director in the Bank and Mr. David Avner and Mr. Amos Sapir were elected to serve as new directors in the Bank. In addition, Ms. Zipporah Samet was elected as a new external director in the Bank, pursuant to the Companies Law, 1999 for a period of three years. The new directors were elected in place of Mr. Avraham Guzman, Adv. Jacob Mashaal and Mr. Zvi Koren who retired by rotation.

The Supervisor of Banks confirmed he has no objections to the appointment as directors of all the candidates elected in the Meeting, as aforementioned. As a result, Ms. Zipporah Samet and Mr. David Avner commenced their terms of office on 25 July 2011, and Mr. Amos Sapir, after a cooling off period as an external director in accordance with Proper Conduct of Banking Business Directive 301, commenced his term of office on 31 October 2011.

On 4 October 2011, Dr. Ehud Shapira resigned from his term of office as a director in the Bank.

The Board of Directors expressed its thanks to Messrs. Israel Gilead, Rami Avraham Guzman, Jacob Mashaal, Zvi Koren and Ehud Shapira, who made a significant contribution to promoting and furthering the Bank's business. For information regarding the above Annual General Meeting of the Bank, and the election of candidates to serve as directors, see page 20 above.

At the Meeting of the Board of Directors that took place on 28 March 2012, it was decided to approve and publish the audited consolidated financial statements of the Group as at 31 December 2011 and for the periods ended on that date.

During 2011, the Board of Directors held 52 plenary meetings and 143 committee meetings.

The Board of Directors of the Bank expresses its appreciation and gratitude to the employees and managers of the Bank and Group companies in Israel and abroad, for their dedicated work and their contribution to the promotion of the business of the Group.

David Brodet
Chairman of the Board of Directors

Galia Maor
President and Chief Executive Officer

28 March 2012

Below are tables of detailed financial information by subjects, segments and periods:

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Balance Sheets as at end of years 2007-2011
Reported Amounts

Exhibit A:

	31 December				
	2011	2010	2009	2008	2007
	NIS millions				
Assets					
Cash and deposits with banks	**53,044**	30,052	42,933	33,130	42,329
Securities	**47,936**	55,791	57,505	44,910	47,169
Securities borrowed or purchased under agreements to resell	**1,225**	1,190	744	201	655
Credit to the public (a)	**245,287**	234,255	215,067	222,732	207,006
Allowance for credit losses (a)	**(3,967)**	(10,274)	(10,398)	(9,517)	(8,449)
Credit to the public, net	**241,320**	223,981	204,669	213,215	198,557
Credit to governments	**448**	379	407	520	642
Investments in companies included on equity basis	**2,270**	1,924	2,178	1,842	1,873
Buildings and equipment	**3,653**	3,638	3,553	3,445	3,276
Intangible assets and goodwill (a)	**181**	45	125	142	159
Assets in respect of derivative instruments (a)	**11,573**	8,717	6,440	10,047	4,947
Other assets (a) (b)	**4,204**	2,605	3,356	3,556	2,544
Total assets	**365,854**	328,322	321,910	311,008	302,151
Liabilities and equity capital					
Deposits of the public	**279,404**	249,584	250,418	244,783	238,045
Deposits from banks	**5,056**	2,691	3,785	3,742	6,139
Deposits from governments	**519**	660	712	831	1,198
Securities lent or sold under repurchase agreements	**442**	1,006	273	549	231
Debentures, bonds and subordinated notes	**29,999**	26,939	25,261	20,636	19,248
Liabilities in respect of derivative instruments (a)	**12,069**	9,985	7,559	10,513	4,647
Other liabilities (a) (b)	**14,737**	13,846	12,088	11,442	12,989
Total liabilities	**342,226**	304,711	300,096	292,496	282,497
Non-controlling interests	**254**	318	282	245	105
Equity attributable to shareholders of the banking corporation (b)	**23,374**	23,293	21,532	18,267	19,549
Total equity	**23,628**	23,611	21,814	18,512	19,654
Total liabilities and equity	**365,854**	328,322	321,910	311,008	302,151

(a) Reclassified
(b) Restated – see Note 1.S.2 below.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statements of Profit and Loss for the years 2007-2011
Reported Amounts

Exhibit B:

	For the year ended 31 December				
	2011	2010	2009	2008	2007
	NIS millions				
Net interest income before expenses in respect of credit losses	**7,550**	7,433	7,023	6,380	7,648
Expenses in respect of credit losses	**734**	584	1,517	2,145	407
Net interest income after expenses in respect of credit losses	**6,816**	6,849	5,506	4,235	7,241
Operating and other income					
Operating commissions (a)	**3,702**	3,739	3,540	3,538	3,550
Profits (losses) from investments in shares, net	**(12)**	216	707	(912)	461
Other income (a)	**46**	156	316	174	211
Total operating and other income	**3,736**	4,111	4,563	2,800	4,222
Operating and other expenses					
Salaries and related expenses (b)	**5,067**	4,676	3,896	4,118	4,218
Building and equipment maintenance and depreciation	**1,704**	1,591	1,514	1,397	1,274
Amortization of intangible assets and goodwill (a)	**2**	80	21	17	15
Other expenses (a)	**1,574**	1,604	1,350	1,471	1,430
Total operating and other expenses	**8,347**	7,951	6,781	7,003	6,937
Operating profit before taxes	**2,205**	3,009	3,288	32	4,526
Provision for taxes on operating profit (b)	**418**	1,239	1,272	421	1,722
Operating profit (loss) after taxes	**1,787**	1,770	2,016	(389)	2,804
Group's equity in operating profits of companies included on equity basis, net of related tax effect	**148**	420	81	249	184
Net operating profit					
Before attribution to non-controlling interests	**1,935**	2,190	2,097	(140)	2,988
Attributable to non-controlling interests	**(46)**	(39)	(36)	(18)	(4)
Attributable to shareholders of the banking corporation	**1,889**	2,151	2,061	(158)	2,984
Net profit from extraordinary activities after taxes, before attribution to non-controlling interests	**2**	183	28	250	373
Net profit for the period					
Before attribution to non-controlling interests	**1,937**	2,373	2,125	110	3,361
Attributable to non-controlling interests	**(46)**	(39)	(36)	(18)	(4)
Attributable to shareholders of the banking corporation	**1,891**	2,334	2,089	92	3,357

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statements of Profit and Loss for the years 2007-2011 (cont'd)
Reported Amounts

Exhibit B (cont'd):

	For the year ended 31 December				
	2011	2010	2009	2008	2007
Earnings per share					
Basic earnings:					
	NIS				
Net operating profit (loss) attributable to shareholders of the banking corporation (b)	**1.28**	1.46	1.40	(0.11)	2.11
After-tax profit from extraordinary items attributable to shareholders of the banking corporation	**-**	0.12	0.02	0.17	0.26
Net profit	**1.28**	1.58	1.42	0.06	2.37
Diluted earnings:					
Net operating profit (loss) attributable to shareholders of the banking corporation (b)	**1.28**	1.46	1.40	(0.11)	2.08
After-tax profit from extraordinary items attributable to shareholders of the banking corporation	**-**	0.12	0.02	0.17	0.26
Total	**1.28**	1.58	1.42	0.06	2.34

(a) Reclassified
(b) Restated – see Note 1.S.2 below.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Rates of Financing Income and Expenses (on Consolidated Basis) (a)
Reported Amounts

Exhibit C:

	2011				2010			
			Rate of income (expense)				Rate of income (expense)	
	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)
	NIS millions		(%)		NIS millions		(%)	
Israeli currency - unlinked								
Assets (c) (d)	173,811	8,007	4.61		158,730	5,760	3.63	
Effect of embedded and ALM derivatives (e)	69,873	664			54,193	298		
Total assets	243,684	8,671		3.56	212,923	6,058		2.85
Liabilities (d)	143,550	(3,050)	(2.12)		133,192	(1,715)	(1.29)	
Effect of embedded and ALM derivatives (e)	76,226	(790)			58,727	(292)		
Total liabilities	219,776	(3,840)		(1.75)	191,919	(2,007)		(1.05)
Interest margin			2.49	1.81			2.34	1.80
Israeli currency - linked to the CPI								
Assets (c) (d)	60,571	3,669	6.06		58,921	3,594	6.10	
Effect of embedded and ALM derivatives (e)	3,447	144			3,029	95		
Total assets	64,018	3,813		5.96	61,950	3,689		5.95
Liabilities (d)	48,101	(2,994)	(6.22)		48,287	(3,012)	(6.24)	
Effect of embedded and ALM derivatives (e)	11,267	(236)			10,559	(581)		
Total liabilities	59,368	(3,230)		(5.44)	58,846	(3,593)		(6.11)
Interest margin			(0.16)	0.52			(0.14)	(0.16)
Foreign currency:								
(including Israel currency - linked to foreign currency)								
Assets (c) (d)	83,057	8,200	9.87		88,001	(4,312)	(4.90)	
Effect of derivatives (e):								
Effect of hedging derivatives	350	(3)			683	2		
Effect of embedded and ALM derivatives	149,312	8,781			137,416	(6,971)		
Total assets	232,719	16,978		7.30	226,100	(11,281)		(4.99)
Liabilities (d)	101,226	(8,300)	(8.20)		103,508	7,378	7.13	
Effect of derivatives (e):								
Effect of hedging derivatives	415	1			677	-		
Effect of embedded and ALM derivatives	136,096	(7,655)			126,743	5,585		
Total liabilities	237,737	(15,954)		(6.71)	230,928	12,963		5.61
Interest margin			1.67	0.59			2.23	0.62

See notes on page 314 below.

Note - Full details of the rates of financing income and expenses in each sector, for the various balance sheet categories, are available on request.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Rates of Financing Income and Expenses (on Consolidated Basis) (a) (cont'd)
Reported Amounts

Exhibit C (cont'd):

	2011				2010			
			Rate of income (expense)				Rate of income (expense)	
	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)
	NIS millions		(%)		NIS millions		(%)	
Total:								
Monetary assets generating interest income (d) (f)	**317,439**	**19,876**	**6.26**		305,652	5,042	1.65	
Effect of derivatives (e):								
Effect of hedging derivatives	**350**	**(3)**			683	2		
Effect of embedded and ALM derivatives	**222,632**	**9,589**			194,638	(6,578)		
Total assets	**540,421**	**29,462**		**5.45**	500,973	(1,534)		(0.31)
Monetary liabilities generating financing expenses (d)	**292,877**	**(14,344)**	**(4.90)**		284,987	2,651	0.93	
Effect of derivatives (e):								
Effect of hedging derivatives	**415**	**1**			677	-		
Effect of embedded and ALM derivatives	**223,589**	**(8,681)**			196,029	4,712		
Total liabilities	**516,881**	**(23,024)**		**(4.45)**	481,693	7,363		1.53
Interest margin			**1.36**	**1.00**			2.58	1.22
In respect of options		**147**				71		
In respect of other derivatives (excluding options, hedging derivative instruments, ALM derivative and embedded derivatives which have been separated (e))		**7**				15		
Financing commissions and other financing income (g)		**974**				1,501		
Other financing expenses		**(16)**				17		
Net interest income before expenses in respect of credit losses		**7,550**				7,433		
Expenses in respect of credit losses		**(734)**				(584)		
Net interest income after expenses in respect of credit losses		**6,816**				6,849		
Total:								
Monetary assets generating interest income (d) (f)	**317,439**				305,652			
Assets derived from derivative instruments (h)	**8,861**				7,762			
Other monetary assets (d) (j)	**4,644**				4,177			
Allowance in respect of credit losses (i)	**(4,951)**				(845)			
Total monetary assets	**325,993**				316,746			
Total:								
Monetary liabilities generating financing expenses (d)	**292,877**				284,987			
Liabilities derived from derivative instruments (h)	**10,264**				9,092			
Other monetary liabilities (d) (j)	**8,616**				8,272			
Total monetary liabilities	**311,757**				302,351			
Total excess of monetary assets over monetary liabilities	**14,236**				14,395			
Non-monetary assets	**9,683**				8,692			
Non-monetary liabilities	**1,061**				413			
Total capital resources (j)	**22,858**				22,674			

See notes on page 314 below.

Note - Full details of the rates of financing income and expenses in each sector, for the various balance sheet categories, are available on request.

Exhibit C (cont'd):

Notes:

(a) The data in this exhibit are before and after the effect of derivative instruments (including the effect of off-balance sheet derivative instruments).

(b) Based on monthly opening balances, and quarterly opening balances in foreign subsidiaries, except for the unlinked Israeli currency sector in which 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 (losses), from adjustments to fair value of debentures held for trading and available for sale, has been deducted from (added to) the average balance of the assets as follows:

In the unlinked Israeli currency sector - the amount of NIS (93) million (31 December 2010 – NIS 36 million)

In the index-linked Israeli currency sector – the amount of NIS 103 million (31 December 2010 – NIS 269 million)

In the foreign currency sector (including Israeli currency linked to foreign currency) – the amount of NIS (142) million (31 December 2010 – NIS (20) million).

(d) Excluding derivative instruments.

(e) Hedging derivative instruments (excluding options), embedded derivatives that have been separated, and ALM derivatives which constitute part of the Bank's asset and liability management system.

(f) From the average balance of the assets has been deducted (added to) the balance of unrealized profits (losses) from adjustments to fair value of debentures held for trading and available for sale, in the amount of NIS (132) million in the various sectors (31 December 2010 – NIS 285 million).

(g) Includes profits and losses on sales of investments in debentures and adjustments to fair value of debentures held for trading.

(h) Average balance-sheet balance of derivative instruments (does not include average of off-balance sheet derivative instruments).

(i) Reclassified.

(j) Restated – see Note 1.S.2 below.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Rates of Financing Income and Expenses (on Consolidated Basis) (a) (cont'd)
Nominal U.S. $

Exhibit C (cont'd):

	2011				2010			
			Rate of income (expense)				Rate of income (expense)	
	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)	Average balance (b)	Financing income (expense)	Excluding the effect of derivatives	Including the effect of derivatives (e)
	NIS millions		(%)		NIS millions		(%)	
Foreign currency: Local activity (including Israel currency linked to foreign currency)								
Assets (c) (d)	**14,049**	**364**	**2.59**		14,305	307	2.15	
Effect of derivatives(e):								
Effect of hedging derivatives	**98**	**(1)**			182	1		
Effect of embedded derivatives and ALM	**41,790**	**34**			36,616	32		
Total assets	**55,937**	**397**		**0.71**	51,103	340		0.67
Liabilities (d)	**20,134**	**(200)**	**(0.99)**		19,565	(103)	(0.53)	
Effect of derivatives(e):								
Effect of hedging derivatives	**116**	**-**			180	-		
Effect of embedded derivatives and ALM	**37,853**	**(62)**			33,758	(45)		
Total liabilities	**58,103**	**(262)**		**(0.45)**	53,503	(148)		(0.28)
Interest margin			**1.60**	**0.26**			1.62	0.39
Foreign currency: Foreign activity (integrated operations)								
Assets (c) (d)	**9,315**	**224**	**2.40**		9,147	213	2.33	
Effect of embedded derivatives and ALM (e)	**62**	**22**			61	21		
Total assets	**9,377**	**246**		**2.62**	9,208	234		2.54
Liabilities (d)	**8,326**	**(54)**	**(0.65)**		8,043	(52)	(0.65)	
Effect of embedded derivatives and ALM (e)	**304**	**(13)**			70	(39)		
Total liabilities	**8,630**	**(67)**		**(0.78)**	8,113	(91)		(1.12)
Interest margin			**1.75**	**1.84**			1.68	1.42
Total:								
Monetary assets in foreign currency generating financing income (c) (d)	**23,364**	**588**	**2.52**		23,452	520	2.22	
Effect of derivatives(e):								
Effect of hedging derivatives	**98**	**(1)**			182	1		
Effect of embedded derivatives and ALM	**41,852**	**56**			36,677	53		
Total assets	**65,314**	**643**		**0.98**	60,311	574		0.95
Monetary liabilities in foreign currency generating financing expense (d)	**28,460**	**(254)**	**(0.89)**		27,608	(155)	(0.56)	
Effect of derivatives(e):								
Effect of hedging derivatives	**116**	**-**			180	-		
Effect of embedded derivatives and ALM	**38,157**	**(75)**			33,828	(84)		
Total liabilities	**66,733**	**(329)**		**(0.49)**	61,616	(239)		(0.39)
Interest margin			**1.63**	**0.49**			1.66	0.56

(a) The data in this exhibit are before and after the effect of derivative instruments (including the effect of off-balance sheet derivative instruments).

(b) Based on monthly opening balances and quarterly opening balances in foreign subsidiaries, and after deduction of the average balance sheet balance of the specific provision for doubtful debts.

(c) The average balance of unrealized losses from adjustments to fair value of debentures held for trading and available for sale has been added to the average balance of the assets, in the amount of US$ 37 million (2010 – US$ 5 million).

(d) Excluding derivative instruments.

(e) Hedging derivative instruments (excluding options), embedded derivatives which have been separated, and ALM derivatives that constitute part of the Bank's asset and liability management system.

Note - Full details of the rates of financing income and expenses in each sector, for the various balance sheet categories, are available on request.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Exposure to Interest Rate Fluctuations - on Consolidated Basis
Reported Amounts

Exhibit D:

	31 December 2011												31 December 2010		
	On demand up to one month	Over one month to three months	Over three months to one year	Over one year to three years	Over three years to five years	Over five years to ten years	Over ten years to twenty years	Over twenty years	Without fixed maturity	Total	Internal rate of return	Average duration	Total fair value	Internal rate of return	Average duration (f)
	NIS millions										(%)	(Years)		(%)	(Years)
Israeli currency - unlinked															
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments															
Financial assets (a) (c)	154,396	6,812	18,160	6,004	2,215	3,339	488	-	353	191,767	4.12	0.39	164,964	4.27	0.43
Derivative financial instruments (excluding options)	41,245	68,971	51,963	23,654	15,179	20,261	272	-	-	221,545	-	1.38	178,211	-	1.09
Options (in terms of the underlying asset) (e)	941	1,619	3,204	281	23	6	-	-	-	6,074	-	-	7,278	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total fair value	196,582	77,402	73,327	29,939	17,417	23,606	760	-	353	419,386	4.12	0.91	350,453	4.27	0.76
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments															
Financial liabilities (a)	131,372	6,955	9,436	9,213	1,091	965	-	-	12	159,044	3.70	0.27	140,887	3.67	0.28
Derivative financial instruments (excluding options)	47,902	77,716	48,539	27,929	14,981	18,627	288	-	-	235,982	-	1.30	182,032	-	1.04
Options (in terms of the underlying asset) (e)	1,499	1,591	3,035	605	5	70	-	-	-	6,805	-	-	10,067	-	-
Off-balance sheet financial instruments	-	-	43	-	-	-	-	-	-	43	-	0.50	89	-	0.50
Total fair value	180,773	86,262	61,053	37,747	16,077	19,662	288	-	12	401,874	3.70	0.87	333,075	3.67	0.68
Financial instruments, net															
Exposure to interest rate fluctuations	15,809	(8,860)	12,274	(7,808)	1,340	3,944	472	-							
Accumulated exposure in the sector	15,809	6,949	19,223	11,415	12,755	16,699	17,171	17,171							
Israeli currency – linked to the CPI															
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments															
Financial assets (a)	2,783	3,256	17,484	17,291	11,814	8,495	1,571	37	45	62,776	3.10	2.78	62,174	2.83	2.97
Derivative financial instruments (excluding options)	50	867	1,597	909	249	1,757	212	-	-	5,641	-	3.61	2,704	-	1.89
Options (in terms of the underlying asset) (e)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total fair value	2,833	4,123	19,081	18,200	12,063	10,252	1,783	37	45	68,417	3.10	2.85	64,878	2.83	2.93
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments															
Financial liabilities (a)	5,090	1,378	8,835	12,457	11,908	13,198	1,228	200	-	54,294	2.54	3.60	51,636	2.23	3.83
Derivative financial instruments (excluding options)	1,079	1,019	4,486	2,912	778	330	-	-	-	10,604	-	1.46	9,685	-	2.13
Options (in terms of the underlying asset) (e)	4	-	-	-	-	-	-	-	-	4	-	-	8	-	-
Off-balance sheet financial instruments	-	-	101	-	-	-	-	-	-	101	-	-	83	-	0.50
Total fair value	6,173	2,397	13,422	15,369	12,686	13,528	1,228	200	-	65,003	2.54	3.25	61,412	2.23	3.56
Financial instruments, net															
Exposure to interest rate fluctuations	(3,340)	1,726	5,659	2,831	(623)	(3,276)	555	(163)							
Accumulated exposure in the sector	(3,340)	(1,614)	4,045	6,876	6,253	2,977	3,532	3,369							

See notes on page 318.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Exposure to Interest Rate Fluctuations - on Consolidated Basis (cont'd)
Reported Amounts

Exhibit D (cont'd):

	31 December 2011												31 December 2010		
	On demand up to one month	Over one month to three months	Over three months to one year	Over one year to three years	Over three years to five years	Over five years to ten years	Over ten years to twenty years	Over twenty years	Without fixed maturity	Total	Internal rate of return	Average duration	Total fair value	Internal rate of return	Average duration (f)
	NIS millions										(%)	(Years)		(%)	(Years)
Foreign currency and foreign currency linked															
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments															
Financial assets (a) (d)	51,412	16,525	8,858	5,628	3,849	1,531	140	38	131	88,112	4.04	0.58	84,043	3.14	0.70
Derivative financial instruments (excluding options)	60,298	47,384	68,608	29,498	3,422	8,732	245	235	166	218,588	-	0.85	198,480	-	0.93
Options (in terms of the underlying asset) (e)	7,194	1,841	2,063	1,603	846	7,768	726	-	-	22,041	-	-	31,614	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total fair value	118,904	65,750	79,529	36,729	8,117	18,031	1,111	273	297	328,741	4.04	0.72	314,137	3.14	0.75
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments															
Financial liabilities (a)	68,573	16,977	21,995	3,551	534	380	46	-	9	112,065	1.59	0.30	99,253	1.43	0.30
Derivative financial instruments (excluding options)	49,567	40,886	62,573	29,699	5,735	10,377	303	273	166	199,579	-	1.02	189,015	-	1.03
Options (in terms of the underlying asset) (e)	6,499	1,904	2,026	1,641	873	7,768	726	-	-	21,437	-	-	28,777	-	-
Off-balance sheet financial instruments	-	-	14	-	-	-	-	-	-	14	-	0.50	72	-	0.50
Total fair value	124,639	59,767	86,608	34,891	7,142	18,525	1,075	273	175	333,095	1.59	0.71	317,117	1.43	0.68
Financial instruments, net															
Exposure to interest rate fluctuations	(5,735)	5,983	(7,079)	1,838	975	(494)	36	-							
Accumulated exposure in the sector	(5,735)	248	(6,831)	(4,993)	(4,018)	(4,512)	(4,476)	(4,476)							
Total exposure to interest rate fluctuations															
Financial assets, amounts receivable in respect of derivative instruments and off-balance sheet financial instruments															
Financial assets (a) (c)	208,591	26,593	44,502	28,923	17,878	13,365	2,199	75	3,413	345,539	3.52	0.88	314,357	3.23	1.01
Derivative financial instruments (excluding options)	101,593	117,222	122,168	54,061	18,850	30,750	729	235	277	445,885	-	1.15	380,616	-	1.02
Options (in terms of the underlying asset) (e)	8,135	3,460	5,267	1,884	869	7,774	726	-	-	28,115	-	-	38,892	-	-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total fair value	318,319	147,275	171,937	84,868	37,597	51,889	3,654	310	3,690	819,539	3.52	0.99	733,865	3.23	0.94
Financial liabilities, amounts payable in respect of derivative instruments and off-balance sheet financial instruments															
Financial liabilities	205,035	25,310	40,266	25,221	13,533	14,543	1,274	200	355	325,737	2.62	0.84	291,824	2.36	0.92
Derivative financial instruments (excluding options)	98,548	119,621	115,598	60,540	21,494	29,334	591	273	251	446,250	-	1.18	381,924	-	1.06
Options (in terms of the underlying asset) (e)	8,002	3,495	5,061	2,246	878	7,838	726	-	-	28,246	-	-	38,852	-	-
Off-balance sheet financial instruments	-	-	158	-	-	-	-	-	121	279	-	0.12	367	-	0.50
Total fair value	311,585	148,426	161,083	88,007	35,905	51,715	2,591	473	727	800,512	2.62	1.00	712,967	2.36	0.93
Financial instruments, net															
Exposure to interest rate fluctuations	6,734	(1,151)	10,854	(3,139)	1,692	174	1,063	(163)							
Accumulated exposure in the sector	6,734	5,583	16,437	13,298	14,990	15,164	16,227	16,064							

See notes on next page.

Exhibit D (cont'd):

Notes:
(a) Excluding balance sheet balances of derivative financial instruments and fair value of off-balance sheet financial instruments.
(b) Weighted average according to fair value of effective duration.
(c) Including shares shown in the "Without fixed maturity" column.
(d) Including Israeli currency linked to foreign currency
(e) Duration less than 0.05 years.
(f) Reclassified.

General notes:
(1) Full details of the effect of changes in the interest rates in each sector, for the various balance sheet categories, are available on request.
(2) In this table, the data for each period represent the present value of the future cash flows of each financial instrument, discounted at the interest rate used for discounting to fair value. For further details of assumptions used in calculating the fair value of financial instruments, see Note 18.C.
(3) The internal rate of return is the interest rate at which expected cash flows are discounted to fair value.
(4) Effective duration of a group of financial instruments represents an approximation of the change in percentages in fair value of the group of financial instruments which will be caused as a result of a small change (increase of 0.1%) in the internal rate of return.
(5) Instruments with options not separated from the host contract are not shown on a separate line but included with the remaining financial assets.
(6) In calculating the average duration of assets and liabilities in the CPI-linked sector, an estimate is taken into account of early repayments and withdrawals at exit points of savings schemes, in accordance with a model which estimates anticipated early repayments based on the behavior of savers. The average duration of assets according to the original cash flow of the savings schemes is longer, reaching 3.94 years, the average duration of liabilities is 3.28 years, with a gap in the internal rate of return (hereinafter: "IRR") amounting to 1.68%. The change in fair value in assets is NIS (587) million and in liabilities is NIS (10) million.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis
Reported Amounts

Exhibit E:

31 December 2011

Activities of borrowers in Israel	Balance sheet credit risk (*) (a)	Off-balance sheet credit risk (*) (b)	Overall credit risk (*)	Problem credit risk (*) (c)	Impaired credit to the public (*)	Expenses in respect of credit losses	Net accounting write-off	Balance of allowance for credit losses
	Credit risk to the public			Credit risk to the public includes:		Credit losses (d)		
	NIS millions							
Agriculture	1,835	327	2,162	109	53	(41)	(33)	(51)
Industry	26,203	11,973	38,176	1,362	861	68	599	(563)
Construction and real estate (g)	39,863	27,081	66,944	3,803	1,956	332	871	(1,168)
Electricity and water	1,159	198	1,357	2	-	-	-	(2)
Commerce	18,274	4,499	22,773	925	384	60	(179)	(271)
Hotels, catering services and food	3,437	267	3,704	946	744	(81)	(39)	(148)
Transport and storage	5,012	1,024	6,036	179	134	9	40	(77)
Communications and computer services	4,915	2,602	7,517	160	122	(19)	61	(60)
Financial services	17,903	8,914	26,817	1,393	1,053	256	137	(335)
Other business services	5,361	1,757	7,118	94	48	(7)	14	(82)
Public and community services	6,342	929	7,271	233	49	12	(6)	(50)
Private individuals - housing loans	56,376	1,519	57,895	955	27	(15)	69	(515)
Private individuals - other	28,153	26,885	55,038	357	47	29	113	(423)
Total	214,833	87,975	302,808	10,518	5,478	603	1,647	(3,745)
Credit risk included in the various economic sectors:								
Settlement movements (e)	2,907	553	3,460	109	49	(70)	9	(39)
Local authorities (f)	3,254	134	3,388	13	1	(6)	-	(2)

31 December 2011

Activities of borrowers abroad	Balance sheet credit risk (*) (a)	Off-balance sheet credit risk (*) (b)	Overall credit risk (*)	Problem credit risk (*) (c)	Impaired credit to the public (*)	Expenses in respect of credit losses	Net accounting write-off	Balance of allowance for credit losses
	Credit risk to the public			Credit risk to the public includes:		Credit losses (d)		
	NIS millions							
Agriculture	42	13	55	4	4	2	-	(3)
Industry	8,029	3,278	11,307	259	83	(4)	19	(86)
Construction and real estate	9,694	3,101	12,795	1,123	618	104	202	(299)
Electricity and water	247	146	393	-	-	-	-	-
Commerce	5,655	2,689	8,344	342	171	40	106	(106)
Hotels, catering services and food	913	384	1,297	52	2	1	-	(6)
Transport and storage	594	102	696	44	22	11	45	(18)
Communications and computer services	623	346	969	3	-	-	-	(5)
Financial services	9,253	1,156	10,409	604	84	(6)	(9)	(70)
Other business services	3,992	1,430	5,422	276	145	(4)	13	(38)
Public and community services	910	52	962	55	54	-	-	(5)
Private individuals - housing loans	1,375	-	1,375	68	66	6	-	(16)
Private individuals - other	1,476	323	1,799	59	57	(19)	46	(38)
Total	42,803	13,020	55,823	2,889	1,306	131	422	(690)

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis
Reported Amounts

Exhibit E (cont'd):

(a) Credit to the public amounting to NIS 209,789 million in respect of activity in Israel and NIS 35,489 million in respect of activity abroad, investments in corporate debentures amounting to NIS 1,414 million in respect of activity in Israel and NIS 6,620 million in respect of activity abroad, and other assets in respect of derivative instruments made against the public amounting to NIS 3,630 million in respect of activity in Israel and NIS 685 million in respect of activity abroad.

(b) Credit risk on off-balance sheet financial instruments as calculated for the purpose of per single borrower credit limitations.

(c) Balance sheet and off-balance sheet credit risk of the public which is impaired, substandard, and special mention.

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

(e) Kibbutzim and moshavim, regional and national organizations and corporations controlled by the settlement movement.

(f) Including corporations under their control.

(g) Including housing loans given to purchasing groups under construction amounting to NIS 932 million and off balance-sheet credit risk amounting to NIS 2,032 million.

* Balance sheet and off-balance sheet credit risk, problem credit risk and impaired credit to the public are shown before the effect of the allowance for credit losses, and before the effect of collateral eligible for deduction for purposes of individual and group borrower limits.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis (cont'd)

Reported Amounts

Exhibit E (cont'd):

31 December 2010

Activities of borrowers in Israel	Balance sheet credit risk (a)	Off-balance sheet credit risk (b)	Overall credit risk to the public	Annual expense in respect of specific provision for doubtful debts	Balance of problem debts (c)
	NIS millions				
Agriculture	1,729	324	2,053	(2)	177
Industry	21,440	13,243	34,683	(51)	1,691
Construction and real estate (f) (g)	38,144	24,649	62,793	212	5,454
Electricity and water	1,257	505	1,762	1	6
Commerce	15,571	3,761	19,332	85	1,228
Hotels, catering services and food	3,441	309	3,750	(34)	1,456
Transport and storage	3,958	1,161	5,119	(61)	642
Communications and computer services	4,836	1,857	6,693	(54)	172
Financial services	16,842	12,049	28,891	(62)	632
Other business services	4,747	1,702	6,449	12	453
Public and community services	6,065	1,110	7,175	11	235
Private individuals - housing loans (g)	50,980	2,553	53,533	(51)	654
Private individuals - other	26,111	25,589	51,700	206	837
Total	195,121	88,812	283,933	212	13,637
Credit risk included in the various economic sectors:					
Settlement movements (d)	2,804	633	3,437	(95)	192
Local authorities (e)	3,154	119	3,273	-	73

31 December 2010

Activities of borrowers abroad (g)	Balance sheet credit risk (a)	Off-balance sheet credit risk (b) (h)	Overall credit risk to the public	Annual expense in respect of specific provision for	Balance of problem debts (c)
	NIS millions				
Agriculture	89	20	109	-	7
Industry	9,303	2,933	12,236	20	103
Construction and real estate	8,524	2,242	10,766	206	1,133
Electricity and water	128	219	347	-	-
Commerce	3,795	2,796	6,591	183	405
Hotels, catering services and food	923	284	1,207	-	94
Transport and storage	275	142	417	8	48
Communications and computer services	297	187	484	-	-
Financial services	15,708	4,051	19,759	39	563
Other business services	2,109	661	2,770	30	57
Public and community services	1,228	221	1,449	-	27
Private individuals	1,239	-	1,239	5	31
Private individuals - other	1,269	512	1,781	18	12
Total	44,887	14,268	59,155	509	2,480

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Overall Credit Risk to the Public by Economic Sector - on Consolidated Basis (cont'd)

Reported Amounts

Exhibit E (cont'd):

(a) Credit to the public amounting to NIS 190,651 million in respect of activity in Israel and NIS 33,975 million in respect of activity abroad, investments in corporate debentures amounting to NIS 1,367 million in respect of activity in Israel and NIS 10,290 million in respect of activity abroad, and other assets in respect of derivative instruments made against the public amounting to NIS 3,103 million in respect of activity in Israel and NIS 622 million in respect of activity abroad.

(b) Credit risk on off-balance sheet financial instruments as calculated for the purpose of per single borrower credit limitations.

(c) Balances of problematic debt net of credit covered by collateral allowed as a deduction for purposes of individual and group borrower limits, including off-balance sheet risk components.

(d) Kibbutzim and moshavim, regional and national organizations and corporations controlled by the settlement movement.

(e) Including corporations under their control.

(f) Including housing loans given to purchasing groups under construction amounting to NIS 853 million and off balance-sheet credit risk amounting to NIS 1,625 million.

(g) Reclassified.

(h) Restated – debentures of banking holding companies abroad that were shown in the past as debentures of banks.

Credit risk and balances of problematic debts are stated net of specific provisions for doubtful debts.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Country Exposure
Reported Amounts

Exhibit F:

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

	31 December 2011					
	Balance sheet exposure					
	Cross-Border Balance Sheet Exposure			Net Foreign-Office Claims on Local Residents		
	To governments (a)	To banks	To others	Balance sheet exposure before deducting local liabilities	Deduction for local liabilities	Balance sheet exposure after deducting local liabilities
Country	NIS millions					
United States	**2,975**	**3,850**	**9,121**	**19,429**	**10,834**	**8,595**
United Kingdom	**-**	**3,877**	**2,340**	**6,120**	**2,124**	**3,996**
France	**-**	**2,155**	**780**	**-**	**-**	**-**
Switzerland	**-**	**380**	**871**	**1,897**	**489**	**1,408**
Germany	**35**	**2,153**	**1,741**	**1**	**-**	**1**
Belgium	**-**	**422**	**132**	**-**	**-**	**-**
Italy	**-**	**378**	**79**	**-**	**-**	**-**
Netherlands	**4**	**1,257**	**1,339**	**-**	**-**	**-**
Others	**360**	**2,768**	**2,916**	**1,740**	**1,036**	**704**
Total exposure to foreign countries	**3,374**	**17,240**	**19,319**	**29,187**	**14,483**	**14,704**
Total exposure to LDC countries	**166**	**576**	**1,307**	**1,679**	**1,036**	**643**
Total exposure to PIIGS countries (c)	**-**	**735**	**236**	**-**	**-**	**-**

	31 December 2011						
	Balance sheet exposure			Off-balance sheet exposure (a)(b)			
						Cross-Border Balance Sheet Exposure	
						Repayment period	
		Balance sheet problem commercial credit risk	Of which: balance of impaired debts	Total off-balance sheet exposure (d)	Of which: Off-balance sheet problem credit risk	Up to one year	Over one year
	NIS millions						
Country							
United States	**24,541**	**609**	**346**	**6,282**	**19**	**8,138**	**7,808**
United Kingdom	**10,213**	**769**	**286**	**3,004**	**4**	**2,755**	**3,462**
France	**2,935**	**1**	**1**	**322**	**-**	**1,165**	**1,770**
Switzerland	**2,659**	**80**	**80**	**770**	**-**	**739**	**512**
Germany	**3,930**	**2**	**2**	**304**	**-**	**2,807**	**1,122**
Belgium	**554**	**-**	**-**	**32**	**-**	**492**	**62**
Italy	**457**	**1**	**1**	**15**	**-**	**72**	**385**
Netherlands	**2,600**	**57**	**30**	**176**	**-**	**1,609**	**991**
Others	**6,748**	**654**	**557**	**1,169**	**-**	**3,623**	**2,421**
Total exposure to foreign countries	**54,637**	**2,173**	**1,303**	**12,074**	**23**	**21,400**	**18,533**
Total exposure to LDC countries	**2,692**	**649**	**554**	**629**	**-**	**1,744**	**305**
Total exposure to PIIGS countries (c)	**971**	**5**	**4**	**25**	**-**	**170**	**801**

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Country Exposure
Reported Amounts

Exhibit F (cont'd):

	31 December 2010					
	Balance sheet exposure					
	Cross-Border Balance Sheet Exposure			Net Foreign-Office Claims on Local Residents		
	To governments (a)	To banks	To others	Balance sheet exposure before deducting local liabilities	Deduction for local liabilities	Balance sheet exposure after deducting local liabilities
Country	NIS millions					
United States	455	2,485	11,288	16,661	7,212	9,449
United Kingdom	18	3,462	1,439	5,502	1,832	3,670
France	1,184	2,022	560	-	-	-
Germany	248	2,734	1,237	-	-	-
Switzerland	-	350	886	1,266	495	771
Others	605	6,076	5,400	1,708	970	738
Total exposure to foreign countries	2,510	17,129	20,810	25,137	10,509	14,628
Total exposure to LDC countries	103	154	1,186	1,658	969	689
Total exposure to PIGS countries (c)	-	447	40	-	-	-

	31 December 2010					
	Balance sheet exposure		Off-balance sheet exposure			
	Total balance sheet exposure				Cross-Border Balance Sheet Exposure	
					Repayment period	
		Balance of problem debts (b)	Total off-balance sheet exposure	Of which: Off-balance sheet problem credit risk	Up to one year	Over one year
	NIS millions					
Country						
United States	23,677	782	11,743	-	6,191	8,037
United Kingdom	8,589	395	7,782	-	2,441	2,478
France	3,766	14	3,226	-	1,257 (e)	2,509
Germany	4,219	1	4,835	-	2,708	1,511
Switzerland	2,007	147 (e)	2,314	-	755	481
Others	12,819	237	2,850	-	6,511	5,570
Total exposure to foreign countries	55,077	1,576	32,750	-	19,863	20,586
Total exposure to LDC countries	2,132	168	688	-	1,117	326
Total exposure to PIGS countries (c)	487	3	65	-	100	387

(a) Including governments, official institutions and central banks.
(b) Balance of problem debts less debts covered by collateral eligible for deduction for purposes of single borrower and group borrower debt limitations. Does not include off-balance sheet risk components.
(c) Exposure to PIIGS countries include: Portugal, Italy, Ireland, Greece, and Spain (in 2010 without Italy).
(d) The reduction in total exposure derives from a change in the method of calculating risk in respect of derivatives pursuant to Directive 313, and pursuant to offsetting transactions with set-off agreements.
(e) Reclassified.

Exhibit F (cont'd):

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

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

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

- Third party guarantees - according to the country of residence of the guarantor.
- Securities - the country of residence is that of the issuer of the security.
- The directive makes it clear that real estate and debtors' balances do not represent collateral for purposes of determining end-risk.
- For purposes of determining end-risk, only specific collaterals were taken into account.

Part B – At 31 December 2011, there was no aggregate amount of balance sheet exposure to countries whose total individual exposure was between 0.75% and 1% of the total consolidated assets or 15%-20% of equity, whichever is the lower (at 31 December 2010, the total was NIS 4,165 million, relating to Holland and Belgium).

Part C – The amount of exposure to foreign countries with liquidity problems as defined by the FITCH Liquidity Index and by the Bank of Israel (a country receiving financial aid from the IMF or whose obligations are rated with a credit rating of CCC or lower) amounts to NIS 1,106 million and relates to 13 countries (at 31 December 2010, this totaled NIS 1,276 million and related to 16 countries).

Bank Leumi le-Israel B.M. and its Consolidated Companies
Quarterly Consolidated Balance Sheets – Multi-Quarter Data
Reported Amounts

Exhibit G:

Year	2011				2010			
Quarter	4	3	2	1	4	3	2	1
	NIS millions							
Assets								
Cash and deposits with banks	**53,044**	**54,662**	**45,566**	**36,802**	30,052	40,360	47,180	41,664
Securities	**47,936**	**38,356**	**40,146**	**47,090**	55,791	54,373	51,211	52,526
Securities borrowed or purchased under repurchase agreements	**1,225**	**1,252**	**1,330**	**2,068**	1,190	914	725	638
Credit to the public (a)	**245,287**	**241,171**	**232,670**	**230,017**	234,255	227,515	222,806	217,994
Allowance for credit losses (a)	**(3,967)**	**(3,856)**	**(4,322)**	**(4,946)**	(10,274)	(10,297)	(10,353)	(10,381)
Credit to the public, net	**241,320**	**237,315**	**228,348**	**225,071**	223,981	217,218	212,453	207,613
Credit to governments	**448**	**403**	**352**	**357**	379	385	396	407
Investments in companies included on equity basis	**2,270**	**2,350**	**2,159**	**2,032**	1,924	1,740	1,720	2,196
Buildings and equipment	**3,653**	**3,615**	**3,627**	**3,665**	3,638	3,600	3,564	3,543
Intangible assets and goodwill (a)	**181**	**45**	**45**	**45**	45	112	117	121
Assets in respect of derivative instruments (a)	**11,573**	**11,496**	**7,764**	**8,419**	8,717	9,444	8,303	6,019
Other assets (a) (b)	**4,204**	**3,681**	**3,719**	**3,118**	2,605	2,656	2,757	3,061
Total assets	**365,854**	**353,175**	**333,056**	**328,667**	328,322	330,802	328,426	317,788
Liabilities and equity capital								
Deposits of the public	**279,404**	**267,249**	**252,704**	**248,258**	249,584	245,820	251,677	244,579
Deposits from banks	**5,056**	**6,327**	**5,362**	**3,814**	2,691	6,788	3,288	3,160
Deposits from governments	**519**	**443**	**443**	**721**	660	614	909	678
Securities loaned or sold under repurchase agreements	**442**	**778**	**791**	**1,533**	1,006	709	740	175
Debentures, bonds and subordinated notes (a)	**29,999**	**28,573**	**27,034**	**26,985**	26,939	28,744	26,846	26,812
Liabilities in respect of derivative instruments (a)	**12,069**	**12,636**	**9,447**	**10,170**	9,985	11,183	9,498	7,277
Other liabilities (a) (b)	**14,737**	**14,055**	**14,098**	**14,384**	13,846	13,264	12,040	12,509
Total liabilities	**342,226**	**330,061**	**309,879**	**305,865**	304,711	307,122	304,998	295,190
Non-controlling interests	**254**	**343**	**333**	**314**	318	310	292	285
Equity attributable to shareholders of the banking corporation (b)	**23,374**	**22,771**	**22,844**	**22,488**	23,293	23,370	23,136	22,313
Total equity capital	**23,628**	**23,114**	**23,177**	**22,802**	23,611	23,680	23,428	22,598
Total liabilities and equity capital	**365,854**	**353,175**	**333,056**	**328,667**	328,322	330,802	328,426	317,788

(a) Reclassified
(b) Restated – see Note 1.S.2 below

Bank Leumi le-Israel B.M. and its Consolidated Companies
Quarterly Consolidated Statements of Profit and Loss – Multi-Quarter Data
Reported Amounts

Exhibit H:

Year	2011				2010			
Quarter	4	3	2	1	4	3	2	1
	NIS millions							
Net interest income before expenses in respect of credit losses	1,968	1,692	1,952	1,938	2,141	1,846	1,639	1,807
Expenses (income) in respect of cre	385	378	73	(102)	212	46	196	130
Net interest income after expenses in respect of credit losses	1,583	1,314	1,879	2,040	1,929	1,800	1,443	1,677
Operating and other income								
Operating commissions (a)	901	901	918	982	986	919	924	910
Profits (losses) from investments in shares, net	(5)	(75)	38	30	28	14	100	74
Other income (a)	19	6	10	11	76	50	15	15
Total operating and other income	915	832	966	1,023	1,090	983	1,039	999
Operating and other expenses								
Salaries and related expenses (b)	1,197	1,248	1,272	1,350	1,213	1,054	1,199	1,210
Building and equipment maintenance and depreciation	442	422	432	408	419	401	391	380
Amortization of goodwill (a)	2	-	-	-	67	5	4	4
Other expenses (a)	481	392	374	327	596	345	350	313
Total operating and other expenses	2,122	2,062	2,078	2,085	2,295	1,805	1,944	1,907
Operating profit before taxes	376	84	767	978	724	978	538	769
Provision for (benefit from) taxes on operating profit (b)	(246)	32	259	373	376	415	136	312
Operating profit after taxes	622	52	508	605	348	563	402	457
Group's equity in operating profits (losses) of companies included on equity basis, net of related tax effect	3	115	72	(42)	161	57	117	85
Net operating profit								
Before attribution to non-controlling interests	625	167	580	563	509	620	519	542
Attributable to non-controlling interests	(7)	(11)	(18)	(10)	(10)	(14)	(12)	(3)
Attributable to shareholders of the banking corporation	618	156	562	553	499	606	507	539
After-tax profit (loss) from extraordinary items before attribution to non-controlling interests	-	(1)	2	1	(3)	-	182	4
Net profit for the period								
Before attribution to non-controlling interests	625	166	582	564	506	620	701	546
Attributable to non-controlling interests	(7)	(11)	(18)	(10)	(10)	(14)	(12)	(3)
Attributable to shareholders of the banking corporation	618	155	564	554	496	606	689	543

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Quarterly Consolidated Statements of Profit and Loss – Multi-Quarter Data
Earnings per Share by Quarter for 2010-2011

Reported Amounts

Exhibit H (cont'd):

Year	2011				2010			
Quarter	4	3	2	1	4	3	2	1
Basic and diluted earnings per share:								
Net operating profit attributable to shareholders of the banking corporation (b)	0.41	0.11	0.38	0.38	0.34	0.41	0.34	0.37
After-tax profit from extraordinary activities attributable to shareholders of the banking corporation	-	-	-	-	-	-	0.12	-
Total	0.41	0.11	0.38	0.38	0.34	0.41	0.46	0.37

(a) Reclassified
(b) Restated – see Note 1.S.2 below

Certification

I, Galia Maor, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2011 (the "Report").

2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact that is necessary so that the statements included therein, in light of the circumstances under which such statements were included, are not misleading with reference to the period covered by the Report.

3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity and cash flows of the Bank for the dates and periods covered by the Report.

4. I and the Bank's other certifying officers are responsible for establishing and maintaining controls and procedures with regard to the Bank's disclosure and internal control of financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"), and also:

   (a) We have established such controls and procedures, or caused such controls and procedures to be determined under our supervision, so as to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and in those corporations, particularly during the period of preparation of the Report;

   (b) We have established such internal control over financial reporting, or caused such internal control to be established under our supervision, so as to provide a reasonable level of confidence regarding the reliability of financial reporting and that the financial statements for external purposes are prepared in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions;

   (c) We have evaluated the effectiveness of the Bank's disclosure controls and procedures and presented our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report, based on our evaluation; and

   (d) We have disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during the fourth quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting.

5. I and the Bank's other certifying officers have disclosed to the Joint Auditors, the Board of Directors and the Audit Committee of the Board of Directors of the Bank, based on our most recent evaluation of internal control over financial reporting:

   (a) All significant deficiencies and material weaknesses in the establishment or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether material or immaterial, in which Management was involved or in which other employees were involved who have a significant role in the Bank's internal control over financial reporting.

The above does not derogate from my responsibility or the responsibility of any other person, pursuant to any law.

28 March 2012

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Galia Maor
President and Chief Executive Officer

Certification

I, Menachem Schwartz, certify that:

1. I have reviewed the Annual Report of Bank Leumi le-Israel B.M. (the "Bank") for the year 2011 (the "Report").

2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact that is necessary so that the statements included therein, in light of the circumstances under which such statements were included, are not misleading with reference to the period covered by the Report.

3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity and cash flows of the Bank for the dates and periods covered by the Report.

4. I and the Bank's other certifying officers are responsible for establishing and maintaining controls and procedures with regard to the Bank's disclosure and internal control of financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"), and also:

   (a) We have established such controls and procedures, or caused such controls and procedures to be determined under our supervision, so as to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and in those corporations, particularly during the period of preparation of the Report;

   (b) We have established such internal control over financial reporting, or caused such internal control to be established under our supervision, so as to provide a reasonable level of confidence regarding the reliability of financial reporting and that the financial statements for external purposes are prepared in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions;

   (c) We have evaluated the effectiveness of the Bank's disclosure controls and procedures and presented our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report, based on our evaluation; and

   (d) We have disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during the fourth quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting.

5. I and the Bank's other certifying officers have disclosed to the Joint Auditors, the Board of Directors and the Audit Committee of the Board of Directors of the Bank, based on our most recent evaluation of internal control over financial reporting:

   (a) All significant deficiencies and material weaknesses in the establishment or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether material or immaterial, in which Management was involved or in which other employees were involved who have a significant role in the Bank's internal control over financial reporting.

The above does not derogate from my responsibility or the responsibility of any other person, pursuant to any law.

28 March 2012

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Menachem Schwartz
First Executive Vice President,
Chief Accounting Officer,
Head of Accounting Division

Report of the Board of Directors and Management on Internal Control over Financial Reporting

The Board of Directors and Management of Bank Leumi le-Israel B.M. (henceforth: "the Bank"), are responsible for establishing and maintaining appropriate internal control over financial reporting (as defined in the Public Reporting Directives concerning "The Directors' Report"). The internal control system of the Bank has been designed to provide a reasonable level of confidence to the Board of Directors and Management of the Bank concerning the preparation and appropriate presentation of financial statements published in accordance with accepted accounting principles and the directives of the Supervisor of Banks and his instructions. Irrespective of the quality level of their design, all internal control systems have inherent limitations. Therefore even if it is determined that they are effective, they can only provide a reasonable level of confidence with reference to the preparing and presentation of a financial statement.

The Management, under the supervision of the Board of Directors, maintains a comprehensive internal control system designed to ensure that transactions are executed in accordance with the authorizations of Management, that assets are protected, and that accounting entries are reliable. Furthermore, Management, under the supervision of the Board of Directors, takes steps to ensure that channels of information and communication are effective and monitor performance, including performance of internal control procedures.

The Management of the Bank, under the supervision of the Board of Directors, has evaluated the effectiveness of internal control of the Bank over financial reporting as at 31 December 2011, based on the criteria determined in the internal control model of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, the Management believes that as at 31 December 2011, the Bank's internal control over financial reporting is effective.

The effectiveness of the Bank's internal control over financial reporting as at 31 December 2011 was audited by the Bank's Auditors, Kost Forer Gabbay & Kasierer and Somekh Chaikin, as stated in their Report on page 332, which includes an opinion regarding the effectiveness of the Bank's internal control over financial reporting as at 31 December 2011.

28 March 2012

David Brodet
Chairman of the Board of Directors

Galia Maor
President and Chief Executive Officer

Menachem Schwartz
First Executive Vice President,
Chief Accounting Officer,
Head of Accounting Division

Report of the Joint Auditors to the Shareholders of Bank Leumi le-Israel B.M. in accordance with Public Reporting Directives of the Supervisor of Banks regarding Internal Control over Financial Reporting

We have audited the internal control of Bank Leumi le-Israel B.M. and subsidiaries (hereinafter together: "the Bank") over financial reporting as of 31 December 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Bank's Board of Directors and of its Management are responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of the Board of Directors and Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Bank's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB) in the United States regarding the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A bank's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and with the directives and guidelines of the Supervisor of Banks. A bank's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and transfers of the assets of the company (including dispositions); (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in Israel (Israeli GAAP), and the directives and guidelines of the Supervisor of Banks, and that receipt and payment of funds of the Bank are being made only in accordance with authorizations of the Management and Board of Directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Bank maintained, in all material respects, effective internal control over financial reporting as of 31 December 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with generally accepted auditing standards in Israel, and certain auditing standards, of which implementation in audit of banking institutions was required in directives and guidelines of the Supervisor of Banks, the consolidated balance sheets of the Bank and its subsidiaries as at 31 December 2011 and 2010, and for each of the three years the last of which ended 31 December 2011, and our report of 28 March 2012 included an unqualified opinion on those financial statements, as well as drawing attention to that stated in Notes 18.G paragraphs 2 and 4, 18.L, 18.M, and 18.N.

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Somekh Chaikin
Certified Public Accountants (Isr.)

Joint Auditors

28 March 2012

Report of the Joint Auditors to the Shareholders of Bank Leumi le-Israel B.M.
Annual Financial Statements

We have audited the accompanying consolidated balance sheets of Bank Leumi le-Israel B.M. ("the Bank") and its subsidiaries ("the Group") as at 31 December 2011 and 2010, and the related consolidated statements of profit and loss, statements of changes in shareholders' equity and the consolidated statements of cash flows for each of the three years, the last of which ended 31 December 2011. These financial statements are the responsibility of the Bank's Board of Directors and of its Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of the consolidated subsidiaries, whose assets constitute approximately 1.4% and 2% of the total consolidated assets as at 31 December 2011 and 2010, respectively, and whose net interest income before expenses for credit losses included in the consolidated statements of profit and loss constitutes about 0.1%, 3% and 2% of the total consolidated interest income before expenses for credit losses for the years ended 31 December 2011, 2010, and 2009, respectively. The financial statements of those subsidiaries were audited by other auditors whose reports thereon have been furnished to us and our opinion, insofar as it relates to amounts included in respect of these companies, is based on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards in Israel, including standards prescribed by the Auditors (Manner of Auditor's Performance) Regulations, 1973 and certain auditing standards implementation of which in audit of banking institutions was required in directives and guidelines of the Supervisor of Banks. Such standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board of Directors and by Management of the Bank, as well as evaluating the appropriateness of the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Bank and its consolidated companies as at 31 December 2011 and 2010, and the results of operations, changes in shareholders' equity and cash flows of the Group for each of the three years the last of which ended 31 December 2011, in conformity with generally accepted accounting principles (Israeli GAAP). Furthermore, the above financial statements have, in our opinion, been prepared in accordance with the directives and guidelines of the Supervisor of Banks.

Without qualifying our above opinion, we draw attention to:

1. that stated in Note 18.G paragraphs 2 and 4, regarding claims against the Bank and against consolidated companies, including applications for their approval as class actions.
2. that stated in Note 18.L regarding matters concerning a company included on equity basis and its investee companies which include claims dependent on the receipt of services from infrastructure companies and natural gas suppliers, and contacts conducted after the date of the report between a consolidated company and its creditors for the receipt of letters of waiver regarding compliance with standards and/or changes in the financial ratios set out in them.
3. that stated in Note 18.M regarding a determination by the Antitrust Commissioner, and that stated in Note 18.N regarding investigations carried out against the Group in connection with its activity with US customers.

The Bank is unable to estimate the implications of the above-mentioned matters on the Bank, if any, on its financial position and operating results, and whether or not they will be material.

We have also audited, in accordance with the standards of the PCAOB (Public Company Accounting Oversight Board) in the United States regarding the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel, internal control over financial reporting of the Bank as of 31 December 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report of 28 March, 2012 included an unqualified opinion on the effectiveness of internal control on financial reporting by the Bank.

Somekh Chaikin
Certified Public Accountants (Isr.)

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

Joint Auditors

28 March 2012

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Balance Sheet as at 31 December 2011
Reported Amounts

	Note	31 December 2011	31 December 2010
		(NIS millions)	
Assets			
Cash and deposits with banks	2, 14	53,044	30,052
Securities	3, 14	47,936	55,791
Securities borrowed or purchased under agreements to resell		1,225	1,190
Credit to the public (a)	4	245,287	234,255
Allowance for credit losses (a)	4	(3,967)	(10,274)
Credit to the public, net		241,320	223,981
Credit to governments	5	448	379
Investments in companies included on equity basis	6	2,270	1,924
Buildings and equipment	7	3,653	3,638
Intangible assets and goodwill (a)	6 (e)	181	45
Assets in respect of derivative instruments (a)	18	11,573	8,717
Other assets (a) (b)	8	4,204	2,605
Total assets		365,854	328,322
Liabilities and equity capital			
Deposits of the public	9	279,404	249,584
Deposits from banks	10	5,056	2,691
Deposits from governments		519	660
Securities lent or sold under agreements to repurchase		442	1,006
Debentures, bonds and subordinated notes	11	29,999	26,939
Liabilities in respect of derivative instruments (a)	18	12,069	9,985
Other liabilities (a) (b)	12	14,737	13,846
Total liabilities		342,226	304,711
Non-controlling interests		254	318
Equity attributable to shareholders of the banking corporation (b)		23,374	23,293
Total equity	13	23,628	23,611
Total liabilities and equity capital		365,854	328,322

(a) Comparative figures have been reclassified in order to comply with the method of presentation in the current period. Comparative figures in respect of credit to the public and the allowance for credit losses have not been restated pursuant to implementation of the new directives, and are not comparable with current data.
(b) Restated – see Note 1.S.2 below.

The accompanying notes are an integral part of these condensed financial statements.
For the condensed financial statements of the Bank only – see Note 30.

David Brodet Chairman of the Board of Directors	**Prof. Efraim Sadka** Director	**Reuven Adler** Director	**Galia Maor** President and Chief Executive Officer	**Menachem Schwartz** First Executive Vice President, Chief Accounting Officer, Head of Accounting Division

Date of approval of the financial statements: 28 March 2012

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Profit and Loss
for the year ended 31 December 2011
Reported Amounts

	Note	2011	2010	2009
		(NIS millions)		
Net interest income before expenses in respect of credit losses	20	7,550	7,433	7,023
Expenses in respect of credit losses	4	734	584	1,517
Net interest income after expenses in respect of credit losses		6,816	6,849	5,506
Operating and other income				
Operating commissions (a)	21	3,702	3,739	3,540
Profits (losses) from investments in shares, net	22	(12)	216	707
Other income (a)	23	46	156	316
Total operating and other income		3,736	4,111	4,563
Operating and other expenses				
Salaries and related expenses (b)	24	5,067	4,676	3,896
Building and equipment maintenance and depreciation		1,704	1,591	1,514
Amortization of intangible assets and goodwill (a)		2	80	21
Other expenses (a)	25	1,574	1,604	1,350
Total operating and other expenses		8,347	7,951	6,781
Operating profit before taxes		2,205	3,009	3,288
Provision for taxes on operating profit (b)	26	418	1,239	1,272
Operating profit after taxes		1,787	1,770	2,016
Group's equity in after-tax operating profits of companies included on equity basis, net of related tax effect		148	420	81
Net operating profit				
Before attribution to non-controlling interests	6	1,935	2,190	2,097
Attributable to non-controlling interests		(46)	(39)	(36)
Attibutable to shareholders of the banking corporation	27	1,889	2,151	2,061
Net profit from extraordinary activities after taxes before attribution to non-controlling interests		2	183	28
Net profit for the period				
Before attribution to non-controlling interests		1,937	2,373	2,125
Attributable to non-controlling interests		(46)	(39)	(36)
Attibutable to shareholders of the banking corporation		1,891	2,334	2,089
Earnings per share				
Basic and diluted earnings per share:		(NIS)		
Net operating profit after taxes attributable to shareholders of the banking corporation (b)		1.28	1.46	1.40
Profit from extraordinary activities after taxes attributable to shareholders of the banking corporation		-	0.12	0.02
Net profit		1.28	1.58	1.42
Weighted average of the number of shares for calculation of basic and diluted earnings		1,473,551	1,473,551	1,473,551

(a) Reclassified.
(b) Restated – see Note 1.S.2 below.
The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only – see Note 30.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Statement of Changes in Shareholders' Equity for the year ended 31 December 2011
Reported Amounts

	Capital reserves				Total other overall profit (loss)							
	Share capital	Premium	Capital reserves in respect of share-based payment transactions and others (a)	Total share capital and capital reserves	Adjustments in respect of presentation of securities available for sale at fair value	Translation adjustments (b)	Capital reserves in respect of companies included on equity basis	Retained earnings	Loans to employees for purchase of the Bank's shares	Total	Non-controlling interests	Total shareholder's equity
	(NIS millions)											
Balance as at 1 January 2009 (d)	7,059	855	284	8,198	(648)	(502)	-	11,593	(374)	18,267	245	18,512
Net profit for the accounting year (d)	-	-	-	-	-	-	-	2,089	-	2,089	36	2,125
Expiry of options	-	117	(117)	-	-	-	-	-	-	-	-	-
Employee benefit - tax effect	-	-	30	30	-	-	-	-	-	30	-	30
Other overall profit in companies included on equity basis charged directly to reserves	-	-	-	-	-	-	-	164	-	164	-	164
Adjustments in respect of presentation of available-for-sale securities at fair value	-	-	-	-	2,357	-	-	-	-	2,357	1	2,358
Losses in respect of securities available for sale that were realized and/or charged to profit and loss (e)	-	-	-	-	(876)	-	-	-	-	(876)	-	(876)
Related tax effect	-	-	-	-	(524)	-	-	-	-	(524)	-	(524)
Adjustments arising from translation of financial statements of companies included on equity basis	-	-	-	-	-	28	-	-	-	28	-	28
Loans to employees for purchase of the Bank's shares	-	-	-	-	-	-	-	-	(3)	(3)	-	(3)
Balance as at 31 December 2009 (d)	7,059	972	197	8,228	309	(474)	-	13,846 (f)	(377)	21,532	282	21,814
Net profit for the accounting year (d)	-	-	-	-	-	-	-	2,334	-	2,334	39	2,373
Expiry of options	-	157	(157)	-	-	-	-	-	-	-	-	-
Benefit to employees - tax effect	-	-	(30)	(30)	-	-	-	-	-	(30)	-	(30)
Dividend paid	-	-	-	-	-	-	-	(500)	-	(500)	-	(500)
Dividend proposed	-	-	-	-	-	-	-	(500)	-	(500)	-	(500)
Adjustments in respect of companies included on equity basis, net	-	-	-	-	-	14	25	(117)	-	(78)	-	(78)
Adjustments in respect of presentation of available-for-sale securities at fair value	-	-	-	-	538	-	-	-	-	538	-	538
Profits in respect of available-for-sale securities that were realized and/or charged to profit and loss (e)	-	-	-	-	(303)	-	-	-	-	(303)	-	(303)
Related tax effect	-	-	-	-	(76)	-	-	-	-	(76)	-	(76)
Loans to employees for purchase of the Bank's shares	-	-	-	-	-	-	-	-	376	376	-	376
Changes in non-controlling interests	-	-	-	-	-	-	-	-	-	-	(3)	(3)
Balance as at 31 December 2010 (d)	7,059	1,129	10	8,198	468	(460)	25	15,063 (f)	(1)	23,293	318	23,611
Adjustment of opening balances in respect of impaired debts - IFRS (b) (c)	**-**	**-**	**-**	**-**	**-**	**381**	**-**	**(1,090)**	**-**	**(709)**	**(14)**	**(723)**
Net profit for the year	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**1,891**	**-**	**1,891**	**46**	**1,937**
Dividend paid	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(400)**	**-**	**(400)**	**(15)**	**(415)**
Employee benefit from share-based payment transactions	**-**	**-**	**13**	**13**	**-**	**-**	**-**	**-**	**-**	**13**	**-**	**13**
Adjustments in respect of companies included on equity basis, net	**-**	**-**	**-**	**-**	**-**	**58**	**15**	**(11)**	**-**	**62**	**-**	**62**
Adjustments in respect of presentation of securities available for sale at fair value	**-**	**-**	**-**	**-**	**(982)**	**-**	**-**	**-**	**-**	**(982)**	**(2)**	**(984)**
Profits in respect of available-for-sale securities that were realized and/or charged to profit and loss (e)	**-**	**-**	**-**	**-**	**(39)**	**-**	**-**	**-**	**-**	**(39)**	**-**	**(39)**
Related tax effect	**-**	**-**	**-**	**-**	**335**	**-**	**-**	**-**	**-**	**335**	**1**	**336**
Adjustments arising from translation of financial statements of companies included on equity basis	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(47)**	**-**	**(47)**	**(80)**	**(127)**
Loans to employees for purchase of the Bank's shares	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(43)**	**(43)**	**-**	**(43)**
Balance as at 31 December 2011	**7,059**	**1,129**	**23**	**8,211**	**(218)**	**(21)**	**40**	**15,406 (f)**	**(44)**	**23,374**	**254**	**23,628**

See notes on next page.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Statement of Changes in Shareholders' Equity
for the year ended 31 December 2011 (cont'd)
Reported Amounts

Notes:

(a) Including NIS 10 million other capital reserves.

(b) Adjustments from translation of financial statements of investee companies overseas whose functional currency differs from the functional currency of the Bank (see Note 1.F.3 and F.2. In 2011, translation differences amounting to NIS 381 million were transferred to accumulated retained earnings following the change to reporting under IAS 21.

(c) Including NIS 721 million in respect of the change to implementation of the Impaired Debts Directives (NIS 1,319 million gross).

(d) Restated – see Note 1.S.2.

(e) Including .provision for impairment.

(f) Including NIS 763 million not available for allocation as dividend (31 December 2010 – NIS 543 million, 31 December 2009 – NIS 1,059 million). The balance of the amount for distribution is subject to Bank of Israel directives and limitations detailed in Proper Conduct of Banking Business Regulations.

The accompanying notes are an integral part of the consolidated financial statements.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows
for the year ended 31 December 2011
Reported Amounts

	2011	2010	2009
	(NIS millions)		
Cash flows from operating activities:			
Net profit for the year (b)	**1,937**	2,373	2,125
Adjustments required to cash flows generated by operating activities:			
Group share in undistributed profits of companies included on equity basis (a)	**(72)**	(348)	(79)
Benefit in respect of share-based payment transactions	**13**	-	-
Depreciation of buildings and equipment	**711**	638	612
Amortization	**2**	80	21
Expenses in respect of credit losses	**734**	584	1,517
Provision for impairment of assets transferred to Group ownership	**11**	14	-
Net gain on sale of securities available for sale	**(334)**	(310)	(1,085)
Realized and unrealized loss from adjustment to fair value of securities held for trading	**(218)**	(148)	(240)
Gain on receipt of shares without payment	**-**	(2)	(1)
Net loss (gain) on realization of investments in companies included on equity basis after tax	**4**	(181)	-
Net losses (gains), after tax, on sale of buildings and equipment	**2**	(2)	(28)
Provision for impairment of debentures available for sale	**24**	6	200
Provision for impairment of shares available for sale	**271**	1	9
Decrease in provision for impairment in fixed assets	**(4)**	-	-
Deferred taxes, net (b)	**(308)**	(68)	247
Increase (decrease) in excess of provisions for severance pay and pensions over amounts funded (b)	**620**	234	(464)
Other, net	**8**	3	(6)
Net cash from operating activities	**3,401**	2,874	2,828

(a) After deducting dividend received.
(b) Restated – see Note 1.S.2.
The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only, see Note 30.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows (cont'd)
for the year ended 31 December 2011
Reported Amounts

	2011	2010	2009
	(NIS millions)		
Cash flows from activities in assets:			
Net decrease (increase) in deposits with banks for an initial period exceeding three months	**(1,956)**	1,330	(562)
Acquisition of debentures held to maturity	**-**	(77)	(68)
Proceeds from redemption of debentures held to maturity	**-**	226	725
Acquisition of securities available for sale	**(27,167)**	(30,511)	(36,231)
Proceeds from sale of securities available for sale	**28,907**	16,038	14,880
Proceeds from redemption of securities available for sale	**6,782**	14,668	9,102
Net decrease (increase) in securities held for trading	**(849)**	1,355	1,213
Net decrease (increase) in credit to the public	**(19,226)**	(19,242)	7,212
Net decrease (increase) in credit to governments	**(69)**	28	113
Additional investment in shares of consoldiated companies	**(115)**	-	-
Acquisition of subsidiary consolidated for the first time (Appendix A)	**1,848**	-	-
Acquisition of shares in companies included on equity basis	**(110)**	(14)	(39)
Proceeds from sale of investment in companies included on equity basis	**50**	765	-
Acquisition of buildings and equipment	**(755)**	(719)	(759)
Net increase in securities borrowed or purchased under agreements to resell	**(35)**	(446)	(543)
Proceeds from sale of buildings, after deduction of related tax	**6**	24	42
Proceeds from realization of assets transferred to Group ownership	**7**	8	43
Repayment of shareholders' loan to a company included on equity basis	**2**	2	-
Net decrease (increase) in assets in respect of derivative instruments (a)	**(2,848)**	(2,239)	3,648
Net (increase) decrease in other assets (a)	**(481)**	813	(260)
Net cash used for activities in assets	**(16,009)**	(17,991)	(1,484)
Cash flows generated by activities in liabilities and capital			
Net increase (decrease) in:			
Deposits of the public	**27,055**	(834)	5,635
Deposits from banks	**2,602**	(1,094)	43
Deposits from governments	**(141)**	(52)	(119)
Issue of debentures, bonds and subordinated notes	**3,386**	4,075	4,806
Redemption of debentures, bonds and subordinated notes	**(928)**	(2,834)	(865)
Dividend paid to minority shareholders in consolidated companies	**(15)**	(3)	-
Net increase in other liabilities	**1,272**	1,252	1,613
Net increase (decrease) in securities loaned or sold under agreements to repurchase	**(564)**	733	(276)
Net increase (decrease) in liabilities in respect of derivative instruments (a)	**1,923**	2,440	(2,932)
Dividend paid to shareholders	**(900)**	(500)	-
Repayment of loans to employees for purchase of the Bank's shares	**-**	376	1
Loans to employees for purchase of the Bank's shares	**(43)**	-	-
Net cash from activities in liabilities and capital	**33,647**	3,559	7,906
Increase (decrease) in cash	**21,039**	(11,558)	9,250
Balance of cash at beginning of year	**28,697**	40,255	31,005
Balance of cash at end of year	**49,736**	28,697	40,255

(a) Comparative figures have been reclassified in order to adapt to the current method of presentation.
(b) Restated – see Note 1.S.2 below.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only, see Note 30.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Consolidated Statement of Cash Flows (cont'd)
for the year ended 31 December 2011
Reported Amounts

Appendix A - Net cash flow from acquisition of a subsidiary consolidated for the first time:

	2011
	(NIS million)
Working capital (excluding cash and cash equivalents, net)	1,990
Non-monetary assets	(4)
Intangible assets and goodwill	(138)
Net cashflow from acquisition of a subsidiary consolidated for the first time	1,848

Appendix B - Transactions not involving cash:

In 2011:

(1) During the year, securities were transferred from credit to the public to the available for sale portfolio, in the amount of NIS 562 million, due to the completion of lending of securities.
(2) During the year, assets were transferred from credit to the public to other assets, in the amount of NIS 6 million, in respect of loans that were repaid

In 2010:

(1) Proposed dividend of NIS 500 million (paid on 27 January 2011).
(2) During the year, shares were transferred from the available for sale portfolio to credit to the public, in the amount of NIS 651 million, due to lending of securities.
(3) During the year, assets were transferred from credit to the public to other assets, in the amount of NIS 16 million, in respect of loans that were repaid.
(4) During the year, fixed assets were acquired against liabilities to suppliers, in the amount of NIS 26 million.

In 2009:

(1) During the year, shares were transferred from the available for sale portfolio to credit to the public, in the amount of NIS 359 million, due to lending of securities.
(2) During the year, assets were transferred from credit to the public to other assets, in the amount of NIS 65 million, in respect of loans that were repaid.

The accompanying notes are an integral part of the consolidated financial statements.
For condensed financial statements of the Bank only, see Note 30.

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Note 1 – Significant Accounting Policies

A. General

The financial statements have been prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and the directives and guidelines of the Supervisor of Banks relating to the preparation of annual financial statements of a banking corporation.

Publication of the financial statements is on the basis of the consolidated statements only. Condensed financial statements of the Bank on a single-entity basis appear in Note 30.

The financial statements were approved for publication by the Board of Directors of the Bank on 28 March 2012.

B. Definitions

In these financial statements -

Consolidated companies - companies of which the financial statements are fully consolidated, directly or indirectly, in the statements of the Bank.

Companies included on equity basis - companies, other than consolidated companies, and companies consolidated under proportional consolidation including a partnership or joint enterprise, in which the Bank's investment is included, directly or indirectly, in the financial statements on equity basis.

Investee companies - consolidated companies, companies consolidated under proportional consolidation, or companies included on equity basis.

Overseas units - representative offices, agencies, branches or consolidated companies of the Bank outside Israel

Functional currency - the currency of the main economic environment in which the Bank generally operates. This is the currency of the environment where the corporation produces and spends most of its cash funds.

Reporting currency - the currency in which the financial statements are reported.

Related parties - as defined in Opinion No. 29 of the Institute of Certified Public Accountants in Israel, except for interested parties.

Interested parties - as defined in paragraph 1 of the definition "Interested Party, in a Corporation" in Paragraph 1 of the Securities Law, 1968.

Index - the Consumer Price Index in Israel published by the Central Bureau of Statistics.

Adjusted amount - historical nominal amount adjusted to the December 2003 CPI, in accordance with the provisions of Opinions 23 and 36 of the Institute of Certified Public Accountants in Israel.

Reported amount - amount adjusted to the transition date (31 December 2003) with the addition of amounts in nominal values that were added after the transition date and less amounts that were eliminated after the transition date.

Nominal financial reporting - financial reporting based on reported amounts.

Note 1 – Significant Accounting Policies (cont'd)

Adjusted financial reporting - financial reporting in values adjusted according to the changes in the general purchasing power of the Israeli currency in accordance with the provisions of the opinions of the Institute of Certified Public Accountants in Israel.

Fair value is defined as the amount/price that would be received from the sale of an asset or that would be paid to transfer a liability in a transaction between a willing seller and a willing buyer at the measurement date.

Recorded debt balance – the recorded debt balance is defined as the outstanding debt after deducting accounting write-offs, but before deducting an allowance for credit losses in respect of that debt.

C. Basis for preparation of the financial statements

(1) Reporting principles

The financial statements of the Bank have been prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and the directives and guidelines of the Supervisor of Banks. In preparing the financial statements, the Bank implements, *inter alia*, certain International Financial Reporting Standards (IFRS) and accounting principles generally accepted by US banks, in the manner explained below:

- On subjects that are a core part of the banking business – the accounting treatment is in accordance with the Public Reporting Directives and instructions of the Supervisor of Banks and in accordance with accounting principles generally accepted by US banks that were adopted within the framework of the Public Reporting Directives of the Supervisor of Banks.

- On subjects that are not a core part of the banking business – the accounting treatment is in accordance with accounting principles generally accepted in Israel and in accordance with certain International Financial Reporting Standards (IFRS), as set out in the directives and instructions of the Supervisor of Banks. International standards are implemented in accordance with the principles detailed below:

  1.1 In cases where a material issue arises that is not addressed in the international standards or the Supervisor's instructions for implementation, the Group treats the issue in accordance with accounting principles generally accepted by US banks that apply specifically to these issues;

  1.2 In cases where there is no specific reference in the standards or interpretations to material issues, or there are a number of alternatives for the treatment of a material issue, the group acts according to specific implementation instructions decided on by the Supervisor;

  1.3 In those places where an international standard that has been adopted contains a reference to another international standard adopted in the Public Reporting Directives, the Group acts in accordance with the provisions of the International Standard;

  1.4 In those places where an international standard that has been adopted contains a reference to another international standard not adopted in the Public Reporting Directives, the Group acts in accordance with the Reporting Directives and with accounting principles generally accepted in Israel;

  1.5 In those places where an international standard that has been adopted contains a reference to a definition of a term defined in the Public Reporting Directives, the reference to the definition in the Directives shall replace the original reference.

For details of the international accounting standards implemented for the first time, see paragraph D below.

(2) Functional currency and reporting currency

The shekel is the currency representing the principal economic environment in which the Bank operates.

The financial statements are reported in new shekels rounded to the nearest million, unless stated otherwise.

(3) Financial statements in reported amounts

3.1 General

The financial statements are shown in reported amounts in accordance with the accounting standards of the Israeli Accounting Standards Board and the directives of the Supervisor of Banks.

Amounts of non-monetary assets do not necessarily show realizable value or current economic value, but only the amounts reported for those assets.

In the financial statements "cost" means cost in a reported amount.

3.2 Balance Sheet

- Non-monetary items (mainly buildings and equipment; investments in non-quoted shares; amortizable expenses relating to issuance of debentures, bonds and subordinated notes) and share capital are shown in reported amounts.

- Monetary items are shown in the balance sheet at historical nominal values as at the balance sheet date.

- The equity value of investments in companies included on equity basis is determined based on the financial statements of these companies in reported amounts or translated to new Israeli shekels.

3.3 Profit and Loss Statement

- Income and expenses that arise from non-monetary items (for example, depreciation and amortization and prepaid income and expenses) or from provisions included in the balance sheet are derived from the difference between the reported amount of the opening balance and the reported amount of the closing balance.

- The Bank’s share in the operating results of investee companies and the minority interest in the results of consolidated companies is determined based on the financial statements in reported amounts of these companies.

- Other components of the profit and loss statement are shown at their nominal values (for example, net interest income, operating commissions).

3.4 Statement of changes in shareholders' equity

Dividend declared or paid in the year of the report is stated in nominal values.

Note 1 – Significant Accounting Policies (cont'd)

(4) Use of estimates

When preparing the financial statements, in accordance with generally accepted accounting principles in Israel and directives and guidelines of the Supervisor of Banks, management is required to use estimates, evaluations and their discretion affecting the reported amounts of assets and liabilities, the disclosure relating to contingent assets and liabilities and amounts of income and expenses during the reporting period. It should be made clear that actual results may differ from such estimates.

When formulating accounting estimates used in preparing the Bank's financial statements, Bank management has to make assumptions concerning circumstances and events which involve significant uncertainty. In its consideration of the estimates, Bank management bases itself on past experience, various facts, external factors, and on reasonable assumptions in accordance with circumstances appropriate to each estimate.

The estimates and the assumptions on which they are based are reviewed on a routine basis. Changes in accounting estimates are recognized in the period in which the estimates were amended and for each period affected in the future.

For changes in the estimate of leaving rates of employees with increased severance pay pursuant to the instructions of the Supervisor of Banks, see paragraph S.2 below.

D. First-time Implementation of Accounting Standards, Updates to Accounting Standards, and Directives of the Banking Supervision Department

As of reporting periods commencing 1 January 2011, the Bank implements the accounting standards and directives set out below:

- Directives of the Banking Supervision Department on the subject of measurement and disclosure of impaired debts, credit risk and allowance for credit losses, and an amendment to directives on the treatment of problem debts, including Accounting Standards Update ASU 2011-02 – "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring".

- Certain International Financial Reporting Standards (IFRS) and the interpretations of the IFRIC Interpretations Committee relating to the implementation of these standards as set out in the directives of the Supervisor of Banks.

Reporting Standard	Subject
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 33	Earnings per Share
IFRS 2	Share-based Payment
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 34	Interim Financial Reporting
IFRS 3 (2008)	Business Combinations
IAS 27 (2008)	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 36	Impairment of Assets
IAS 17	Leases
IAS 16	Fixed Assets
IAS 40	Investment Property
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IAS 10	Events after the Reporting Period
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance

Note 1 – Significant Accounting Policies (cont'd)

IAS 31	Interests in Joint Ventures
IAS 38	Intangible Assets

- US Financial Accounting Standard FAS 157 (ASC 820-10) - "Fair Value Measurements", and US Financial Accounting Standard FAS 159 (ASC 825-10) - "Fair Value Alternative for Financial Assets and Financial Liabilities".

- Directives of the Banking Supervision Department on strengthening the internal control over financial reporting of employee rights.

For further details regarding the changes made in accounting policy, see paragraphs F-H and K below.

E. Foreign currency and linkage

(1) Assets (other than investments in investee companies, buildings and equipment) and liabilities are stated in the balance sheet as follows:

- Those in foreign currency or linked thereto are stated according to the representative rates of exchange published by Bank of Israel as at balance sheet date, or other appropriate date, in accordance with the terms of the transactions.

  Exchange rate differences deriving from the adjustment of assets and liabilities denominated in foreign currency are included in the statement of profit and loss.

- Exchange rate differences from shares in the available for sale portfolio are charged directly to capital reserve.

- Those fully linked to the CPI are stated on the basis of either the latest index published prior to balance sheet date or some other appropriate index, in accordance with the terms of the transactions.

(2) Non-monetary assets and liabilities in foreign currency measured at fair value are translated into the functional currency at the exchange rate in effect on the date on which the fair value is determined.
Non-monetary items denominated in foreign currency and measured at historical cost are translated according to the exchange rate prevailing on the date of the transaction.

(3) Income and expenses in foreign currency are included in the statement of profit and loss according to current representative exchange rates as at the transaction dates and with the addition of exchange rate differences on the assets and liabilities in respect of which the above income and expenses arose.

Note 1 – Significant Accounting Policies (cont'd)

(4) Data on representative exchange rates and CPI and the percentage of change therein:

	31 December			Rate of change in		
	2011	2010	2009	**2011**	2010	2009
	NIS			%		
Exchange rate of:						
U.S. dollar	**3.821**	3.549	3.775	**7.7**	(6.0)	(0.7)
Euro	**4.938**	4.738	5.442	**4.2**	(12.9)	2.7
Pound Sterling	**5.892**	5.493	6.111	**7.3**	(10.1)	10.2
Swiss franc	**4.062**	3.788	3.667	**7.2**	3.3	2.9
Currency basket	**4.407**	4.111	4.433	**7.2**	(7.3)	1.1
Consumer Price Index:	(Points)					
November – known index	**104.0**	101.4	99.2	**2.6**	2.3	3.8
December – index for the month	**104.0**	101.8	99.2	**2.2**	2.7	3.9
Devaluation (reevaluation) in real terms of NIS in relation to:						
Exchange rate of the dollar				**5.4**	(8.4)	(4.4)
Exchange rate of the currency basket				**4.9**	(9.7)	(2.7)

F. Translation of financial statements of foreign subsidiaries and branches

(1) Pursuant to the directives of the Supervisor of Banks, all foreign subsidiaries of the Bank are considered as a foreign activity whose functional currency is identical to the functional currency of the Bank.

(2) The financial statements of foreign subsidiaries and branch offices are translated into Israeli currency as follows:
Non-monetary items are translated at historical exchange rates and are adjusted to the changes in the general purchasing power of the shekel from their date of purchase until 31 December 2003. Monetary items are translated at the exchange rates in effect as at balance sheet date. Financial statement translation differences are included in the statement of profit and loss.

Items in the statement of profit and loss are translated at the exchange rates in effect at the end of each quarter.

(3) Up until 31 December 1994 certain foreign subsidiaries were considered as autonomous entities. The differences between the value of the investment in the above companies, adjusted according to the changes in the general purchasing power of the Israeli currency, and the Bank's share in their equity according to their financial statements adjusted for changes in the purchasing power of the currency in which they were presented and after being translated according to the exchange rates as at balance sheet date, were transferred to "translation adjustments" within shareholders' equity. The translation adjustments will be transferred to the statement of profit and loss upon realization of the investments in those companies.

(4) IAS 21 – The Effects of Changes in Foreign Exchange Rates

Pursuant to the instructions of the Supervisor of Banks, prior to the adoption date of IAS 21, an overseas unit of a banking corporation was classified as a foreign operation whose functional currency is the same as the functional currency of the banking corporation. In accordance with IFRS, in order to determine the functional currency, the banking corporation has to consider, *inter alia*, the following factors:

Note 1 – Significant Accounting Policies (cont'd)

- The currency that mainly influences sale prices for goods and services (this will often be the currency in which sales prices for goods and services are denominated and settled), and the currency of the country whose competitive forces and regulations mainly determine the sale prices of its goods and services.

- The currency that mainly influences labor, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

- Additional factors that may provide evidence of an entity's functional currency, such as the currency in which funds from financing activities are generated, and the currency in which receipts from operating activities are usually retained.

- The relationship of the overseas unit with the banking corporation – whether the foreign operation has a significant degree of autonomy; whether transactions of the overseas unit with the banking corporation are a high or low proportion of the foreign operation's activities; whether cash flows of the foreign operation directly affect the cash flows of the banking corporation and are readily available for remittance to it; and whether cash flows from the foreign operation are sufficient to service existing and normally expected debt obligations of the entity, without funds being made available by the banking corporation.

Pursuant to the instructions of the Supervisor of Banks regarding the manner of initial implementation, the Standard has been applied to financial statements for periods commencing 1 January 2011. In light of this, a debit capital reserve of translation differences in the sum of NIS 381 million, which were accumulated until 1994 in respect of overseas banking entities, classified previously as autonomous entities, has been classified on the date of transition to retained earnings.

During February 2012, an instruction was published by the Supervisor that included criteria set out by the Banking Supervision Department for purposes of determining the functional currency of an overseas banking office which differs from the shekel. When determining the functional currency, the Bank is required to examine the existence or nonexistence of each of the criteria listed below, and document the results of the examination:

- The primary environment in which the office generates and expends cash is a foreign currency and the activity of the office in shekels is marginal.

- Recruiting customers by the office – the activity of the office vis-à-vis the bank's customers referred to the office by the Bank is not significant.

- The activity of the office vis-à-vis the Bank and/or related parties is not significant. Similarly, the office has no significant dependence on sources of funding from the Bank.

- The activity of the office is essentially independent and stands alone, and is not an extension or supplementary to the local activity of the Group. Similarly, the office performs its activities with a significant degree of autonomy.

When one of the said criteria is clearly not fulfilled (for example, the transactions of the office carried out with the Bank's customers are so significant that they represent most of the office's transactions), this indicates that the office is to be treated as a foreign operation whose functional currency is the shekel. In another situation, the determination is to be made according to an examination of a range of criteria.

The Bank has reexamined the classification of its overseas banking offices in accordance with the new criteria. In the light of this new examination, the Bank is of the opinion that, as of 1

January 2012, the banking overseas in the US and Switzerland will be reclassified as foreign operations whose functional currency is other than the shekel.

The change in classification will be dealt with as a change in the functional currency of the others, so that exchange rate differences from translation will be recognized from 1 January 2012 as total other income, and shown under "Adjustments for translation of foreign operations".

G. Fair Value Measurement

Effective 1 January 2011, the Bank implements the rules set out in FAS 157 (ASC 820-10) that defines fair value and establishes a consistent working framework for the measurement of fair value by defining fair value assessment techniques with regard to assets and liabilities, and by establishing a fair value hierarchy and detailed instructions for implementation.

Fair value is defined as the amount/price that would be received from the sale of an asset or that would be paid to transfer a liability in a transaction between a willing seller and a willing buyer at the measurement date. The Standard stipulates, *inter alia*, the need for fair value valuation, to make optimum use of observable inputs, and to minimize the use of unobservable inputs. Observable inputs provide information available to the market received from independent sources, whereas unobservable inputs reflect assumptions by the banking corporation.

FAS 157 stipulates a hierarchy of measurement techniques based on the determination if the inputs used for purposes of determining fair value are observable or unobservable. These types of input create a fair value hierarchy detailed as follows:

- Level 1 inputs: quoted prices (not adjusted) in active markets for identical assets or liabilities.

- Level 2 inputs: prices quoted for similar assets or liabilities in active markets; prices quoted for identical assets or liabilities in inactive markets; prices derived from evaluation methods in which all the significant inputs are observable in the market, or are supported by observable market data.

- Level 3 inputs: unobservable inputs for the asset or the liability deriving from evaluation model for which one or more of the significant inputs are not observable.

This hierarchy requires the use of observable market data, where such exist. When this is possible, the Bank considers relevant observable data in its evaluation, the scope and frequency of the transactions, the size of the bid-ask margin, and the size of adjustment required when comparing similar transactions, are all factors taken into account when determining the level of market liquidity and the degree of relevance of observable prices in those markets.

The level in the scale of fair value to which the fair value measurement of the financial instrument belongs is to be determined on the basis of the lowest level of the figure that is significant for the fair value measurement as a whole.

The implementation of the rules set out in FAS 157 allow for the recognition of day-one profits and do not require the fair value measurement of derivative instruments not traded on an active market be determined according to the transaction price.

The Standard requires the banking corporation to reflect credit risk and non-performance risk in the measurement of the fair value of debt, including derivative instruments, issued by the banking corporation and measured at fair value. Non-performance risk includes the credit risk of the banking corporation, but is not limited to this risk only.

Note 1 – Significant Accounting Policies (cont'd)

For further details regarding the methods and main assumptions used for purposes of assessing the fair value of financial instruments, see Note 18.D below, under the subject of balances and fair value measurements of financial instruments.

Methods of assessment implemented by the banking corporation for measuring fair value are to be evaluated taking into consideration the relevant circumstances for the various transactions, including prices of recent transactions in the market, indicative prices of assessment services, and the results of back-testing of similar types of transactions.

Pursuant to transitional directives for 2011, which were extended also for 2012, specific instructions were given concerning methodology data used in calculating the fair value of derivative instruments. A banking corporation is not required to use complex models that include various scenarios of potential exposure in order to contend with the credit risk component included in the fair value of derivative instruments. In accordance with the above transitional directives, and pursuant to the instructions of the Supervisor of Banks, the Bank carries out the aforesaid adjustment calculation on a Group basis, while making use of a credit quality model according to groups of similar counterparties, e.g. based on internal ratings.

The Fair Value Option for Financial Assets and Financial Liabilities
FAS 159 allows a banking corporation to elect, on defined dates, to measure financial instruments and certain other items (the eligible items) at fair value, which under the Public Reporting Directives are not required to be measured at fair value. Unrealized profits and losses in respect of changes in the fair value of the items for which the fair value alternative is selected, shall be reported in the statement of profit and loss for each consecutive reporting period. In addition, prepaid costs and fees related to the items for which the fair value alternative is selected, shall be recognized in profit and loss on the date of creation, rather than deferred. The election to apply the fair value alternative, as noted above, shall be made instrument by instrument, and cannot be cancelled. In addition, FAS 159 establishes presentation and disclosure requirements aimed at facilitating comparisons between banking corporations that choose different bases for measurement of similar types of assets and liabilities.

Notwithstanding the above, it is clarified by the Banking Supervision Department that a banking corporation shall not elect the fair value alternative unless it has developed prior know-how, systems, procedures, and controls at a high level, which will enable it to measure the item to a high degree of reliability. Thus, a banking corporation shall not elect the fair value alternative with regard to any asset requiring classification as level 2 or level 3 of the fair value hierarchy, or with regard to any liability, unless it receives prior approval to do so from the Banking Supervision Department.

There was no material effect from the implementation of the above standards as of 1 January 2011.

H. Principles of consolidation and implementation of equity method

(1) Principles of consolidation

Subsidiary companies are entities controlled by the Bank. Control exists when the Bank has the ability to determine the financial and operating policy of the entity in order to obtain benefit from its resources and activities. Control exists when the Bank holds, directly or indirectly, shares granting more than 50% of the voting rights in the subsidiary and the rights to appoint the majority of the members of its Board of Directors, unless there are reasons which clearly prevent the parent company from implementing actual control.

The consolidated financial statements include the audited financial statements of the Bank and of entities in which the Bank has control. The financial statements of subsidiary companies are included in the consolidated financial statements from the date control is obtained until the date control ceases. The accounting policy of subsidiary companies was amended as necessary in order to adapt it to the accounting policy adopted by the Bank, except in those cases when the Supervisor of Banks otherwise permitted.

Intercompany balances and transactions between consolidated companies are eliminated in the consolidated financial statements.

The financial statements of two wholly-owned real estate and service companies are consolidated in the financial statements of the Bank only.

Non-controlling interests are the part of the equity of subsidiary companies, directly or indirectly, which are not attributable to the parent company. These rights, which grant the holder part of the net assets of the acquiree, are measured for fair value on the date of acquisition.

Transactions with non-controlling interests, while maintaining control, are treated as equity transactions. Any difference between the proceeds paid or received in the change of non-controlling interests is charged to the owners' share of the Bank, directly to equity. The amount for which non-controlling interests are adjusted is calculated as follows: if the holding percentage increases, according to the relative part acquired from the balance of the non-controlling interests in the consolidated financial statements prior to the transaction. If the holding percentage decreases, it is calculated according to the relative part realized by the owners of the bank in net assets of the subsidiary company including goodwill. Furthermore, when there are changes in the holding percentage in a subsidiary company, while maintaining control, the Bank reapportions the aggregate amounts recognized under "Other Profit", between the shareholders and the non-controlling interests.

Business combinations

The Group applies the acquisition method with regard to all business combinations. The acquisition date is the date when the acquirer achieved control over the acquiree.

For acquisitions occurring after 1 January 2011, the Group recognizes goodwill at the acquisition date at the fair value of the proceeds paid, including amounts recognized in respect of any rights not conferring control over an acquiree, as well as the fair value at the acquisition date of equity rights in the acquiree that were held prior to then by the acquirer, after deducting the net amount attributable on acquisition to identifiable assets that were acquired and liabilities that were assumed.

The Bank recognizes a contingent liability assumed in a business combination at the date of acquisition if there is a current liability deriving from past events whose fair value can be measured in a reliable manner.

In the event the Group carries out an acquisition at an advantageous price (an acquisition that includes negative goodwill), it recognizes the profit generated as a result in the profit and loss statement at the acquisition date, after carrying out an additional examination of the amounts attributed to the assets and liabilities of the entity acquired.

The proceeds transferred includes the fair value of the assets transferred to the previous owners of the acquiree, liabilities assumed by the acquirer vis-à-vis the previous owners of the acquiree, and equity rights issued by the Group. In a business combination achieved in stages, the difference between the fair value at the date of acquisition of the equity rights in the acquiree held previously by the Group, and the book value at the same date, is charged to the statement of profit and loss under "Profit from extraordinary activities". Furthermore, the proceeds transferred include the fair value of the conditional proceeds. Subsequent to the date of acquisition, the Group recognizes changes in the fair value of the conditional proceeds classified as a financial liability in the statement of profit and loss.

Costs of a transaction resulting from a business combination transaction are charged immediately to profit and loss.

In every reporting period, the Bank reviews the need to record impairment in companies included on equity basis - see paragraph W below.

(2) Companies included on equity basis

Investments in shares of companies included on equity basis are stated according to the equity method based on the audited financial statements of these companies. Investments include goodwill calculated at the date of acquisition and shown after deducting accrued losses from impairment. The accounting policy of companies included on equity basis which is implemented by them is in accordance with generally accepted accounting principles in Israel or international accounting principles if the company included on equity basis is in a foreign country or is otherwise permitted by the Supervisor of Banks.

The financial statements of a company included on equity basis are prepared using an uniform accounting policy with the banking corporation with regard to similar transactions and events under similar circumstances; except for adjustments to accounting policy referring to subjects that are a core part of the banking business, that were implemented by a non-banking company included on equity basis. In addition, the financial statements of companies included on equity basis are prepared for the same dates and periods as those of the banking corporation.

The Bank's share in the operating results of the said companies is shown after amortization of the cost generated on their acquisition. Excess cost attributed to the assets and liabilities is amortized over the useful life of the asset. Positive goodwill is not amortized and is included in the book value of the investment, and negative goodwill is recognized in profit and loss at the acquisition date with the approval of the Supervisor of Banks.

Profits or losses from the realization of companies included on equity basis are charged to the item "Extraordinary Profit" in the statement of profit and loss.

The statement of changes in shareholders' equity includes the Bank's share in "translation adjustments" of units held by companies included on equity basis, as units whose activity is in a functional currency differing from the functional currency of the Bank.

The Bank examines the necessity, in each reporting period, of recording impairment of its investment in companies included on equity basis - see paragraph W below.

(3) Business Combinations (IFRS 3) (2008), Consolidated and Separate Financial Statements (IAS 27), and Investments in Associates (Equity Basis) (IAS 28) – initial implementation

Pursuant to the instructions of the Supervisor of Banks, the Group adopted the relief provided in IFRS 1 – Initial Implementation of International Financial Reporting Standards. Accordingly, the Group does not implement IFRS 3 (2008) retroactively with regard to business combinations, acquisitions of companies included on equity basis, acquisitions of companies under joint control, and acquisitions of minority interests occurring prior to 1 January 2011. Thus, for acquisitions occurring prior to 1 January 2011, goodwill recognized and surplus costs generated represent the amounts recognized in accordance with the Public Reporting Directives of the Supervisor of Banks.

Note 1 – Significant Accounting Policies (cont'd)

In light of the above, there was no material effect as a consequence of the initial implementation of the above Standards.

The Bank made a first-time implementation of IAS 27, except for the treatment of investments in investee companies in the separate financial statements of the Bank. Consequently, in the preparation of the separate financial statements, the Bank continues to treat investee companies by the equity basis method, in accordance with the directives and instructions of the Supervisor of Banks.

In accordance with international standards, certain potential voting rights are to be considered when determining the existence of a material effect. The Group implemented the international standards prospectively as of the financial statements for periods commencing on 1 January 2011.

Accordingly, an investment in a company included on equity basis classified up until 31 December 2010 as available for sale, was classified as a company included on equity basis as of 1 January 2011.

I. Securities

(1) Securities are classified in three portfolios: debentures held to maturity, securities available for sale and securities held for trading.

a. Debentures held to maturity

Debentures which the Bank intends and is able to hold until redemption date. Debentures held to maturity are stated at cost with the addition of accrued interest, linkage and foreign currency differences, taking into consideration the proportion of the premium or discount and less provision for impairment in their value which is not of a temporary nature.

b. Securities held for trading

Securities which were acquired and are held with the aim of selling them in the near future, and securities for which the banking corporation chose to make fair value measurement through the statement of profit and loss. Securities held for trading are stated at fair value at the reporting date. Unrealized gains and losses are included in the statement of profit and loss.

c. Securities available for sale

Securities not classified as debentures held to redemption or as securities held for trading. Securities available for sale are stated in the balance sheet at their fair value on the reporting date, except for shares, options and venture capital funds in respect of which the fair value is not available, in which case they are stated at cost.

Differences between the fair value and the adjusted cost are shown in a separate item within shareholders' equity, under total other accumulated profit, net of the tax effect.
Impairment in value which is not of a temporary nature is charged to the profit and loss statement as detailed in paragraph 3 below.

Unrealized gains or losses from adjustments to fair value of securities available for sale designated as being hedged by fair value hedges, are charged to the statement of profit and loss over the period of hedge.

Note 1 – Significant Accounting Policies (cont'd)

d. Fair Value

With regard to the determination of fair value, see paragraph G below.

In determining the fair value of securities and other financial instruments that are traded on an occasionally inactive market, significant use is made of discretion, including examining whether transactions have been made under pressure or coercion. In those cases where there is no available price quotation in an active market, the fair value is determined using generally accepted pricing models, based on evaluations obtained from experts in valuing financial instruments or on an independent system of the Bank. The evaluation methods include the use of various parameters, such as interest curves, currency rates and standard deviations, and take into account assumptions regarding other factors.

Most of the portfolio is calculated each month by a well-known international institution which is engaged in the calculation of fair value and is independent of the issuing entities and the marketing entities. The calculation is based mainly on the prices of transactions in active markets. The balance of the portfolio is revalued based on quotes from brokers or from the makers of the instruments, or based on the Bank's system.

(2) Dividend income, accumulated interest, linkage and price differences, amortization of premium or discount (in accordance with the effective interest method), as well as losses from impairment in value not of a temporary nature, are recorded to the profit and loss statement.

Interest income in respect of beneficial interests which have been acquired, such as asset-backed financial instruments, e.g., MBS, CLO, SCDO and CMO (except for high-quality loan instruments) is recognized using the prospective interest method (future interest that also anticipates future changes) , adjusting the interest rate used for recognizing interest for changes in the estimate of future cash flows. High quality loan beneficial interests are beneficial interests issued under the guarantee of the United States government or agencies of the U.S. government, and asset-backed securities whose international credit rating is at least AA.

(3) The Bank's investments in venture capital funds are dealt with according to cost less losses from impairment of a nature other than temporary. Profits from venture capital investments are credited to the profit and loss statement when the investment is realized.

(4) Impairment

The Bank examines the necessity, in each reporting period, for making a provision for impairment of securities which is not of a temporary nature. The examination is carried out if there are indications that the value of the securities might be impaired. The criteria for determining if the impairment is not of a temporary nature are based on the following considerations and tests:

- Intention and ability to hold the security until the forecasted recovery in full of the cost.
- The assets and collaterals backing up the security.
- The percentage of impairment from the cost of the security.
- Duration of period in which the fair value of the security is lower than cost.
- Evaluation of repayment ability and rating.
- An adverse change in the situation of the issuer or in the state of the market as a whole.

The Bank's policy is to recognize the impairment of a security as having a nature other than temporary, at least in respect of the impairment of any security that fulfils one or more of the following conditions:

- A security which was sold before the publication of the report to the public.
- A security which the Bank intended to sell within a short period of time before the publication of the report to the public.
- A debenture for which there was a significant rating decrease between the rating of the debenture at the date of acquisition by the Bank and the rating of the debenture at the date of publication of the report. Only a rating decrease below BBB- is considered a significant rating decrease for purposes of this paragraph.
- A debenture which was classified as problematic by the Bank after its acquisition.
- A debenture in respect of which there was a credit failure which was not rectified within a reasonable period of time.
- A security whose fair value was lower than the purchase value for a period of time of at least nine months before the end of the period of the financial statement, and at the end of the statement period as well as at a date shortly before publication of the report was lower by 35% or more than the cost (in the case of a debenture – the depreciated cost). In this matter an exception is possible if the Bank has concrete objective evidence and a conservative analysis of all the relevant factors, to show with a high degree of certainty that the impairment is of a temporary nature. The objective evidence and the relevant factors include parameters such as: an increase in value after the date of the financial report, a high credit rating (group A or above), an analysis of stability in stress scenarios carried out by an independent external party or by the Bank, backing and direct government investment in shareholders' equity for purposes of ensuring the strength of the issuer.

These principles are in accordance with the guideline issued by the Supervisor of Banks, except for the definitions of "significant rating" and "significant impairment" which were determined by the Bank.

When impairment in value occurs not of a temporary nature, the cost of the security is reduced to the fair value and serves as a new cost basis. Losses from securities which are not of a temporary nature are charged to the statement of profit and loss. Increases in value over the new cost basis in subsequent reporting periods, are included in a separate item in shareholders' equity under total other accumulated profit and is not charged to profit and loss.

J. Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

The Bank applies the measurement and disclosure principles prescribed in US Accounting Standard FAS 140 (ASC 860-10) - Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, amended by FAS 166 (ASC 860-10) - Transfers and Servicing of Financial Assets, for the purpose of dealing with transfers of financial assets and extinguishment of liabilities. In accordance with these principles, the transfer of a financial asset will be accounted for as a sale, if and only if, all of the following conditions are fulfilled: (1) the transferred financial asset has been isolated from the transferor, both in a state of bankruptcy or other receivership; (2) any recipient (or, if the recipient is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the financial assets it receives, each third-party holder of its beneficial interests) can pledge or exchange the assets (or beneficial interests) it received, and no condition exists that also constrains the recipient (or a third-party of its beneficial interests) from taking advantage of its right to pledge or exchange and provides the transferor with more than a trivial benefit; (3) the transferor or consolidated companies included in its financial statements or its agents do not maintain effective control over the financial assets or beneficial interests relating to the transferred financial assets.

Note 1 – Significant Accounting Policies (cont'd)

In addition, in order for the transfer of some of the financial asset to be considered a sale, the part transferred must comply with the definition of participating interests. Participating interests must comply with the following criteria: the interest must represent a proportionate interest in relation to an entire financial asset; all cash flows received from the assets are divided proportionately among the participating interest holders in an amount equal to their share of ownership; the rights are not subordinated rights in relation to other rights; there is no right of recourse to the transferor or to other holders in participating interests (other than in the event of a breach of representations or warranties, ongoing contractual obligations to service the entire financial asset and administer the transfer contract, and contractual obligations to share in any set-off benefits received by any holder of participating interests); and neither the transferor, nor the participating interest holder has the right to pledge or exchange the entire financial asset, unless all participating interest holders agree to pledge or exchange the entire financial asset.

If the transaction meets the conditions for treating a transaction as a sale, the transferred financial assets are deducted from the Bank's balance sheet. If the sale conditions are not fulfilled, the transfer is considered a secured debt. A sale of part of a financial asset which is not a participating interest is treated as a secured debt, i.e., the transferred assets continue to be recorded in the Bank's balance sheet and the proceeds from the sale will be recognized as a liability of the Bank.

In view of the above, securities sold under conditions of repurchase or purchased under conditions of resale, securities borrowed or lent, and other financial instruments transferred or received by the Bank, in which the Bank did not lose control over the transferred asset or did not acquire control in the asset received, are treated as secured debt. Financial instruments transferred in transactions such as the above, are measured in accordance with the same principles applied before their transfer.

Securities sold are not deducted from the balance sheet and are shown under "Securities", and as opposed to these, the deposit, for which those securities were pledged to ensure its repayment, is shown under "Securities lent or sold under agreements to repurchase".

Securities purchased are recorded according to their value on the day the transaction was made under "Securities borrowed or purchased under agreements to resell".

The Bank monitors the fair value of securities borrowed and lent as well as securities transferred under purchase and resale agreements on a daily basis, and a demand for collateral is made in appropriate cases. Interest received or paid in respect of the said securities is reported as financial income or expense, respectively.

Pursuant to the directives of the Supervisor, securities lending transactions executed as "ordinary" credit transactions, in which the Bank lends securities against the collateral portfolio, and the borrower does not provide the banking corporation with a security margin relating specifically to the securities lending transaction, are shown as credit to the public according to market value and are added to the debt of the borrower. Changes in the value of the above securities on an accrual basis are shown in the profit and loss statement under income from credit to the public, and the adjustment to market value is shown under adjustments in respect of securities available for sale according to fair value.

The Bank deducts a liability if and only if the liability is repaid, i.e. one of the following conditions exist: (a) the Bank paid the lender and was released from its obligation under the liability, or (b) the Bank was legally released, by legal proceedings or by agreement of the lender, from being the principal debtor under the liability.

Note 1 – Significant Accounting Policies (cont'd)

K. Buildings and equipment

(1) Recognition and measurement

Buildings and equipment are shown at cost less accumulated depreciation and losses from impairment in value. Cost includes expenses which can be directly attributed to acquisition of the asset.

When significant parts of fixed assets have a different life span they are dealt with as separate items of fixed assets.

Buildings earmarked for sale are shown at the lower of cost or realizable value.

Profit or loss on the sale of fixed assets is included under "profit after taxes from extraordinary activities" in the statement of profit and loss.

(2) Subsequent costs

The cost of replacement of part of an item of fixed assets is recognized as part of the book value of that item if it is expected that the future economic advantages inherent in the part replaced will come to the Bank, and if its cost can be measured accurately. The book value of the part replaced is deducted in the books. Ongoing maintenance costs of fixed asset items are charged to the profit and loss statement when incurred.

(3) Costs of software

Software purchased is measured by costs less accumulated depreciation and losses from impairment in value.

Costs in connection with the development and adaptation of computer software intended for internal use are capitalized only if development costs can be measured reliably, the software can be implemented from a technical point of view, a future economic advantage is expected and the Bank has both an intention and sources of funds to complete the development and use the software. Capitalized costs include direct costs and overhead expenses which can be attributed directly to the preparation of the software for its intended use. These costs are measured by cost less accumulated depreciation and losses from impairment in value. Other costs are charged to profit and loss when incurred.

Subsequent costs of software are recognized as an asset only if they increase the future economic advantages inherent in the asset for which they were expended. Other costs are charged to profit and loss when incurred.

(4) Depreciation

Depreciation is calculated on the cost, in accordance with estimated useful life, on a straight line basis from the date the asset is ready for use. The Bank depreciates separately each part of a fixed asset for which a different useful life has been determined. Leasehold improvements are amortized over the leasing period, including an option which is likely to be exercised, or over its useful life, whichever is shorter. The estimates regarding useful life and residual value are examined periodically.

In connection with impairment of non-monetary assets, see paragraph W below.

Initial implementation of IAS 16 – Fixed Assets and IAS 38 – Intangible Assetshad no material effect on the statements of the Bank from initial implementation of the Standard.

(5) Leases

In accordance with IAS 17, leases, including leases of land from the Israel Land Authority or other third parties, where the Group materially bears all the risks and returns from the property, are classified as finance leases. At the commencement of the initial lease term, leased assets are recognized at an amount equal to the lower of fair value and the present value of future minimum lease payments. Future payments for exercising an option to extend the period of the lease with the Israel Land Authority are not recognized as part of the asset and related liability to the extent their amount is derived from the fair value of the land at future renewal dates of the lease agreement. After initial recognition, the asset is dealt with in accordance with accepted accounting policy regarding this asset. The asset is amortized over the term of the lease, and the liabilities are measured at adjusted cost in accordance with the effective interest method.

The period of the lease is the period which cannot be canceled, for which the lessor made a contractual agreement for the lease of the asset together with any additional periods for which the lessee has the option of continuing to lease the asset, for an extra payment of for no extra payment, when it is reasonable certain at the date of the leasing commitment that the lessee will exercise the option.

The effect at the date of initial implementation is expressed in the amortization of properties over the term of the lease in the sum of about NIS 23 million.

The other leases are classified as operating leases, and the leased assets in these cases are not recognized in the balance sheet.

Payments in the framework of an operational lease are charged to the statement of profit and loss on a straight-line basis over the term of the lease.

(6) Investment Property

Investment property is real estate (land or buildings – or part of the same – or both) held by the Bank (as owners or under a financial lease) for purposes of generating rental income or for an increase in equity value or both, and not the purposes of:

1. Use for production or supply of goods or services for administrative purposes; or

2. Sale in the normal course of business.

Investment property is measured initially at purchase cost plus transaction costs. In subsequent periods, investment property is measured at cost less accumulated amortization and losses from impairment.

The Bank made a first-time implementation of IAS 40 as of 1 January 2011. There was no material effect from the implementation of the Standard.

L. Issue expenses

Expenses of issue of debentures, bonds and subordinated notes are amortized by the effective interest method.

Note 1 – Significant Accounting Policies (cont'd)

M. Basis of recognition of income and expenses

Income and expenses are included on an accrual basis, except for the following:

- Income and expenses from securities held for trading and derivative financial instruments are recognized according to the changes in fair value.

- Interest accruing on problematic debts that were classified as non-accrual loans is recognized on a cash basis when there is no doubt with regard to collection of the remaining recorded debt balance of an impaired debt. In these situations, an amount collected on account of the interest that is recognized as interest income, is limited to the amount that would be accumulated in the reporting period on the remaining recorded balance of the debt according to the contractual interest rate. Interest income on a cash basis is classified in the statement of profit and loss as a profit from financing activity (before allowance for credit losses) under the relevant item in "finance income in respect of assets". When there is doubt as to collection of the remaining rercorded balance of debt, all payments collected serve to reduce the loan principal. In addition, interest on past-due amounts in respect of housing loans is recognized in the profit and loss statement on an actual collection basis.

- Income from commissions on early repayment of loans, after deducting a relative portion relating to the financial equity, are included in the profit and loss statement in equal annual amounts during the period of the remainder of the period until repayment of the loan or for three years from the date of early repayment, whichever period is shorter.

- Allocation fees for credit facilities, together with commissions on financing business, are recognized in the statement of profit and loss relative to the periods of the transactions.

- Operating commissions for granting services are charged to profit and loss when the service is granted.

- In successive periods of an impairment which is other than of a temporary nature, interest income from investments in debt instruments will be recognized in the following way:

  Beneficial interests acquired or beneficial interests that have continue to be held by the Bank in the securitization of financial assets, which are accounted for using the prospective interest method – the excess of the amount of expected cash flows to be collected over the fair value of the debt instrument will be recognized as interest income over the remaining life of the debt instrument. In rare instances in which the Bank has no reasonable estimate with regard to amounts and timing of expected cash flows to be collected from the debt instruments, the Bank recognizes income using the cost recovery method or recognizes income on a cash basis.

  Other debt instruments – Income in the reporting period is accrued on the basis of the excess of expected cash flows of the debt instrument. (The base amount of the debt instrument at the date of impairment in value which is of a nature other than temporary constitutes its fair value).

N. Derivative financial instruments and hedge accounting

(1) The Bank holds derivative financial instruments for purposes of hedging foreign currency risks and interest rate risks, and also carries out activity in derivatives not for hedging purposes.

(2) If an instrument is earmarked for hedging, the Bank, at the date the hedge is made, formally documents the hedging relationships between the hedging instrument and the hedged item, including the purpose of risk management and the Bank's strategy in creating the hedging transaction, and the manner in which the Bank will evaluate the effectiveness of hedging relationships. The Bank evaluates the effectiveness of hedging relationships both at the beginning of the hedge and also on an ongoing basis.

(3) Fair value hedging

Changes in the fair value of derivative financial instruments designated to hedge fair value are charged to the profit and loss statement. The hedged item is also shown at fair value with reference to the risks hedged, and changes in fair value are charged to the profit and loss statement.

If the hedging instrument no longer fulfills the criteria of an accounting hedge, or expires, is sold, cancelled or realized, or the Bank cancels the designation of a fair value hedge, the Bank ceases utilization of hedge accounting. When a hedged firm commitment no longer fulfills the definition of a firm commitment, any asset or liability recorded in accordance with recognition of the firm commitment will be cancelled and recognized as profit or loss in the statement of profit and loss for the current period.

(4) Economic hedging

Hedge accounting is not applied with regard to derivative instruments serving as part of the Bank's asset and liability management system (ALM). Changes in the fair value of these derivatives are recognized in the statement of profit and loss when incurred.

(5) Derivatives not used for hedging

Changes in the fair value of derivatives not used for hedging are charged immediately to profit and loss.

(6) Embedded derivatives

Embedded derivative instruments are separated from the host contract and dealt with separately if: (a) there is no clear and close relationship between the economic characteristics and risks of the host contract and of the embedded derivative instrument, including credit risks attributable to certain embedded credit derivatives; (b) a separate instrument with the same conditions as the embedded derivative instrument would fulfill the definition of a derivative; and (c) the hybrid instrument is not measured according to fair value through profit and loss.

An embedded derivative that was separated is included in the balance sheet together with the host contract, and changes in fair value of separated embedded derivatives are charged on a current basis to profit and loss.

In certain cases (such as in cases when the Bank is not able to separate the embedded derivative from the host contract), pursuant to American Accounting Standard 155 (FAS 155), Accounting Treatment of Certain Hybrid Financial Instruments, the Bank elects not to separate the embedded derivative and to measure the hybrid instrument as a whole for fair value while reporting on changes in the fair value in the statement of profit and loss when they occur. The above election is made at the date of purchase of the hybrid instrument or on the occurrence of certain events when the instrument is subject to re-measurement (a re-measurement event), such as a result of business combinations or material changes in the debt instrument. Such fair value election is irrevocable.

(7) Fair value

With regard to the determination of fair value, see paragraph G above. In determining the fair value of financial instruments that are not traded on an active market, significant use is often made of discretion, including if the transactions were made under pressure or duress. In those instances when there is no quotation available of prices in an active market, fair value is determined according to generally accepted pricing models, based on an independent and validated system of the Bank, or based on assessments received from experts in the valuation of financial instruments. Methods of valuation include the use of various parameters, such as interest curves, currency rates, and standard deviations, taking into account assumptions regarding various factors.

O. Impaired Debts, Credit Risk and Allowance for Credit Losses

The Directive has been implemented with regard to all debt balances such as deposits in banks, bonds, securities borrowed or purchased under repurchase agreements, credit to the public, credit to the government, etc. Credit to the public and other debt balances for which no specific rules were made in the Public Reporting Directives regarding the measurement of the allowance for credit losses (such as credit to the government, deposits in banks, etc.) are reported in the books of the Bank according to the recorded debt balance. It should be explained that prior to 1 January 2011, the Bank applied different rules according to which the debt balance in the Bank's books included the interest component accumulated before the debt was classified as a non-income bearing problem debt. Accordingly, and in light of credit balances written off in accordance with the new directives, loan balances reported in periods before the initial implementation period of the Directive are not comparable with loan balances reported after the commencement of implementation. With regard to other debt balances, for which there are specific rules for measurement and recognition of impairment (such as bonds), the Bank continues to apply the same rules for measurement.

The Bank is required to maintain an allowance for credit losses at a level appropriate to cover expected credit losses relating to its loan portfolio, including in respect of off-balance sheet credit risk. Allowances for credit losses include:

- Individual allowance for credit losses – The allowance is made based on the measurement of the impairment of the debt, based on the present value of future expected cash flows, discounted at the effective rate of interest of the debt; or, when a debt is dependent on collateral or when an asset is expected to be seized, according to the fair value of the collateral pledged to secure such credit (less costs of sale). The need for an individual allowance is assessed for each debt whose contractual balance (without deducting: accounting write-offs not involving a legal waiver, interest not recognized, allowances for credit losses, and collateral) is NIS 1.0 million or more, and any other debt identified for individual assessment by the Bank. In some of the consolidated subsidiary companies, the assessment is made also for lower amounts. The individual allowance is calculated for each debt classified as impaired (see below).

- Collective allowance for credit losses – This is implemented for allowances for impairment for large groups of relatively small and homogeneous debts, and in respect of debts that have been assessed individually and found not to be impaired. Measurement of credit losses, on balance sheet credit and on off-balance sheet credit instruments, is performed based on an estimate of rates of past credit losses of each homogeneous group of debts with similar risk characteristics. The allowance assessed on a group basis for off-balance sheet credit instruments is based on the rates of allowance determined for balance sheet credit, taking into account the percentage of off-balance sheet credit risk expected to be realized. The credit realization percentage is calculated by the Bank based on credit conversion coefficients as set out in Proper Conduct of Banking Business Directive No. 203 – Measurement and Adequacy of Capital – Credit Risk – Standardized Approach, with certain adjustments in cases where the Bank has prior experience indicating percentages for the realization of credit.

  A temporary directive was issued for the years 2011-2012 (hereinafter: “the transitional period”), which contains a simpler model for calculating credit loss allowances on a collective basis. According to the temporary directive, the rate of allowances for credit losses on a collective basis will be determined for the transitional period based on the range of historical rates for provisions for doubtful debts during the years 2008-2010, segmented by sector of the economy, as well as on the actual rate of net accounting write-offs as of 1 January 2011. In addition to calculating the range of historical rates in the various sectors of the economy as mentioned above, the Bank, for purposes of determining the appropriate rate of the provision, takes into account other data, including trends in the volume of credit in each sector and the conditions of the sector, macroeconomic data, a general assessment of the quality of credit to sectors of the economy, changes in volume and the trend of balances in arrears and impaired balances, and the effect of the changes on credit concentrations.

The minimum provision for doubtful debts in respect of housing loans is calculated according to a formula determined by the Supervisor of Banks, taking into account the extent of arrears, whereby the rates of the provision increase as the arrears grow. The application of the calculation of the provision according to the formula of the extent of arrears refers to all housing loans, except for loans not payable in regular installments and loans financing activity of a business nature.

The Bank classifies the balance of its various problem debts as follows:

Special mention balance sheet credit is a debt which has potential weaknesses in respect of which special attention is required by the management of the corporation. Off-balance sheet credit is classified as special mention credit if realization of the liability contingent on this item is "possible", and if the debts which may be recognized as a result of the contingent realization are suitable for classification in this category.

Substandard balance sheet credit is credit which is insufficiently protected by the current established value and the debtor's repayment ability, or by the pledged collateral, if any. Balance sheet credit risk classified as such has a well-defined weakness or weaknesses that put the realization of the debt at risk. Credit for which an allowance for credit losses is recognized on a collective basis will be classified substandard when it becomes a debt with arrears of 90 days or more.

Impaired debt is credit of which the banking corporation, based on current information and events, will probably not be able to collect the entire amount due (principal and interest), according to the contractual terms of the loan agreement. In particular, a debt is classified as impaired when its principal or interest is in arrears of more than 90 days, except if the debt is well secured or in collection proceedings. In addition, an impaired debt is also considered as a debt whose terms were changed due to problem debt restructuring.

A problem debt restructuring is considered as such insofar as the banking corporation, against the backdrop or economic difficulties or legal circumstances, grants a waiver to the borrower which it would not grant under different conditions. With regard to the examination of the existence of these conditions, see below.

Restructuring a Problem Debt:

A debt which formally underwent a problem debt restructuring is defined as a debt in respect of which, for economic or legal reasons related to the debtor's financial difficulties, the Bank granted a waiver by way of modification of the terms of debt, in order to alleviate the burden for the debtor of near-term cash payments or by way of receipt of other assets as payment of the debt. For purposes of determining whether a debt agreement executed by the Bank comprises a problem debt restructuring, the Bank performs a qualitative examination of the totality of the terms of the arrangement and the circumstances under which it was made, in order to determine whether (1) the debtor is in financial difficulties and (2) the Bank granted a waiver under the arrangement to the debtor.

In order to determine whether the debtor is in financial difficulties, the Bank examines whether there are signs that point to the fact that the borrower is in difficulties at the time of the arrangement or the existence of a reasonable possibility that the borrower would get into financial difficulties if not for the arrangement.

The Bank examines, *inter alia*, the existence of one or more of the following circumstances:

Note 1 – Significant Accounting Policies (cont'd)

- At the time of the debt arrangement the borrower is in default, including when any other debt of the borrower is in default; with regard to debts which at the time of the arrangement are not in arrears, the Bank estimates if according to the current repayment ability it is likely that in the foreseeable future the borrower will get into a default situation, and will not meet the original contractual terms of the debt;

- The debtor was declared bankrupt,

- is under receivership, or there are significant doubts as to the borrower's continued existence as a going concern;

- and that without changing the terms of the debt, the debtor will not be able to raise debt from other sources at market rates of interest for debtors not in default. The Bank will conclude that the debtor was granted a waiver under the arrangement, even if under the arrangement an increase was made in the contractual interest rate, if one or more of the following situations exists:

  - As a result of restructuring, the Bank is not expected to collect all amounts outstanding (including accrued interest according to the contractual terms);

  - The updated fair value of the collateral, in respect of debts conditional on collateral, does not cover the contractual balance of the debt and indicates the inability to collect all amounts due;

  - The debtor has no possibility of raising resources at the rate prevailing in the market for a debt with terms and characteristics such as those of the debt granted under the arrangement.

In addition, the Bank will not classify debt as a restructured problem debt if, under the arrangement, the debtor was granted a stay of payments that is not material, given the frequency of the payments in the contractual repayment period and the expected duration of the original debt. In this regard, if several arrangements were made involving changes in the terms of the debt, the Bank takes into account the cumulative effect of the previous arrangements for the purpose of determining whether the stay of payments is not material.

Restructured debts, including those that prior to the restructuring were examined on a group basis, will be classified as impaired debt and will be evaluated on an individual basis for purposes of making an allowance for credit losses, or an accounting write-off. Given that the debt, for which the problem debt restructuring was carried out, will not be paid in accordance with its original contractual terms, the debt continues to be classified as impaired debt, even after the debtor returns to the repayment schedule in accordance with the new terms.

In April 2011, the FASB published Accounting Standards Update ASU 2011-02 – "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring".

The rules set out in the ASU for identifying arrangements to be defined as problem debt restructuring, were adopted by the Banking Supervision Department and came into effect for reporting periods commencing 1 July 2011. The rules are applicable for purposes of determining if the restructuring represents a problem debt restructuring with regard to any debt arrangement as of 1 January 2011. Changes in the method of measurement of the allowance for credit losses were applied prospectively, so that the updating of the provision required to be calculated on an individual basis was recorded in the third quarter of 2011. The initial implementation of the ASU had no material effect on the results of the Bank.

Recognition of income:

At the time the debt is classified as impaired, the Bank defines the debt as a debt not accruing interest income, and ceases accruing interest income on it, except that stated above regarding certain impaired debts after restructuring. In addition, at the time the debt is classified as impaired, the Bank cancels all the interest income accrued but not yet collected, which was recognized as income in profit and loss. The debt remains classified as a debt not accruing interest income, as long as the impaired debt classification is not canceled. A debt that underwent a formal problem debt restructuring, and after the restructuring there is reasonable certainty that the debt will be repaid and will perform in accordance with its new terms, will be treated as an impaired debt accruing interest income. For details regarding recognition of income on a cash basis for debts classified as impaired, see paragraph M.

Regarding debts assessed and provided for on a collective basis, which are in arrears of 90 days or more, the Bank continues to accrue interest income. These debts are subject to methods of evaluation for the allowance for credit losses that ensure that the profit of the Bank is not overstated. Late-payment commissions for these debts are included as income on the date the Bank becomes entitled to receive them from the customer, provided that collection is reasonably certain.

Accounting write-off:

- The Bank makes an accounting write-off for any debt or part thereof examined on an individual basis that is considered uncollectible, or a debt which the Bank has made efforts to collect over an extended period.

- The Bank makes an accounting write-off immediately against the allowance for credit losses for any part of a debt which exceeds the value of the collateral, which is identified as uncollectible.

- The Bank makes an accounting write-off for any debt in respect of which the Bank is making efforts to collect the debt and for which individual allowances for credit losses have been made, generally within a period not exceeding two years.

- The Bank writes off problem debts in respect of which the allowance is measured based on a collective allowance for credit losses when the period of arrears exceeds 150 days.

It should be explained that accounting write-offs do not involve a legal waiver, and they reduce the reported balance of debt for accounting purposes only, while creating a new cost base for the debt in the Bank's books.

Initial implementation of the directives of the Banking Supervision Department on Measurement and Disclosure of Impaired Debts, Credit Risk, and Allowance for Credit Losses

In accordance with the instructions of the Banking Supervision Department, the directive was not applied retroactively in financial statements for previous periods.

At the time of initial implementation, the Bank was required, *inter alia*:

- To write off in the accounts any debt that at that date meets the conditions for being written off in the accounts.

- To classify as special mention, substandard, or impaired, any debt that meets the conditions for such classification.

- To cancel all interest income which has accumulated at the date of implementation of the directive but not yet collected, in respect of any debt which at that date meets the relevant conditions.

- Differences generated at the date of initial implementation of the new instructions, between the balance of allowances for credit losses under existing instructions, and their balance calculated under the new instructions, were charged to retained earnings in shareholders' equity.

- With the aim of adapting the definitions and terms included in Proper Conduct of Banking Business Directive No. 315, on the subject of "Supplementary provision for doubtful debts", to the terms included in the new directives, effective 1 January 2011, the term "problem debts" will be changed to "Credit risk under negative classification and credit risk under special mention", and will include three types of debts as mentioned above: "impaired debts", "substandard debts" and "special mention debts".

  The supplementary provision serves only as an indicator regarding the group allowance so that if the amount of the total group allowance is less than the supplementary and general provision, provision is to be made for the higher of the two calculations.

The rates of supplementary provision applying to the various types of problem debts will be as follows:

- "Special mention" credit risk – 1%

- "Substandard" credit risk – 2%

- "Impaired" credit risk – 4%

Doubtful Debts Provision Policy before the Implementation of the Directives on Impaired Debts, Credit Risk, and Allowance for Credit Losses

Provisions for doubtful debts are determined specifically, together with a general and a supplementary provision, in accordance with directives of the Supervisor of Banks. Provisions for doubtful debts in consolidated banking companies overseas are determined in accordance with generally accepted principles in their country of domicile.

The specific provision for doubtful debts is made based on a careful assessment by management of losses inherent in the credit portfolio, including debts in non-balance sheet items. In this assessment, management takes into account, among its other considerations, to what degree the risks are connected to the financial strength of the borrowers, based on information available to it regarding their financial condition, business activity, compliance with their obligations, and an assessment of the value of the collateral received from them.

Interest income in respect of a loan determined as doubtful is not recorded from the beginning of the quarter in which the debt was determined as doubtful. When the interest is collected, the interest income is recorded under other financial income.

A specific provision for housing loans granted by the Bank and investee banking companies in Israel is calculated in accordance with the directives of the Supervisor of Banks, taking into account the length of the period in arrears, with the rates of the provision increasing as the arrears increase.

The supplementary provision for doubtful debts is based on the quality of the customer credit portfolio, according to risk characteristics defined in the directives of the Supervisor of Banks. Different provision percentages are stipulated for each of the risk characteristics. The supplementary provision for doubtful debts is calculated according to percentages stipulated for the various characteristics. The general provision is in figures adjusted to the end of 2004, in an amount comprising 1% of total liabilities under the responsibility of the Bank and its investee banking companies as at 31 December 1991.

The effect of initial implementation in the sum of about NIS 1,319 million before tax and some NIS 721 million after tax have been recorded as a reduction in retained earnings as at 1 January 2011.

P. Assets transferred to Group ownership following the settlement of problematic debts

Assets that were transferred to Group ownership following the settlement of problematic debts and are included in other assets are stated according to the lower of the asset's market value on the date they were transferred or as at balance sheet date. Decreases in value are charged to operating and other expenses.

Q. Setting off assets and liabilities

(1) The Bank sets off assets and liabilities for the same counterparty and reports their net balance in the balance sheet when the following cumulative conditions exist:

- When in respect of those liabilities there is a legally enforceable right to set off the liabilities from the assets;

- There is intent to repay the liabilities and realize the assets on a net basis or simultaneously.

(2) The Bank sets off assets and liabilities with two different counterparties and reports a net balance in the balance sheet when the two cumulative conditions above exist, provided that there is an agreement between the three parties clearly defining the Bank's right of off-set in respect of those liabilities.

(3) The Bank sets off deposits whose repayment to the depositor is conditional upon the amount collected from the credit, and the credit is granted from these deposits, in respect of which the Bank has no risk of loss from the credit. The interest margin from this activity is included under "Operating Commissions".

(4) The Bank sets off between derivative instruments carried out with the same counterparty which are subject to a master netting arrangement.

R. Contingent liabilities

Appropriate provisions have been made for claims which, in the opinion of Bank Management and the Managements of its consolidated companies, based on the opinions of legal counsel, will not be dismissed or canceled, notwithstanding the fact that such claims are refuted by the Bank. In addition, legal proceedings exist whose chances or results cannot be estimated at this stage and therefore no provision was recorded in respect thereof.

Claims made against the Bank are classified in three categories, according to the probability of realization of the risk exposure as follows:

(1) Probable risk – probability of realization of the risk exposure exceeding 70%. For claims included in this risk group, appropriate provisions are included in the financial statements.

(2) Reasonably possible risk – probability of realization of the risk exposure between 20% and 70%. For claims included in this risk group, provisions are not included in the financial statements but only disclosure is made.

(3) Remote risk – probability realization of the risk exposure less than or equal to 20%. For claims included in this risk group, provisions are not included in the financial statements and no disclosure is made.

In rare cases where the Bank determines that, in the view of Bank Management, with reliance on its legal advisors, it is not possible to evaluate the likelihood of realization of the risk exposure with regard to a normal claim and a claim approved as a class action, no provision is made.

In addition, the Group is exposed to legal claims that have not yet been made / submitted, *inter alia*, on the existence of a doubt in the interpretation of an agreement and/or the provision of a law, and/or the method of their implementation. This exposure is brought to the Group's attention in a number of ways. In assessing the risk arising from the demands / claims not yet submitted, the Group relies on internal assessments of the officials dealing with the issues and the management, who weigh the assessment of the risk for submitting a claim, the chance of the claim's success, if it is submitted, and payment in a compromise, if there be any. The assessment is based on accumulated experience in relation to the submission of claims and on an analysis of claims in their own right. In the nature of things, in light of the preliminary stage of clarification of the legal claim, the actual result could be different from the assessment made at a stage prior to the claim being submitted.

In Note 18 details are shown of the amount of the additional exposure in respect of contingent claims whose amount exceeds NIS 2 million and whose realization is not remote, as well as a description of material legal proceedings against the Bank and the consolidated companies.

S. Employee rights

(1) There are appropriate reserves for all liabilities regarding employer/employee relations, pursuant to the law, agreements, accepted practice and management's expectations. Future liabilities for pensions and jubilee grants are calculated by a qualified actuary, using the accrued benefit valuation method, taking into account probabilities based on past experience. The capitalization rate of the reserves is determined by the Supervisor of Banks, the mortality rate is based on instructions determined for insurance companies by the Commissioner of Capital Markets, Insurance and Savings, and the rate of increase in salary is based on past experience and varies according to the age of the employee.

(2) Instructions and Clarifications on the Strengthening of Internal Control over Financial Reporting relating to Employee Rights

During 2011, instructions were published by the Banking Supervision Department on the strengthening of internal control over financial reporting relating to employee rights. The instructions provide a number of clarifications concerning assessing the liability in respect of employee rights, and instructions in the matter of internal control over the financial reporting process on the subject of employee rights, with a requirement for the engagement of a certified actuary, the identification and classification of liabilities in respect of employee rights, the maintaining of internal controls for purposes of reliance on the actuary's valuation and its validation, as well as certain disclosure requirements.

It was stipulated, *inter alia*, that a banking corporation expecting to pay its employees, on their leaving, benefits in excess of contractual terms, shall take into account the percentage of employees expected to leave and the benefits expected, for the calculation of pension and jubilee grant obligations. As a result of the above instruction, the percentage of employees expected to leave early was changed in the actuarial models on which pension and jubilee grant obligations are based, and benefits in excess of contractual terms were taken into account.

The change in the above provisions was reported as a restatement of the balance of retained earnings as at 31 December 2008, and as of that date the effect on profit and loss was reported for each period, by restating salary expenses, the provision for taxes, and the net profit. The effect of NIS 405 million net after tax was charged as an adjustment to the opening balance of retained earnings at 1 January 2009 (the earliest period reported in the financial statements). Comparative figures were adjusted accordingly for earlier reporting periods.

Note 1 – Significant Accounting Policies (cont'd)

Below are details of the amounts that changed as a result of implementing the above directive (NIS millions):

Item	**For the year ending 31 December 2010**			For the year ending 31 December 2009		
	Balance before restatement	Change	Balance after restatement	Balance before restatement	Change	Balance after restatement
Salary expenses	**4,615**	**61**	**4,676**	4,052	(156)	3,896
Tax expenses	**1,256**	**(17)**	**1,239**	1,191	81	1,272
Net profit	**2,378**	**(44)**	**2,334**	2,014	75	2,089
Basic and diluted profit per share	**1.61**	**(0.03)**	**1.58**	1.37	0.05	1.42
	As at 31 December 2010			As at 31 December 2009		
Other assets	**2,453**	**152**	**2,605**	3,221	135	3,356
Other liabilities	**13,320**	**526**	**13,846**	11,623	465	12,088
Shareholders' equity	**23,667**	**(374)**	**23,293**	21,862	(330)	21,532
Capital adequacy ratio to risk assets	**15.10%**	**(0.14%)**	**14.96%**	14.09%	(0.19)%	13.90%

(3) Liabilities for severance pay and pensions are covered mainly by amounts funded which are deposited in provident funds for pension and severance pay. For amounts of liabilities not covered as stated, a provision is made in the financial statements.

(4) Share-based payment transactions

Share-based payment transactions include transactions with employees that were settled with equity instruments. The fair value at the date that option and share warrants were granted to employees is attributed to salary expenses concurrently with an increase in capital over the course of the period during which the employees' entitlement to option and share warrants is attained. The amount attributed as an expense is adjusted in order to show option-warrants for shares which are expected to become vested. Fair value is determined by using an acceptable costing model. Deferred tax in respect of a share-based payment is calculated in accordance with the difference between the exercise price and the price of the share.

In transactions in which the Bank also grants rights to equity instruments to employees of the subsidiary companies, the Bank treats this as a share-based payment transaction settled with equity instruments.

T. Taxes on income

Taxes on income in the statement of profit and loss include current taxes and deferred taxes. Tax expenses in respect of current or deferred taxes are charged to the statement of profit and loss, except when they refer to items charged directly to equity. In these cases, the effect of the tax is also charged to the relevant item in equity.

The liability for current taxes is determined by using tax rates and tax laws that were passed, or whose legislation has effectively been completed by the balance sheet date, as well as adjustments required in connection with the liability to pay tax for previous years.

The provision for taxes on the income of the Bank and its consolidated companies that are financial institutions for Value Added Tax purposes, include profit tax levied on the income according to the Value Added Tax Law. Value Added Tax Law levied on salaries in financial institutions is included in the statement of profit and loss under "Salaries and allied expenses".

Deferred taxes are calculated in respect of temporary differences between amounts included in the financial statements and the amounts taken into account for tax purposes, except for a small number of exceptions and in accordance with the directives of the Supervisor of Banks. Deferred taxes relating to items charged directly to equity are also charged to the items referring to equity.

The main factors, in respect of which deferred taxes were not recorded, are as follows:

- Amounts of adjustment to changes in the purchasing power of the new shekel, referring mainly to buildings, according to the principles determined by the Israel Accounting Standard Board in Standard 19, see Note 26.G.

- Investments in investee companies which the Bank intends to hold and not to sell.

- A deferred tax asset in respect of temporary differences where the possibility of realization of the asset is in doubt.

- Initial recognition of goodwill.

A deferred tax asset in respect of losses carried forward and in respect of a tax credit carried forward to offset tax, is recognized in the books in those cases where realization of the said tax will be in the foreseeable future and is not in any doubt. A deferred tax asset in respect of temporary differences will be recognized when it is probable that a tax saving will be generated in their respect when reversed. The creation of net deferred tax assets shall not exceed current taxes during the accounting period, except in special cases where realization of the tax in the foreseeable future is not in any doubt.

Deferred taxes are calculated according to the tax rates expected to be in force at the time of utilization or realization of the assets, on the basis of tax rates which have been legislated or whose legislation has effectively been completed by the balance sheet date.

The Bank offsets deferred tax assets and liabilities if there is a legal and enforceable right to offset current tax assets and liabilities.

The Bank may incur additional tax in the event of allocation of a dividend in respect of investee companies. This additional tax is not included in the financial statements in view of the policy of the investee companies not to bring about an allocation of a dividend which involves additional tax for the Bank in the foreseeable future. In cases where an investee company is expected to allocate a dividend from earnings involving additional tax for the bank, the Bank creates a tax reserve for the additional tax which it may incur.

Deferred tax in respect of intercompany transactions in the consolidated accounts is recorded at the rate of tax of the acquirer company.

U. Earnings per share

The Bank reports basic and diluted earnings per share with regard to its weighted ordinary share capital. Basic earnings per share are calculated by dividing the profit or loss attributed to the ordinary shareholders of the Bank by the weighted average number of ordinary shares that were in circulation during the period. Diluted earnings per share is determined by adjusting the profit or loss relating to the ordinary shareholders, and adjusting the weighted average of ordinary shares in circulation, for the effect of all the potential dilutive ordinary shares.

The initial implementation of IAS 33 – "Earnings Per Share" had no effect on the method of calculating earnings per share.

Note 1 – Significant Accounting Policies (cont'd)

V. Statement of cash flows

The statement of cash flows is presented when it is classified under cash flows from operating activities, from activities in assets, and from activities in liabilities and capital. The above statement shows the net cash flows from activities in assets and in liabilities, other than changes in non-monetary assets, in available-for-sale securities, debentures, bonds and subordinated notes.

The item "Cash" includes cash and deposits with central banks and other banks for an original period not exceeding three months.

W. Impairment in value of non-monetary assets

(1) The Bank examines the necessity, for every reporting period, of recording a provision for the impairment of non-monetary assets (such as: buildings and equipment, investments in companies included on equity basis, intangible assets including goodwill) when there are signs, resulting from events or changes in circumstances, which indicate that its assets in the balance sheet are shown at an amount which is in excess of their recoverable value.

The recoverable amount of an asset or a cash-generating unit is the higher of the net selling price and the value-in-use. The value-in-use is the present value of the estimated future cash flows, discounted by the pre-tax rate of interest, which are expected to be derived from use and realization of the asset. For the purpose of examining impairment, assets which cannot be examined individually are grouped together into the smallest group generating cash flows from continued use, which is largely independent of assets in other groups (“cash-generating unit”). For the purpose of examining impairment of goodwill recognized in the framework of a business combination, cash-generating units to which goodwill has been allocated are grouped so that the level at which impairment is examined represents the lowest level at which goodwill can be monitored for purposes of internal reporting, but will not be larger than an operational segment. When there is a change in the composition of one or more cash-generating units to which the goodwill was allocated, the goodwill is to be reallocated to those units affected.

Assets of the head office of the Bank do not produce separate cash flows. If there are indications that impairment has occurred in an asset belonging to the Bank’s headquarters, a recoverable value is determined for the group of cash producing units served by the headquarters.

When the value of the asset is higher than its recoverable value, the Bank recognizes a loss from the impairment in value in the amount of the difference between the book value of the asset and its recoverable value. The loss thus recognized will be cancelled only in the event of changes occurring in the estimates that were used to determine the recoverable value of the asset after the date on which the most recent loss from the decline in value was recognized, except for impairment of value of goodwill, which is not cancelled.

(2) Impairment with regard to costs of in-house software development

Examination for impairment with regard to costs of in-house software development is to be carried out if the indicators stated in US generally accepted accounting principles exist:

(a) It is not expected that the software will provide any significant potential uses;

(b) A material change has occurred in the manner or scope of use of the software or of the expected use of the software;

(c) A material change has been made or will be made to the software;

Note 1 – Significant Accounting Policies (cont'd)

(d) Costs for developing or adapting the software designated for in-house use deviate significantly from the sums projected in advance;

(e) It is no longer expected that the software will be completed and utilized.

If one or more of the indicators stated above exist, it is required to make an examination for impairment in accordance with the principles set out in IAS 36 – Impairment of Assets.

(3) Impairment of investments in companies included on equity basis reported according to the equity basis method

An investment in a company included on equity basis is examined for impairment when there is objective evidence indicative of impairment in accordance with IAS 39 – Preparation and Measurement of Financial Instruments.

Impairment is examined with relation to the investment as a whole. Goodwill representing part of the investment account in a company included on equity basis is not recognized separately, and is therefore not examined separately in the test for impairment. If there is objective evidence indicative that there may be impairment of the investment, the Group makes an evaluation of the amount refundable of the investment which is the higher of the useful value and its net sale price.

When determining the usage value of an investment in a company included on equity basis, the Group assesses its share in the present value of estimated future cash flows, which are forecast to be generated by the company included on equity basis, including cash flows from activities of the company included on equity basis and the consideration from the final realization of the investment, or the present value of estimated future cash flows that are forecast to stem from dividends received and the final realization.

A loss from impairment is recognized when the book value of the investment, after applying the equity base method, exceeds the recoverable amount, and is recognized under the "share of the banking corporation in operating gains or losses of companies included on equity basis, after taxes" in the profit and loss statement. A loss from impairment is not allocated to any asset, including goodwill comprising part of the investment account in the company included on equity basis. A loss from impairment will be canceled only if changes have taken place in assessments used in determining the recoverable amount of the investment from the date the loss from impairment was last recognized. The book value of the investment, after canceling the loss from impairment, shall not exceed the book value of the investment that would have been determined according to the equity base method if the loss from impairment had not been recognized. Cancelation of the loss from impairment will be recognized under the "share of the banking corporation in operating gains or losses of companies included on equity basis, after taxes".

The Bank applies IAS 36 – Impairment of Assets, retroactively as of 1 January 2011. There was no material effect of the implementation of the Standard.

Note 1 – Significant Accounting Policies (cont'd)

X. Comparative figures

Comparative figures appear in the financial statements after reclassification. Following the first-time implementation of certain accounting standards and directives of the Supervisor of Banks, certain paragraphs in the context of the financial statements and the comparative figures were reclassified so as to be compatible with the headings and reporting requirements during the current period. Specifically, the following have been reclassified:

Items included in the condensed consolidated balance sheet:

Goodwill in the amount of NIS 45 million, included in the balance sheets as at 31 December 2010 under the heading of other assets, have been reported in the balance sheet as at 31 December 2011 in a separate line.

Assets in respect of derivative instruments in the amount of NIS 8,717 million, included in the balance sheets as at 31 December 2010 under the heading of other assets, have been reported in the balance sheet as at 31 December 2011 in a separate line.

Liabilities in respect of derivative instruments in the amount of NIS 9,985 million, included in the balance sheets as at 31 December 2010 under the heading of other liabilities, have been reported in the balance sheet as at 31 December 2011 in a separate line.

Figures for credit to the public, net, as at 31 December 2010, have been reclassified so as to be compatible with reporting as a gross amount as of 1 January 2011, and as stated above are not comparable with current figures.

Items included in the condensed consolidated profit and loss statement:

Expenses in respect of amortization of goodwill in the amount NIS 80 million and NIS 21 million have been reclassified from other expenses and reported in a separate line for the periods ending 31 December 2010 and 31 December 2009, respectively.

Y. New Accounting Standards and Directives of the Supervisor of Banks in the period prior to their implementation

(1) In December 2006, the Israel Accounting Standards Board published Accounting Standard No. 23 – "The Accounting Treatment of Transactions between an Entity and its Controlling Shareholder". The standard replaces the provisions of the Securities Regulations (Presentation of Transactions between a Company and its Controlling Shareholder in the Financial Statements), 1996, as adopted in the Public Reporting Directives of the Supervisor of Banks. The standard provides that assets and liabilities included in a transaction between the entity and its controlling shareholder shall be measured on the transaction date at fair value and that the difference between the fair value and the consideration recorded in the transaction shall be included in shareholders' equity. A debit difference effectively constitutes a dividend and accordingly reduces retained earnings. A credit difference effectively constitutes an investment by the shareholder and shall therefore be presented as a separate item under shareholders' equity called "capital reserve from transaction between an entity and its controlling shareholder".

The standard discusses three issues relating to transactions between an entity and its controlling shareholder, as follows: (1) The transfer of an asset to the entity by the controlling shareholder, or alternatively, the transfer of an asset from the entity to the controlling shareholder; (2) The assumption by the controlling shareholder of all or part of a liability of the entity to a third party, indemnification of the entity by the controlling shareholder in respect of an expense, and the waiving by the controlling shareholder of all or part of the entity's debt to it; and (3) Loans that were granted to the controlling shareholder or loans that were received from the controlling shareholder. The standard also determines the disclosure that is to be made in the financial statements regarding transactions between the entity and its controlling shareholder during the period.

On 30 November 2011, a circular was promulgated on the subject of "Adoption of Certain International Financial Reporting Standards (IFRS)". In the context of the circular it was stipulated, *inter alia*, that as of 1 January 2012, for purposes of the accounting treatment of transactions between a banking corporation and its controlling interest, and a company controlled by the banking corporation, the accounting principles generally accepted by banks in the US are to be implemented. In those situations where the above principles do not include a reference to the manner of treatment, the principles laid out in Standard 23 are to be implemented, consistent with the principles of adoption of international financial reporting standards on matters not part of the core banking business.

In the Bank's opinion, no significant effect is expected from the initial implementation of the Standard.

(2) In July 2006, the Israel Accounting Standards Board published Accounting Standard No. 29 – "Adoption of International Financial Reporting Standards". The standard prescribes that entities that are subject to the Securities Law, 1968, and that are required to report according to the regulations of that law, shall prepare their financial statements in accordance with IFRS for periods commencing 1 January 2008. The aforementioned does not yet apply to banking corporations, the financial statements of which are prepared in accordance with the directives and guidelines of the Supervisor of Banks.

In June 2009, the Banking Supervision Department published a circular on the subject of "Reporting of Banking Corporations and Credit Card Companies in Israel in accordance with International Financial Reporting Standards (IFRS)", which determines the expected manner of adoption of IFRS by banking corporations. Pursuant to the circular, the target date for reporting of banking corporations and credit card companies according to IFRS standards is:

Subjects that are not a core part of the banking business – as of 1 January 2011. However, IFRS standards on the subjects set out below have not yet come into force and will be adopted pursuant to instructions by the Banking Supervision Department when published regarding the timing and manner of their initial implementation:

- IAS 7 Statement of Cash Flows
- IAS 12 Income Taxes
- IAS 19 Employee Benefits
- IAS 23 Borrowing Costs
- IAS 24 Related Party Disclosures

On 30 November 2011, a circular was promulgated on the subject of Adoption of Certain International Financial Reporting Standards (IFRS). In the context of the circular it was stipulated, *inter alia*, that these international financial reporting standards, with the exception of IAS 19, are to be implemented as of 1 January 2012. On the initial implementation of these international financial reporting standards, banks are required to act in accordance with the transitional directives laid out in the Standards, including the retroactive amendment of comparative figures if this is required.

The Bank is examining the expected effect of initial implementation of the Standards.

For subjects that are a core part of the banking business – beginning 1 January 2013, while the Banking Supervision Department intends to make a final decision in this regard during 2011. The final decision will be made while taking into account the timetable laid down in the US, and progress made in the convergence process between the international and US standard boards. A final decision has not yet been made.

(3) In April 2011, the FASB published Accounting Standards Update ASU 2011-03 – "Reconsideration of Effective Control for Repurchase Agreements", which constitutes an update to the rules set out in FAS 166 (ASC 860).

According to the update, the method of assessing the existence of effective control by the transferor in repurchase agreements is required to be changed. Assessing the existence of effective control will focus on the contractual rights and contractual liabilities of the transferor, and so the following will not be taken into account: (1) the criterion requiring the transferor to have the ability to repurchase securities transferred, even in the event of default by the transferee, and (2) instructions relating to the collateral maintenance related to the above criterion. Other criteria for assessing the existence of effective control were not amended by the ASU. These criteria indicate that the transferor retains effective control of the assets transferred (and so the transfer of assets will be treated as a secured debt) if all of the following conditions are met:

- The assets to be repurchased or redeemed are the same or substantially the same as those transferred;

- The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price; and

- The agreement is entered into contemporaneously with the transfer.

The update is effective for reporting periods beginning after 1 January 2012 and is to be applied prospectively for new transactions and modifications of existing transactions taking place as of the beginning of the first quarterly or annual period after the effective date. Early adoption is not permitted. No significant effect is expected from the initial implementation of the Standard.

(4) Draft directive regarding the format of the statement of profit and loss for a banking corporation and adoption of generally accepted accounting principles in US banks on the measurement of interest income.

On 29 December 2011, a Supervisor of Banks Directives circular was promulgated intended to adapt the Public Reporting Directives for purposes of:

- Determining the method of presenting the statement of profit and loss - the directive adapts the format of the statement of profit and loss to the accepted way of reporting worldwide and in the US. The new format changes the way the components of the financing profit are presented in the body of the statement of profit and loss and accompanying notes; eliminates the distinction between commissions on financing transactions and operating commissions; changes the classification of linkage differentials on principal as part of “interest”, and also changes the classification and names of other sections of the statement of profit and loss. In addition, the directive eliminates the item for “Income from extraordinary activities” and adopts the approach used in the US under which special items are defined as items which are “unusual" and “infrequent” and determines that the classification of any event as an extraordinary item would be allowed only with prior approval of the Banking Supervision Department. In addition, the directive determines changes to the format of additional notes to the financial statements.

  Implementation of the directives regarding the format of the statement of profit and loss from the report will be carried out as of the financial statement for the first quarter of 2012, by way of retroactive application. Initial implementation is not expected to have any effect apart from changes in presentation.

Note 1 – Significant Accounting Policies (cont'd)

- Adoption of the rules prescribed in accounting standards generally accepted in the US on "Nonrefundable Fees and Other Costs" - the directive establishes rules for commissions from originating loans and direct loan originating costs. Eligible fees and costs according to criteria specified in the directive will not be recognized immediately in the statement of profit and loss, but will be taken into account in calculating the effective interest rate of the loan. In addition, the directive changes the treatment of fees and costs associated with commitments to allocate credit, including credit card transactions. Furthermore, rules were set out in the directive regarding the treatment of changes in the terms of the debt that do not constitute a restructuring of a problem debt, the treatment of early repayments of debts, and the treatment of other transactions granting credit, such as syndicated transactions.

  The rules prescribed in the directive constitute a significant change compared with the rules existing currently in the Public Reporting Directives, as explained above. Preparations for implementing the rules established in the directive are complex and the Banking Supervision Department intends to accompany the process of preparation by the banking corporations, especially with regard to identifying the eligible costs. According to the draft circular, it was decided that the rules be implemented as of 1 January, 2013. Provisions relating to changing the definition of "interest" in respect of impaired debts will be implemented for debts classified as impaired as of 1 January 2012.

  The Bank is studying the draft directive and examining the implications of its initial implementation.

(5) Accounting Standards Update ASU 2011-04 – "Fair Value Measurement"

This Accounting Standards Update updates instructions regarding the method of calculating fair value set out in US Financial Accounting Standard FAS 157 (ASC 820-10). The updates in the ASU include clarifications of the FASB regarding its intent on the application of existing fair value measurement rules and disclosure requirements, and amendments setting out particular principles or requirements for measuring fair value or for disclosing information about fair value measurements.

Clarifications were given, *inter alia*, that the market in which most of the volume takes place, at the level of activity for that asset or liability, will be considered as the principal market in which the measurement is to be made, and not the market that reflects such volume or level in the eyes of the entity. In addition, additional instructions were set out for fair value measurement within financial asset portfolios. The following new disclosure requirements will also apply:

(1) For fair value measurements classified within level 3 in the fair value hierarchy:

- The valuation processes used by the reporting entity;
- Analysis of the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, if any.

(2) The use of a nonfinancial asset in a way that differs from the asset's highest and best use, when that asset is measured at fair value in the financial statement sheet or when its fair value is included within disclosures on the basis of its highest and best use.

(3) The classification by level of the fair value hierarchy for items that are not measured at fair value in the financial statement, but for which the fair value is required to be disclosed.

The standard is to be applied to annual periods commencing on 1 January 2012. Early application is not allowed. Updates set out in the ASU are to be applied prospectively.

No effects are expected from the initial implementation of the standard, except for presentation differences.

Note 2 - Cash and Deposits with Banks

Reported Amounts

	31 December 2011	31 December 2010
	NIS millions	
Cash and deposits with central banks	**42,980**	21,686
Deposits with commercial banks (a)	**9,763**	8,033
Deposits with specialized banking entities	**301**	333
Total	**53,044**	30,052
Including: Cash and deposits with central and commercial banks for original periods not exceeding three months	**49,736**	28,697

(a) After deduction of the allowance for credit losses.
Note: For liens – See Note 14.

Note 3 - Securities

Reported Amounts

	31 December 2011					31 December 2010 (e)				
	Amount in Balance	Amortized cost (for shares cost)	Other total accumulated gain		Fair Value (a)	Amount in Balance Sheet	Amortized cost (for shares cost)	Other total accumulated gain		Fair Value (a)
			Profits	Losses				Profits	Losses	
	NIS millions									
(1) Securities available for sale:										
Bonds -										
Government of Israel	19,775	19,624	154	(3)	19,775	25,382	25,267	154	(39)	25,382
Foreign governments	3,675	3,677	3	(5)	3,675	2,101	2,098	6	(3)	2,101
Financial institutions in Israel	397	392	8	(3)	397	454	441	20	(7)	454
Financial institutions abroad	7,854	8,436	14	(596)	7,854	10,590	10,866	35	(311)	10,590
Asset-backed (ABS) or Mortgage-backed securities (MBS)	2,444	2,492	26	(74)	2,444	4,341	4,229	176	(64)	4,341
Others in Israel	604	639	5	(40)	604	534	514	21	(1)	534
Others abroad	1,254	1,264	17	(27)	1,254	855	856	6	(7)	855
	36,003	36,524	227	(748)	36,003	44,257	44,271	418	(432)	44,257
Shares (b)	2,191	1,876	341	(26)	2,191	2,859	2,211	653	(5)	2,859
Total securities available for sale	38,194	38,400	568 (c)	(774) (c)	38,194	47,116	46,482	1,071 (c)	(437) (c)	47,116

	31 December 2011					31 December 2010 (e)				
	Amount in Balance	Amortized cost (for shares cost)	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair Value (a)	Amount in Balance Sheet	Amortized cost (for shares cost)	Unrealized profits from adjustments to fair value	Unrealized losses from adjustments to fair value	Fair Value (a)
	NIS millions									
(2) Securities held for trading:										
Bonds -										
Government of Israel	8,153	8,094	64	(5)	8,153	5,788	5,733	72	(17)	5,788
Foreign governments	183	180	3	-	183	750	757	-	(7)	750
Financial institutions in Israel	173	172	3	(2)	173	155	157	-	(2)	155
Financial institutions abroad	366	389	3	(26)	366	348	366	4	(22)	348
Asset-backed (ABS) or Mortgage-backed securities (MBS)	120	129	2	(11)	120	213	216	1	(4)	213
Others in Israel	330	352	-	(22)	330	336	330	6	-	336
Others abroad	56	53	3	-	56	808	808	7	(7)	808
	9,381	9,369	78	(66)	9,381	8,398	8,367	90	(59)	8,398
Shares	361	363	4	(6)	361	277	636	-	(359)	277
Total securities for trading	9,742	9,732	82 (d)	(72) (d)	9,742	8,675	9,003	90 (d)	(418) (d)	8,675
Total securities	47,936	48,132	650	(846)	47,936	55,791	55,485	1,161	(855)	55,791

See notes on next page.

Note 3 - Securities (cont'd)

Reported Amounts

Notes:

(a) With regard to fair value data, see Note 1.G – Significant Accounting Policies. Such quotations do not necessarily reflect the price which will be obtained upon sale of securities in large volumes.
(b) Including NIS 1,185 million with regard to shares which have no readily available fair value, which are shown at cost (31 December 2010 - NIS 1,289 million).
(c) Regarding securities available for sale, total other income – unrealized profits (losses) are included in shareholders' equity in the item "adjustments in respect of presentation of securities available for sale according to fair value", except for securities intended as hedging instruments for hedging fair value.
(d) Reported in the profit and loss statement but not yet realized.
(e) Comparative figures have been reclassified in accordance with the Directives of the Supervisor of Banks.

Securities lent amounting to NIS 648 million (31 December 2010 – NIS 1,211 million) are shown under Credit to the Public.

For liens – see Note 14. For details of results of investment activities in debentures – see Note 20.E.
For details of results of investment activities in debentures, shares and mutual funds – see Notes 21 and 22.

Note 3 - Securities (cont'd)

Reported Amounts

31 December 2011	Amount in balance sheet	Amortized cost	Other total accumulated gain (loss)*		Fair value
			Profits	Losses	
	NIS millions				
3. Bonds available for sale					
Pass-through securities:					
Securities guaranteed by GNMA	114	109	5	-	114
Securities issued by FNMA and FHLMC	258	250	8	-	258
Total	372	359	13	-	372
Other Mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	921	912	10	(1)	921
Other mortgage-backed securities	440	451	-	(11)	440
Total	1,361	1,363	10	(12)	1,361
Asset-backed securities (ABS)					
Credit card debtors	40	41	-	(1)	40
Lines of credit for any purpose secured by dwelling	2	3	-	(1)	2
Other credit to private persons	5	5	-	-	5
CLO debentures	661	720	1	(60)	661
Others	3	1	2	-	3
Total	711	770	3	(62)	711
Total Asset-backed bonds available for sale	2,444	2,492	26	(74)	2,444

* Amounts charged to capital reserve as part of adjustments of securities available for sale to fair value

Note 3 - Securities (cont'd)

Reported Amounts

	31 December 2010				
	Amount in balance sheet	Amortized cost	Other total accumulated gain (loss)*		
			Profits	Losses	Fair value
	NIS millions				
3. Bonds available for sale (cont'd)					
Pass-through securities:					
Securities guaranteed by GNMA	1,734	1,707	38	(11)	1,734
Securities issued by FNMA and FHLMC	247	237	10	-	247
Total	1,981	1,944	48	(11)	1,981
Other Mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or					
guaranteed by these entities	1,424	1,421	14	(11)	1,424
Other mortgage-backed securities	37	49	-	(12)	37
Total	1,461	1,470	14	(23)	1,461
Asset-backed securities (ABS)					
Debtors in respect of credit cards	38	38	-	-	38
Lines of credit for any purpose secured by dwelling	2	3	-	(1)	2
Credit for purchase of vehicles	4	4	-	-	4
Other credit to private persons	6	6	-	-	6
CLO debentures	760	686	102	(28)	760
CDO debentures	28	28	-	-	28
SCDO debentures	57	45	12	-	57
Others	4	5	-	(1)	4
Total	899	815	114	(30)	899
Total Asset-backed bonds available for sale	4,341	4,229	176	(64)	4,341

* Amounts charged to capital reserve as part of adjustments of securities available for sale to fair value

Note 3 - Securities (cont'd)

Reported Amounts

	31 December 2011				
	Amount in balance sheet	Amortized cost	Unrealized profits from adjustments to fair value*	Unrealized losses from adjustments to fair value*	Fair value
	NIS millions				
4. Debentures for trading					
Pass-through securities					
Securities issued by FNMA and FHLMC	1	1	-	-	1
Foreign securities	5	6	-	(1)	5
Total	6	7	-	(1)	6
Other Mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	96	95	1	-	96
Other mortgage-backed securities	8	11	-	(3)	8
Total	104	106	1	(3)	104
Asset-backed securities (ABS)					
Lines of credit for any purpose secured by dwelling	3	3	-	-	3
Credit not to private persons	4	4	-	-	4
CDO debentures	1	7	-	(6)	1
Others	2	2	1	(1)	2
Total	10	16	1	(7)	10
Total Asset-backed securities for trading	120	129	2	(11)	120

* These profits (losses) have been charged to profit and loss account.

Note 3 - Securities (cont'd)

Reported Amounts

31 December 2010					
	Amount in balance sheet	Amortized cost	Unrealized profits from adjustments to fair value*	Unrealized losses from adjustments to fair value*	Fair value
	NIS millions				
4. Debentures for trading (cont'd)					
Pass-through securities					
Securities issued by FNMA and FHLMC	10	10	-	-	10
Other securities	7	7	-	-	7
Total	17	17	-	-	17
Other Mortgage-backed securities (including CMO and STRIPPED MBS)					
Securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities	27	26	1	-	27
Other mortgage-backed securities	11	13	-	(2)	11
Total	38	39	1	(2)	38
Asset-backed securities (ABS)					
Lines of credit for any purpose secured by dwelling	3	3	-	-	3
Credit for purchase of vehicles	148	149	-	(1)	148
Credit not to private persons	5	5	-	-	5
CDO debentures	-	-	-	-	-
Others	2	3	-	(1)	2
Total	158	160	-	(2)	158
Total Asset-backed securities for trading	213	216	1	(4)	213

* These profits (losses) have been charged to profit and loss account.

Note 3 - Securities (cont'd)

Reported Amounts

(5) Additional details regarding securities available for sale secured by assets for which unrealized losses are included for adjustments to fair value.

	31 December 2011					
	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value
	NIS millions					
Other mortgage-backed securities (including REMIC, CMO and STRIPPED MBS)	**569**	**(3)**	**224**	**(9)**	**793**	**(12)**
Asset-backed securities (ABS)	**298**	**(40)**	**390**	**(22)**	**688**	**(62)**
Total	**867**	**(43)**	**614**	**(31)**	**1,481**	**(74)**

	31 December 2010 (e)					
	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value	Fair value	Unrealized losses from adjustments to fair value
	NIS millions					
Mortgage-backed securities (MBS)	227	(11)	-	-	227	(11)
Other mortgage-backed securities (including REMIC, CMO and STRIPPED MBS)	345	(11)	200	(12)	545	(23)
Asset-backed securities (ABS)	41	-	419	(30)	460	(30)
Total	613	(22)	619	(42)	1,232	(64)

Note 3 - Securities (cont'd)

Reported Amounts

Mortgage Backed Security – MBS
Debentures backed by mortgages for which the payments of interest and principal are based on cash flows resulting from the repayment of loans secured by mortgages.

Sub-Prime – a particular type of MBS
Debentures for which the interest and principal payments are based on a cash flow from a portfolio of mortgages given to borrowers with low credit ratings who are not able to provide appropriate collateral.

Collateralized Debt Obligation - CDO
A debenture backed by a portfolio of debentures and/or loans with varying levels of seniority and ratings.

Synthetic Collateralized Debt Obligation – SCDO
An agreement backed by a portfolio of CDS (which are derivatives) with varying levels of seniority.

Collateralized Loan Obligation – CLO
A debenture backed by a portfolio of loans.

Federal National Mortgage Association - FNMA ("Fannie Mae")
A public company backed by the United States government which purchases mortgages, securitizes them and sells them on the open market (this company's securities do not have U.S. government guarantees).

Federal Home Loan Mortgage Corporation - FHLMC ("Freddie Mac")
A United States government sponsored enterprise which purchases mortgages, securitizes them and sells them on the open market (this company's securities do not have U.S. government guarantees).

Government National Mortgage Association - GNMA ("Ginnie Mae")
A federal mortgage company which guarantees the securities it issues.

Credit Default Swap – CDS
A financial instrument which transfers the issuer's credit exposure between parties to the transaction.

Note 4 - Credit to the Public

Reported Amounts

As of 1 January 2011, the Bank implements the new directive of the Supervisor of Banks on the subject of "Measurement and Disclosure of Impaired Debts, Credit Risk and Provision for Credit Losses." In view of the fact that the new Directive was implemented prospectively, without restating comparative amounts, figures for the current period are also shown below for comparative purposes with the relevant balances as at 31 December, 2010 (pro-forma amounts), as if the Directive had been implemented initially for that year. For the effect of the first implementation of the new directive on the allowance for credit losses in respect of debts and in respect of off-balance sheet credit instruments, and the changes in the balance of the allowance during the year ended 31 December 2011, see details in Note 4.D.

A. Credit to the public:

	31 December 2011		
	Balance of debt in the books	Allowance for credit losses	Net balance of debt
	NIS millions		
Credit to the public examined on an individual basis*	**125,948**	**2,843**	**123,105**
Credit to the public examined on a collective basis**	**119,339**	**1,124**	**118,215**
Total credit to the public	**245,287**	**3,967**	**241,320**
Of which: customers' liabilities for acceptances	**638**	**4**	**634**

	31 December 2010 (Pro-forma) (a)		
	Balance of debt in the books	Allowance for credit losses	Net balance of debt
	NIS millions		
Credit to the public examined on an individual basis*	107,180	4,126	103,054
Credit to the public examined on a collective basis**	121,073	1,252	119,821
Total credit to the public	228,253	5,378	222,875
Of which: customers' liabilities for acceptances	462	3	459

(a) Restated.

* Including credit examined on an individual basis and found to be unimpaired. The credit loss allowance for un respect of this credit was calculated on a collective basis. For further details in respect of credit examined on an individual basis, see Note 4.B.

** Credit in respect of which the credit loss allowance is assessed on a collective basis by the extent of arrears method according to the Appendix to Proper Conduct of Banking Business Directive No. 314, and other credit not examined individually, in respect of which the credit loss allowance was calculated on a collective basis.
See further details in Note 4.C.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

B. Credit to the public examined on an individual basis:

	31 December 2011		
	Balance of debt in the books	Allowance for credit losses	Net balance of debt
	NIS millions		
1. Credit to the public examined on an individual basis includes:			
Impaired credit to the public*	**6,778**	**1,731**	**5,047**
Unimpaired credit to the public, in arrears of 90 days or more**	**-**	**-**	**-**
Unimpaired credit to the public, in arrears of 30 to 89 days **	**946**	**6**	**940**
Other unimpaired credit to the public **	**118,224**	**1,106**	**117,118**
Total unimpaired credit to the public	**119,170**	**1,112**	**118,058**
Total credit to the public examined on an individual basis	**125,948**	**2,843**	**123,105**

	31 December 2010 (Pro-forma) (a)		
	Balance of debt in the books	Allowance for credit losses	Net balance of debt
	NIS millions		
Credit to the public examined on an individual basis includes:			
Impaired credit to the public*	8,937	3,233	5,704
Unimpaired credit to the public, in arrears of 90 days or more**	-	-	-
Unimpaired credit to the public, in arrears of 30 to 89 days **	1,225	17	1,208
Other unimpaired credit to the public **	97,018	876	96,142
Total unimpaired credit to the public	98,243	893	97,350
Total credit to the public examined on an individual basis	107,180	4,126	103,054

(a) Restated.

* Impaired credit not accruing interest income, except for certain credit under restructuring.

** Credit examined on an individual basis and found to be unimpaired. The credit loss allowance in respect of this credit was calculated on a collective basis.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

Additional information on credit to the public examined on an individual basis	31 December 2011	31 December 2010
	NIS millions	
2. Impaired credit to the public in respect of which there is a allowance for credit losses on an individual basis	**4,338**	5,894
Impaired credit to the public in respect of which there is no allowance for credit losses on an individual basis	**2,440**	3,043
Total impaired credit	**6,778**	8,937

	31 December 2011	31 December 2010
3. Impaired credit to the public measured according to present value of cash flows	**4,595**	8,189
Impaired credit to the public measured according to collateral value	**2,183**	748
Total impaired credit to the public	**6,778**	8,937

	31 December 2011		
	Balance of debt in the books	Allowance for credit losses	Net balance of debt
	NIS millions		
4. Problematic credit under restructuring in which changes were made to the terms of credit:			
Not accruing interest income	**692**	**63**	**629**
Accruing interest income	**144**	**1**	**143**
Total (included in impaired credit to the public)	**836**	**64**	**772**

	31 December 2010 (Pro-forma) (a)		
	Balance of debt in the books	Allowance for credit losses	Net balance of debt
	NIS millions		
Problematic credit under restructuring in which changes were made to the terms of credit:			
Not accruing interest income	290	7	283
Accruing interest income	43	1	42
Total (included in impaired credit to the public)	333	8	325

	31 December 2011
	(Unaudited)
	NIS millions
5.	
Average balance of debt in the books for the reporting period of impaired credit to the public	**6,764**
Amount of interest income recorded for the reporting period in respect of this credit during the period it was classified as impaired *	**13**
Amount of interest income that would have been recorded for the reporting period if this credit had accrued interest in accordance with its original terms	**611**
* Of which: interest income that would have been recorded by the cash-basis accounting method	**12**

(a) Restated.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

C. Credit to the public examined on a collective basis including:

1. Housing loans for which a minimum allowance for credit losses was made by extent of arrears:

	31 December 2011							
	Extent of arrears							
	Arrears of 30 to 90 days	Arrears of more than 90 days						
	From 1 to 3 months	From 3 to 6 months	From 6 to 15 months	From 15 to 33 months	Above 33 months	Total above 3 months	Balances in respect of refinanced past-due loans (3)	Total
	NIS millions							
Amount of arrears	**9**	**8**	**11**	**11**	**180**	**210**	**14**	**233**
Of which: balance of provision for interest (1)	**-**	**-**	**-**	**1**	**84**	**85**	**1**	**86**
Balance of debt in the books	**706**	**207**	**135**	**46**	**198**	**586**	**332**	**1,624**
Balance of allowance for credit losses (2)	**-**	**-**	**17**	**20**	**179**	**216**	**133**	**349**
Net balance of debt	**706**	**207**	**118**	**26**	**19**	**370**	**199**	**1,275**

	31 December 2010 (Pro-forma) (Audited) (a)							
	Extent of arrears							
	Arrears of 30 to 90 days	Arrears of more than 90 days						
	From 1 to 3 months	From 3 to 6 months	From 6 to 15 months	From 15 to 33 months	Above 33 months	Total above 3 months	Balances in respect of refinanced past-due loans (3)	Total
	NIS millions							
Amount of arrears	9	7	16	13	214	250	16	275
Of which: balance of provision for interest (1)	-	-	1	1	98	100	1	101
Balance of debt in the books	742	212	147	63	245	667	379	1,788
Balance of provision for credit losses (2)	-	-	19	29	225	273	177	450
Net balance of debt	742	212	128	34	20	394	202	1,338

(1) In respect of interest on amounts in arrears.
(2) Excluding the balance of the allowance for interest.
(3) Loans in which an arrangement was signed for the repayment of arrears by the borrower, with a change made to the repayment schedule in respect of the loan balance of which the repayment date has not yet arrived.

(a) Restated.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

2. **Other credit not examined individually for which an allowance for credit losses was calculated on a collective basis:**

	31 December 2011		
	Balance of debt in the books	Allowance for credit losses	Net balance of debt
	NIS millions		
Impaired credit to the public	**6**	**1**	**5**
Unimpaired credit to the public, in arrears of 90 days or more	**638**	**36**	**602**
Unimpaired credit to the public, in arrears of 30 to 89 days	**371**	**8**	**363**
Other unimpaired credit to the public	**116,700**	**730**	**115,970**
Total credit to the public not examined on an individual basis	**117,715**	**775**	**116,940**

	31 December 2010 (Pro-forma) (a)		
	Balance of debt in the books	Allowance for credit losses	Net balance of debt
	NIS millions		
Impaired credit to the public	6	2	4
Unimpaired credit to the public, in arrears of 90 days or more	63	27	36
Unimpaired credit to the public, in arrears of 30 to 89 days	894	13	881
Other unimpaired credit to the public	118,322	760	117,562
Total credit to the public not examined on an individual basis	119,285	802	118,483

(a) Restated.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

D. Allowance for credit losses in respect of debts and in respect of off-balance sheet credit instruments

	On an individual basis	On a collective basis (a) By extent of arrears	On a collective basis (a) Other	Total
	NIS millions			
Balance of allowance for credit losses as at 31.12.2010	**9,321**	**450**	**770**	**10,541**
Net accounting write-offs recognized at 1.1.2011 (b)	**(5,835)**	**-**	**(5)**	**(5,840)**
Other changes in the allowance for credit losses as at 1.1.2011 (charged to shareholders' equity) (b) (c)	**(107)**	**-**	**1,181**	**1,074**
Balance of allowance for credit losses as at 1 January 2011	**3,379**	**450**	**1,946**	**5,775**
Expenses (income) in respect of credit losses	**382**	**(32)**	**384**	**734**
Accounting write-offs	**(2,011)**	**(69)**	**(438)**	**(2,518)**
Collection of debts written off in the accounts in previous years	**120**	**-**	**329**	**449**
Net accounting write-offs	**(1,891)**	**(69)**	**(109)**	**(2,069)**
Balance of allowance for credit losses as at 31 December 2011	**1,870**	**349**	**2,221**	**4,440**

Composition of balance of the allowance as at 31 December 2011				
In respect of credit to the public	**1,731**	**349**	**1,887**	**3,967**
In respect of debts not being credit to the public	**5**	**-**	**4**	**9**
In respect of off balance-sheet credit instruments (d)	**134**	**-**	**330**	**464**
Balance of allowance for credit losses as at 31 December 2011	**1,870**	**349**	**2,221**	**4,440**
Composition of balance of the allowance as at 31 December 2010				
In respect of credit to the public	3,233	450	1,695	5,378
In respect of debts not being credit to the public	1	-	-	1
In respect of off balance-sheet credit instruments (d)	145	-	251	396
Balance of allowance for credit losses as at 31 December 2010	3,379	450	1,946	5,775

(a) Including allowance on a collective basis in respect of loans examined on an individual basis and found to be unimpaired.

(b) Net accounting write-offs and other changes in the allowance for credit losses as a result of initial implementation of the new Directives on the subject of "Measurement and Disclosure of Impaired Debts, Credit Risk and Allowance for Credit Losses."

(c) The figures are restated compared with the "pro-forma" amounts published in the Annual Report as at 31 December, 2010. The change in the amount of NIS 239 million (before the effect of tax) stems mainly from directives of the Banking Supervision Department on the subject of the collective allowance in respect of housing loans and special mention in respect of individual debts and other estimates, as well as changes to the classification of allowances in respect of interest on principal.

(d) Included under other liabilities.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

E. Additional details of housing loans and the method of calculating the allowance for credit losses

	31 December 2011						
	Housing loans	Impaired housing loans or in arrears of more than 90 days (a)		Balance of allowance for credit losses			
					Other (e)		
	Recorded balance of debt (e) (f)	Amount in arrears (c)	Recorded balance of debt	By extent of arrears (d)	On collective basis	On individual basis	Total
	(NIS millions)						
Housing loans that require calculating the allowance for credit losses according to extent of arrears (b)	**57,452**	**230**	**947**	**502**	**4**	**10**	**516**
Other housing loans	**1,367**	**15**	**55**	**-**	**2**	**14**	**16**
Total	**58,819**	**245**	**1,002**	**502**	**6**	**24**	**532**

	31 December 2010						
	Housing loans	Impaired housing loans or in arrears of more than 90 days (a) (g)		Balance of allowance for credit losses			
					Other (e)		
	Recorded balance of debt (e) (f)	Amount in arrears (c)	Recorded balance of debt	By extent of arrears (d)	On collective basis	On individual basis	Total
	(NIS millions)						
Housing loans that require calculating the allowance for credit losses according to extent of arrears (b)	50,704	266	1,046	592	-	-	592
Other housing loans	-	-	-	-	-	-	-
Total	50,704	266	1,046	592	-	-	592

(a) Impaired housing loans and housing loans in arrears of more than 90 days.
(b) Of which the total balance of loans secured by a residential mortgage is NIS 7,744 million (31 December 2010 – NIS 6,817 million).
(c) Including interest on the amount in arrears.
(d) Including balance of allowance in excess of amount required according to extent of arrears of NIS 222 million, of which NIS 153 million is a collective allowance (31 December 2010 – NIS 256 million and NIS 142 million respectively).
(e) Of which: housing loans at variable rates of interest in the amount of NIS 43,365 million (31 December 2010 – NIS 37,244 million).
(f) The balance includes credit in respect of residential purchasing groups shown under construction and real estate of NIS 879 million (31 December 2010 - NIS 793 million).
(g) Reclassified.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

F. Credit to the public [(a)] and off-balance sheet credit risk [(b)] according to size of debt per borrower

		31 December 2011		
Credit limit		Number of borrowers (c)	Credit (a)	Off-balance sheet credit risk (b)
NIS thousands			NIS millions	
From	To			
0	10	745,889	813	1,657
10	20	316,725	1,685	3,021
20	40	348,893	4,160	5,979
40	80	288,475	8,287	7,969
80	150	148,739	9,892	5,739
150	300	82,429	13,412	3,122
300	600	56,505	20,745	2,374
600	1,200	32,461	23,272	2,767
1,200	2,000	8,870	11,252	1,878
2,000	4,000	5,079	11,093	2,495
4,000	8,000	2,516	10,935	2,927
8,000	20,000	1,890	18,086	5,712
20,000	40,000	884	17,893	6,710
40,000	200,000	769	42,007	19,597
200,000	400,000	94	16,784	9,198
400,000	800,000	49	17,983	8,892
800,000	1,200,000	14	7,592	5,529
1,200,000	1,600,000	5	4,527	2,011
1,600,000	2,000,000	3	2,535	2,559
2,000,000	2,400,000	1	1640	566
2,400,000	2,710,000	2	5,009	293
Total		2,040,292	249,602	100,995

Commencing with a credit level of NIS 8,000 thousand, the classification is set out by the specific consolidation method; with respect to the other borrowers, credit has been classified by the category consolidation method.

(a) Before the effect of allowances for credit losses, and before the effect of collateral permitted for deduction for purposes of single borrower and group of borrowers indebtedness; with the addition of the fair value of derivative instruments in the amount of NIS 4,315 million. Open credit card transactions have been allocated to credit levels by the category consolidation method.
(b) Credit risk in off-balance sheet financial instruments as calculated for purposes of single borrower restrictions.
(c) Number of borrowers by total credit and credit risk.
The definition of "borrower" and the definition of debt, including off-balance sheet credit risk, are in accordance with the directives of the Banking Supervision Department for amendment of Proper Conduct of Banking Business Directive No. 313 - "Restrictions on the Debt of a Single Borrower and of a Group of Borrowers". Accordingly, the figures shown for 31 December 2011 are not comparable with figures for 31 December 2010.

Note 4 - Credit to the Public (cont'd)

Reported Amounts

F. Credit to the public [(a)] and off-balance sheet credit risk [(b)] according to size of debt per borrower (cont'd)

		31 December 2010		
Credit limit		Number of borrowers (c)	Credit (a)	Off-balance sheet credit risk (b) (d)
NIS thousands			NIS millions	
From	To			
0	10	809,508	964	1,420
10	20	313,999	1,674	2,770
20	40	329,829	3,918	5,359
40	80	272,343	7,692	7,571
80	150	139,195	9,216	5,622
150	300	79,026	13,451	3,228
300	600	52,480	20,095	2,249
600	1,200	27,616	20,050	3,575
1,200	2,000	7,354	9,391	1,850
2,000	4,000	4,510	10,061	2,428
4,000	8,000	2,396	10,291	2,996
8,000	20,000	1,888	17,654	5,871
20,000	40,000	825	16,251	6,459
40,000	200,000	706	37,211	20,127
200,000	400,000	93	15,798	10,117
400,000	800,000	46	16,397	8,786
800,000	1,200,000	14	8,017	5,445
1,200,000	1,600,000	4	4,032	1,461
1,600,000	2,000,000	3	969	4,669
2,000,000	2,400,000	-	-	-
2,400,000	2,800,000	1	2,607	59
2,800,000	3,200,000	-	-	-
3,200,000	3,630,000	1	2,612	1,018
Total		2,041,837	228,351	103,080

Commencing with a credit level of NIS 8,000 thousand, the classification is set out by the specific consolidation method; with respect to the other borrowers, credit has been classified by the category consolidation method.

(a) Net of specific provisions for doubtful debts and with the addition of the fair value of derivative instruments in the amount of NIS 3,725 million. Open credit card transactions were allocated to credit levels by the category consolidation method.
(b) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of single borrower restrictions.
(c) Number of borrowers by total credit and credit risk.
(d) Reclassified.

Note 5 - Credit to Governments

Reported Amounts

	31 December 2011	31 December 2010
	(NIS millions)	
Credit to the government	**316**	262
Credit to foreign governments	**132**	117
Total credit to governments	**448**	379

Note 6 - Investments in Investee Companies

Reported amounts

A. Composition:

	31 December 2011	31 December 2010
	Companies included on equity basis	Companies included on equity basis
	NIS millions	
Total investments in shares stated on equity basis (including other assets)	**2,266**	1,918
Loans from shareholders	**4**	6
Total investments	**2,270**	1,924
Including - post-acquisition profits	**1,505**	1,438
Post-acquisition changes in shareholders' equity:		
Adjustments in respect of companies included on equity basis (a)	**(23)**	(71)
Details regarding goodwill and other intangible assets:		
Amortization period	**10 -20 years**	10 -20 years
Original amount, net	**188**	73
Unamortized balance	**144**	21

Details on book value and market value of quoted investments:

	31 December 2011		31 December 2010	
	Book value	Market value	Book value	Market value
	NIS millions			
The Israel Corporation Ltd.	**1,749**	**3,291**	1,635	5,953
Total	**1,749**	**3,291**	1,635	5,953

(a) Restated.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported Amounts

B. Group's equity in profit of companies included on equity basis

	2011	2010	2009
	NIS millions		
Group's equity in operating profit of companies included on equity basis	**143**	452	74
Provision for deferred taxes	**5**	(32)	7
Group's equity in after-tax operating profits of companies included on equity basis	**148**	420	81

C. Details regarding investee companies

(1) Holdings in Non-banking Holding Corporations (Conglomerates)

The Bank's holdings in non-banking corporations are subject to restrictions prescribed in the Banking (Licensing) Law, 1981 (the "Banking Law"). The Banking Law prescribes, *inter alia*, in section 24A of the Law, that a banking corporation may hold more than 1% of the means of control in only one conglomerate ("real holding corporation") (a corporation whose capital is more than some NIS 2,000 million and that operates in more than three branches of the economy). The Bank holds one conglomerate - The Israel Corporation.

It should be noted that under the legislation passed pursuant to the capital market reform, a Bank is allowed to hold five percent of the capital of an insurance company and ten percent of the capital of a corporation controlling an insurance company. In addition, under the amendment to the Banking (Licensing) Law in March 2010, a Bank is allowed to hold only one insurance company whose shareholders' equity under section 35 of the Financial Services Supervision Law (Insurance), 1981, exceeds NIS 2,000 million.

Reported Amounts

C. Details regarding investee companies (cont'd)

(2) Details of a subsidiary company consolidated for the first time

On 10 February 2011, an agreement (hereinafter: "the purchase agreement") was signed between Bank Leumi Le-Israel Ltd. (hereinafter: "Leumi"), directly or through a company under its control, and Island Tower Foundation, Helena S. Safdié, Levy Edmundo Safdié, and G.RS. Participations S.A.R.L., the owners of the Bank Safdié SA in Switzerland (hereinafter: “Bank Safdié”), according to which Leumi will purchase, directly or through a company under its control, all of the share capital in the acquired bank, subject to conditions precedent specified in the agreement. On 30 November 2011, after the fulfilling of the conditions precedent appearing in the agreement, the purchase transaction was completed and Leumi acquired all of the share capital of Bank Safdié. In accordance with the purchase agreement, the total consideration paid on the date of closing is about SFR 143 million, of which SFR 110 was paid to the sellers and the balance of SFR 33 was deposited in trust to secure adjustments to the proceeds deriving from changes in the assets under management by Bank Safdié during the 24-month period following the date of the transaction’s closing, and additional adjustments according to formulas agreed upon by the parties. The surplus cost of NIS 138 million was attributed temporarily to customer portfolios until the completion of the allocation of the surplus cost. On 3 January 2012, the merger was formally completed in the context of which the activities of Bank Safdié merged with the activities of Bank Leumi Switzerland.

	At acquisition date (NIS millions)
Total assets (a)	3,141
Balance of attributed surplus cost generated on acquisition of subsidiary	138
Net profit of attribution to Bank's shareholders at date of acquisition	2

(a) As reported by the Bank.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)
Reported Amounts

D. Details concerning principal investee companies

(1) Consolidated subsidiaries (a)

Name of company	Principal area of activity	Percentage of equity granting a right to profits		Percentage of voting rights		Investment in shares - net asset value		Other equity investments (i)		Contribution to net operating profit		Contribution to profit from extraordinary transactions		Dividend received		Other items in accumulated shareholders' equity (b)		Guarantees for the company in favour of parties outside the Group	
		31 December		31 December		31 December		31 December		31 December		31 December		31 December		31 December		31 December	
		2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
		(%)	(%)	(%)	(%)	NIS millions													
In Israel																					
Arab-Israel Bank Ltd.	General banking services	**99.7**	99.7	**99.7**	99.7	**421**	343	**158**	156	**108**	75	**-**	-	**-**	60	**(22)**	7	**-**	-
Leumi Mortgage Bank Ltd. (k)	Provision of housing loans	**100.0**	100.0	**100.0**	100.0	**2,769**	2,656	**1,009**	535	**203**	175	**-**	-	**-**	-	**(76)**	8	**-**	-
Leumi Agricultural Development Ltd.		**100.0**	100.0	**100.0**	100.0	**59**	58	**-**	-	**1**	-	**-**	-	**-**	1	**-**	-	**-**	-
Leumi Industrial Development Ltd.		**99.6**	99.6	**99.8**	99.8	**105**	104	**-**	-	**1**	1	**-**	-	**-**	1	**-**	-	**-**	-
Leumi Partners Ltd. (c)	Business and financial services	**100.0**	100.0	**100.0**	100.0	**379**	552	**1,200**	1,122	**(114)**	158	**-**	5	**-**	-	**(58)**	15	**-**	-
Leumi Leasing and Investments Ltd. (d)	Equipment leasing and granting loans	**99.5**	99.5	**99.8**	99.8	**937**	902	**-**	-	**35**	17	**-**	-	**-**	-	**-**	-	**2**	2
Leumi Finance Company Ltd.	Raising capital by bond issues	**100.0**	100.0	**100.0**	100.0	**154**	152	**-**	-	**12**	10	**-**	-	**11**	9	**1**	(2)	**-**	7
Leumi Card Ltd.	Provision of credit card services	**80.0**	80.0	**80.0**	80.0	**874**	786	**-**	-	**142**	127	**-**	-	**-**	-	**(54)**	-	**-**	-
Leumi Securities and Investments Ltd.		**100.0**	100.0	**100.0**	100.0	**18**	79	**-**	-	**2**	4	**-**	-	**63**	-	**-**	-	**-**	-
Leumi Capital Market Services Ltd.	Operating services to provident funds	**100.0**	100.0	**100.0**	100.0	**30**	22	**-**	-	**7**	9	**-**	-	**-**	45	**-**	-	**-**	-
Leumi Financial Holdings Ltd.	Financial holdings	**100.0**	100.0	**100.0**	100.0	**434**	470	**-**	-	**9**	5	**-**	-	**-**	-	**-**	-	**-**	-
Abroad																					
Bank Leumi le-Israel Corporation	Holding company - registered in the U.S.	**100.0**	100.0	**100.0**	100.0	**553**	521	**-**	-	**27**	(36)	**-**	-	**-**	-	**5**	6	**-**	-
Bank Leumi USA (e)	General banking services - registered in the U.S.	**99.9**	99.9	**99.9**	99.9	**1,977**	1,787	**-**	-	**183**	(60)	**-**	-	**-**	-	**7**	13	**-**	-
Bank Leumi (UK) plc	General banking services - registered in the U.K.	**99.8**	99.8	**99.8**	99.8	**686**	587	**428**	399	**102**	(29)	**-**	-	**-**	-	**(3)**	(1)	**-**	7
Bank Leumi le-Israel (Switzerland) (f)	General banking services - registered in Switzerland	**94.6**	84.2	**98.0**	93.9	**479**	621	**203**	190	**53**	34	**-**	-	**269**	-	**(6)**	1	**-**	-
Leumi Re Ltd.	Insurance	**100.0**	100.0	**100.0**	100.0	**84**	74	**-**	-	**29**	(2)	**-**	-	**19**	19	**-**	-	**-**	-
Bank Leumi (Luxembourg) SA	General banking services - registered in Luxembourg	**100.0**	100.0	**100.0**	100.0	**130**	107	**55**	52	**22**	1	**-**	-	**-**	-	**-**	3	**7**	14
Bank Leumi Romania (g)	General banking services - registered in Romania	**99.9**	99.9	**99.9**	99.9	**229**	250	**-**	-	**(21)**	(176)	**-**	(4)	**-**	-	**-**	-	**49**	47
Companies held by Bank Leumi USA																					
Leumi Finance Corporation (h)		**99.9**	99.9	**99.9**	99.9	**5,263**	4,872	**-**	-	**391**	(283)	**-**	-	**-**	-	**-**	-	**-**	-
Leumi USA Investment Corporation (h)		**99.9**	99.9	**99.9**	99.9	**3,717**	3,370	**-**	-	**318**	(114)	**-**	-	**-**	-	**-**	-	**-**	-

See notes on next page.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported Amounts

Notes:

(a) Data regarding consolidated companies reflecting the Bank's investment therein less investments of each company in other companies in the Bank Group, and the Bank's share in their results less each company's share in the results of other companies in the Bank Group in respect of the abovementioned investments.
(b) Including adjustments in respect of presentation of the securities available for sale of consolidated companies by fair value.
(c) The Bank's share in a capital reserve in respect of the benefit in controlling shareholders' loans is NIS 58 million.
(d) The Bank's share in a capital reserve in respect of the benefit in controlling shareholders' loans is NIS 82 million.
(e) The investment in the company was made by Bank Leumi Le-Israel Corporation.
(f) The investment includes a balance of goodwill, in the amount of NIS 25.4 million.
(g) The investment is after deducting the balance of goodwill.
(h) Property companies established by Bank Leumi U.S.A. and consolidated in their financial statements. The companies have shareholders' equity against credit transferred from Bank Leumi U.S.A. As a result of adjustment of the financial statements and translation thereof into shekels, income (losses) were generated on the consolidated capital, which are offset from Bank Leumi U.S.A.
(i) Other equity investments include capital notes and shareholders' loans.
(j) Attributed to shareholders of the banking corporation.
(k) On 22 January 2012, the Board of Directors of the Bank approved the intention of Management to take steps for the merger of Leumi Mortgage Bank, which is a wholly-owned subsidiary of the Bank, with the Bank. The Bank intends to complete the merger by the end of 2012. The execution of the abovementioned merger will not have any effect on the consolidated financial statements at the date of the merger.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported Amounts

D. Details concerning principal investee companies (cont'd)

(2) Companies included on equity basis (a)

Name of company	Principal area of activity	Percentage of equity granting a right to profits (e)		Percentage of voting rights (e)		Investment in shares - net book value		Investment in shares - market value		Contribution to net operating profit		Dividend paid		Other items in accumulated shareholders' equity (d)		Guarantees for the company in favour of parties outside the Group	
		31 December		31 December		31 December		31 December		31 December		31 December		31 December		31 December	
		2011	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010	**2011**	2010
		(%)	(%)	**(%)**	(%)	NIS millions											
The Israel Corporation Ltd. (b)	Holding company	**18.1**	18.1	**18.1**	18.1	**1,749**	1,635	**3,291**	5,953	**97**	350	**43**	-	**51**	(118)	**409**	359
Paz Oil Company Ltd (c)	Supply of energy products and management of refueling and commerce areas	**-**	-	**-**	-	**-**	-	**-**	-	**-**	29	**-**	-	**-**	45	**-**	-

(a) The data regarding companies included on equity basis is on a consolidated basis.
(b) Includes balance of other assets in the amount of NIS 41 million (31 December 2010 - NIS 46 million).
(c) The investment was sold on 22 June 2010.
(d) Includes other reserves accumulated in retained earnings.
(e) The Bank has investments classified as companies included on equity basis, in which the percentage holding is less than 20%. The Bank treats these investments as companies included on equity basis in lights of the indicators evidencing a material effect in excess of the percentage holding, such as rights to appoint directors, and the holding of options for purchasing of shares that are exercisable immediately.

Note 6 - Investments in Companies Included on Equity Basis (cont'd)

Reported Amounts

E. Goodwill and Intangible Assets

	Goodwill	Customer securities portfolios	Total
	(NIS millions)		
Cost			
As at 31 December 2009	188	-	188
As at 31 December 2010	188	-	188
Acquisitions in business combinations	**-**	**138**	**138**
As at 31 December 2011	**188**	**138**	**326**
Amortization and losses from impairment			
Balance at 31 December 2009	63	-	63
Amortization for the year	5	-	5
Loss from impairment	75	-	75
Balance at 31 December 2010	143	-	143
Amortization for the year	**1**	**1**	**2**
As at 31 December 2011	**144**	**1**	**145**
Amortized balance at 31 December 2011	**44**	137	181
Book value			
As at 31 December 2009	125	-	125
As at 31 December 2010	45	-	45
As at 31 December 2011	**44**	**137**	**181**

Note 7 – Buildings and Equipment

Reported Amounts

A. Composition:

	Buildings and real estate (a)	Equipment, furniture and vehicles (b)	Software (b)	Total
	NIS millions			
Cost				
As at 31 December 2010	3,271	3,337	3,268	9,876
Additions	**83**	**254**	**393**	**730**
Disposals	**(16)**	**(57)**	**(34)**	**(107)**
As at 31 December 2011	**3,338**	**3,534**	**3,627**	**10,499**
Accumulated depreciation				
As at 31 December 2010	1,625	2,634	1,979	6,238
Current year provision	**105**	**196**	**410**	**711**
Cancelled losses from impairment	**(4)**	**-**	**-**	**(4)**
Disposals	**(10)**	**(55)**	**(34)**	**(99)**
As at 31 December 2011	**1,716**	**2,775**	**2,355**	**6,846**
Balance after depreciation as at 31 December 2011	**1,622**	**759**	**1,272**	**3,653**
Balance after depreciation as at 31 December 2010	1,646	703	1,289	3,638

(a) Including leasehold installations and improvements.
(b) Reclassified.

B. Average depreciation rate:

	31 December 2011	31 December 2010
Buildings and real estate	**4.06%**	3.22%
Equipment, furniture and motor vehicles	**17.35%**	17.49%

C. The Group has rental or lease rights on real estate and equipment for a period of from 1 to 94 years from the balance sheet date in an amount (net of depreciation) of NIS 135 million (31 December 2010 – NIS 133 million).

D. Investment property - buildings and real estate not used by the Group, mainly rental buildings, amount to NIS 81 million in the balance sheet (31 December 2010 – NIS 23 million).

E. The item "Buildings and equipment" includes improvements and leasehold rights, including payments on account. Some of the buildings are on leased land. Assets in the amount of NIS 236 million (31 December 2010 – NIS 198 million) in the balance sheet have not yet been registered in the name of the Bank at the Land Registry Office. The principal reasons for the non-registration are the absence of a land registry arrangement in the area ("parcellation"), and non-registration of the project as a condominium building by the contractor/developer.

F. Buildings earmarked for sale, in the amount of NIS 3 million (31 December 2010 – NIS 4 million) are shown net of a provision for anticipated losses. The fair value of the assets earmarked for sale at 31 December 2011 was NIS 4 million (31 December 2010 - NIS 5 million).

G. The balance of software includes costs capitalized during the year relating to the development of computer software in the amount of NIS 207 million (31 December 2010 – NIS 96 million).

Note 8 – Other Assets

Reported Amounts

	31 December 2011	31 December 2010
	NIS millions	
Deferred tax asset, net (a) - see Note 26.I	**2,396**	1,225
Excess of funds allocated for severance pay over provision – see Note 15.C	**227**	326
Assets transferred to ownership of the Group as a result of settlement of problem loans	**25**	31
Value of insurance policies in foreign branch	**406**	368
Excess of advance tax payments over current provisions	**239**	113
Expenses to be amortized on issuance of debentures, bonds and subordinated notes	**61**	57
Accrued income	**134**	139
Prepaid expenses	**207**	193
Other receivables and prepayments	**509**	153
Total other assets (b)	**4,204**	2,605

(a) Restated.
(b) Reclassified.

Note 9 - Deposits of the Public
Reported Amounts

	31 December 2011	31 December 2010
	NIS millions	
Demand deposits	**63,134**	62,839
Time and other deposits	**212,688**	183,050
Deposits in savings plans (before the reform)	**3,582**	3,695
Total deposits of the public	**279,404**	249,584

Note 10 - Deposits from Banks
Reported Amounts

	31 December 2011	31 December 2010
	NIS millions	
Commercial banks:		
Demand deposits	**3,252**	905
Time deposits	**1,066**	1,226
Acceptances	**638**	462
Specialized banking entities:		
Demand deposits	**76**	64
Time deposits	**24**	34
Total deposits from banks	**5,056**	2,691

Note 11 – Debentures, Bonds and Subordinated Notes

Reported Amounts

	Average duration (a)	Internal rate of return (a)	31 December	
	Years	%	2011	2010
			NIS millions	
Debentures and bonds (b):				
In Israeli currency linked to the CPI	2.83	5.04	1,210	1,184
Subordinated notes (b):				
Unlinked Israeli currency	4.50 (c)	5.71	4,987	4,832
In Israeli currency linked to the CPI (d)	4.03 (c)	4.41	23,372	19,975
In Israeli currency linked to the U.S. dollar	-	-	-	-
In U.S. dollars	0.97 (c)	1.29	430	948
Total debentures, bonds and subordinated notes			29,999	26,939

(a) The average duration is the average of the payment periods, weighted according to the payment flow discounted at the internal rate of return. The internal rate of return is the rate of interest discounting the value of the anticipated future flow of payments to the amount included in the balance sheet.

(b) The unamortized balance of the discount less the premium on debentures and on subordinated notes not yet charged to profit and loss has been deducted from the amount of the debentures.

(c) The average duration as of the date of change in interest is based on a calculation of the effective average duration as calculated for purposes of Exhibit D, in unlinked subordinated notes is 1.73 years, in those linked to the CPI is 4.12 years and in subordinated notes in U.S. dollars is 0.97 years.

(d) Of which: subordinated notes (unquoted) deemed Upper Tier 2 capital in the amount of NIS 503 million (31 December 2010 - NIS 490 million) that in certain circumstances may be converted into shares.

(e) On 16 May 2011, in accordance with a permit received from the Israel Securities Authority, the Leumi Finance published a shelf prospectus for the issue of up to 9 series of debentures (series 179 to 187), up to 11 series of subordinated notes (Series N to W) for NIS 4 billion nominal value of each. In addition, the shelf prospectus allows for the issue of up to NIS 2,950,000,000 nominal value of subordinated notes (Series L) and NIS 3,350,000,000 nominal value of subordinated notes (Series M), in the framework of an expansion of quoted series first issued by means of a shelf prospectus dated 14 September 2010. The shelf prospectus dated 16 May 2011 is valid for two years from its publication.

According to the Shelf Offer Report dated 7 September 2011, Leumi Finance issued a total of about NIS 1.4 billion subordinated notes in the expansion to Series L – M as set out below:

Subordinated notes in the expansion of Series L amounting to NIS 1,142,941,000 par value (proceeds of NIS 1,144,083,941) are due to be repaid in one installment on 10 September 2017, are linked (principal and interest) to the consumer price index for July 2010 and bear interest at 2.6% per annum, payable on 10 September of each year from 2012 to 2017 (inclusive).

Subordinated notes in the expansion of Series M amounting to NIS 276,039,000 par value (proceeds of NIS 275,486,922) are due to be repaid in one installment on 10 September 2017, are not linked (principal and interest) to the any index and bear interest at 5.4% per annum, payable on 10 September of each year from 2012 to 2017 (inclusive).

The subordinated notes have been approved by the Bank of Israel as lower Tier 2 capital.

According to the Shelf Offer Report of 9 November 2011, Leumi Finance issued a total of some NIS 2 billion of subordinated notes in the expansion of Series L and an issue of Series N as follows:

Subordinated notes in the expansion of Series L amounting to NIS 1,078,669,000 par value (proceeds of NIS 1,105,635,725). For further details in respect of Subordinated Notes Series L, see above.

Subordinated notes in the expansion of Series N amounting to NIS 860,745,000 par value are due to be repaid in one installment on 9 November 2020, are linked (principal and interest) to the consumer price index for September 2011 and bear interest at 3.4% per annum, payable on 10 November of each year from 2012 to 2020 (inclusive).

The subordinated notes have been approved by the Bank of Israel as lower Tier 2 capital.

Note 12 - Other Liabilities

Reported Amounts

	31 December 2011	31 December 2010
	NIS millions	
Deferred tax liability, net – see Note 26(I)	118	130
Excess of current provisions for taxes over advance payments	33	158
Excess of provisions for severance pay and pensions over amounts allocated (b) - see Note 15(D)	4,288	3,767
Provisions for unutilized vacations and long service bonus	897	885
Deferred income	537	545
Allowance for credit losses in respect of off-balance sheet items	464	264
Accrued expenses in respect of salaries and related expenses	494	575
Proposed dividend (a)	-	500
Payables in respect of credit cards	5,606	5,581
Accrued expenses	399	368
Market value of securities sold short	838	425
Other payables and credit balances	1,063	648
Total other liabilities (b) (c)	14,737	13,846

(a) Paid 27 January 2011.
(b) Restated.
(c) Reclassified.

Note 13 - Shareholders' Equity and Capital Adequacy

A. Share capital

	31 December 2011		31 December 2010	
	Authorized	**Issued and paid**	Authorized	Issued and paid
	(NIS)		(NIS)	
Ordinary shares of NIS 1.0 each	**2,215,000,000**	**1,473,551,221**	2,215,000,000	1,473,551,221

All shares issued are registered in the names of the shareholders. Shares that have been or will be issued have been or will be converted into ordinary stock which is transferable in units of NIS 1.0.

The ordinary stock is listed on the Tel-Aviv Stock Exchange.

NIS 321,900,000 par value deferred deposits/capital notes (unquoted), issued in June and July 2002, and repayable on 30 June 2011, and that were recognized by the Bank of Israel as Upper Tier 2 capital of the Bank, are convertible, in certain circumstances defined by the Supervisor of Banks, to 138,064,557 ordinary shares of the Bank.

B. Dividend for 2010

In accordance with the recommendation of the Board of Directors of the Bank, the Bank distributed a cash dividend for 2010 amounting to NIS 1.4 billion. The dividend was paid in amounts and on dates as follows: NIS 500 million in November 2010, NIS 500 million in January 2011, and NIS 400 million in June 2011.

Note 13 - Shareholders' Equity and Capital Adequacy (cont'd)

C. Capital adequacy

Calculated pursuant to Proper Conduct of Banking Business Directives Nos. 201-211 on the subject of "Measurement and Adequacy of Capital".

Reported amounts

1. In balance sheet terms		
	31 December 2011	31 December 2010
	NIS millions	
Capital for purposes of calculating capital ratio		
Tier 1 capital, after deduction	**23,225**	22,897 (b)
Tier 2 capital, after deduction	**18,020**	17,716
Total capital	**41,245**	40,613
Weighted balance of risk assets		
Credit risk (c)	**258,601**	239,900
Market risk	**9,011**	10,653
Operational risk (d)	**20,095**	20,904
Total weighted balance of risk assets	**287,707**	271,457
Ratio of capital to risk assets		
Ratio of Tier 1 capital to risk assets	**8.07%**	8.43% (b)
Ratio of total capital to risk assets	**14.34%**	14.96% (b)
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	9.00%
2. Principal subsidiary companies		
Leumi Mortgage Bank		
Ratio of Tier 1 capital to risk assets	**8.58%**	9.27% (b)
Ratio of total capital to risk assets	**12.88%**	13.92% (b)
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	9.00%
Arab Israel Bank		
Ratio of Tier 1 capital to risk assets	**11.30%**	9.90% (b)
Ratio of total capital to risk assets	**15.60%**	14.61% (b)
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	9.00%
Leumi Card Ltd.		
Ratio of Tier 1 capital to risk assets	**14.80%**	14.40%
Ratio of total capital to risk assets	**14.80%**	14.40%
Ratio of total minimum capital required by the Supervisor of Banks	**9.00%**	9.00%
Bank Leumi USA (a)		
Ratio of Tier 1 capital to risk assets	**10.49%**	10.71%
Ratio of total capital to risk assets	**13.26%**	13.58%
Ratio of total minimum capital required by the local authorities	**10.00%**	10.00%

See notes on next page.

Note 13 - Shareholders' Equity and Capital Adequacy (cont'd)

3. Capital components for capital ratio calculation purposes (in consoldiated balance sheet terms)

	31 December 2011	31 December 2010
	NIS millions	
Tier 1 capital		
Shareholders' equity	**23,592**	22,825 (b)
Minority interest of external shareholders in equity of consolidated subsidiaries	**254**	318
Less goodwill	**175**	46
Less intangible assets	**162**	46
Less losses from adjustment to fair value of securities avaliable for sale	**218**	-
Less other deductions from Tier 1 capital	**66**	154
Total Tier 1 capital	**23,225**	22,897
Tier 2 capital		
a. Upper Tier 2 capital		
45% of net profits, before related tax effect, in respect of adjustments to fair value of securities available for sale	**-**	314
General provision for doubtful debts	**428**	428
Hybrid capital instruments	**6,012**	5,911
b. Lower Tier 2 capital		
Subordinated notes	**11,646**	11,217
c. Deductions from Tier 2 capital		
Investments in companies other than non-banking which have a significant effect	**51**	47
Other deductions	**15**	107
Total Tier 2 capital	**18,020**	17,716

(a) The United States office is not obliged to calculate the capital adequacy ratio in accordance with Basel II. Accordingly, the ratios presented are according to Basel I.

(b) Restated pursuant to retroactive implementation of the instructions of the Banking Supervision Department with regard to "Strengthening of Internal Control over Financial Reporting relating to Employee Rights", see Note 1.S.2.

(c) As of 2011, the Bank makes offsets in respect of third party liability in derivative transactions with banks, with whom the Bank has a netting agreement. Pursuant to the above change, there was a decrease in total credit risk assets in respect of derivative transactions of NIS 4,070 million.

(d) As of 2011, First Pillar allocations in respect of operational risk is in accordance with Basel II – Standardized Approach (2010 – Basic Indicator Approach). Pursuant to the above change, there was a decrease in total risk assets of NIS 1,271 million.

Note 14 – Liens and Restrictive Conditions

As at 31 December 2011 and 31 December 2010, debentures and notes issued by consolidated companies in Israel are not secured by floating charges on their assets. Foreign branches and consolidated companies have pledged securities and other assets as security for deposits received from the Federal Home Loan Bank (FHLB) and certain obligations pursuant to requirements of the authorities of the countries in which they operate. Pledged assets amount to NIS 524 million (31 December 2010 - NIS 1,249 million). Total liabilities in respect of which assets were pledged amount to NIS 446 million (31 December 2010 - NIS 1,158 million).

The Bank executes short-term lending of securities in foreign currency from the available portfolio, via the Euroclear clearinghouse, for other customers of the clearinghouse, without knowing the identity of the borrowers. The lending is carried out under a full guarantee of the Euroclear clearinghouse which is an AA+ rated financial institution. The value of the balance of the securities lent to the Euroclear clearinghouse as of 31 December 2011 was about NIS 75 million (31 December 2010 - NIS 93.5 million).

As a member of the Tel Aviv Stock Exchange, the Bank is a member of the Risk Fund of the Stock Exchange Clearing System.

Each of the members of the Risk Fund pledges collateral in favor of the Stock Exchange Clearing System in the amount of its proportionate part in the fund, which secures the member's liabilities to the Clearing System and the member's share in the Risk Fund. Furthermore, such collateral also secures the liabilities of the other members of the Risk Fund, if the collateral that the other member provided is not sufficient to cover the other member's liabilities, and in accordance with the proportionate part of each of the members in the Fund, up to the amount of the collateral provided or up to the amount of the liabilities to the Stock Exchange Clearing System, whichever is the lower. The total of debentures and deposits pledged by the Bank to the Stock Exchange Clearing System as at 31 December 2011 was NIS 191 million (31 December 2010 – NIS 189 million).

The Bank is a member of the Maof Clearing System Risk Fund. The Bank has undertaken to the Maof Clearing System to pay every charge deriving from its Maof transactions for its customers, its nostro, and for Maof transactions of a member of the TASE not clearing independently through the Maof Clearing System. The total of the Bank's liabilities is shown in Note 18.A under Guarantees and Other Liabilities.

The Bank pledges collateral in favor of the Maof Clearing System in the amount of its proportionate part in the Risk Fund and also in respect of its above-mentioned liabilities, which secures its liabilities to the Maof Clearing System and its share in the Risk Fund. Furthermore, such collateral also secures the liabilities of the other members of the Risk Fund: in the event that the collateral that the other member provided were not sufficient to cover all of his liabilities, the Maof Clearing System is entitled to realize the collateral provided to it by the other members of the Risk Fund, in accordance with the proportionate part of each of the members in the fund, up to the amount of the collateral provided or up to the amount of the liabilities to the Maof Clearing System, whichever is the lower.

At the date of the financial statements, the Bank's share of the Maof Clearing System Risk Fund was NIS 222 million (about 24% of the Fund).

The Bank, like any other member of the Clearing System, is entitled to secure its liabilities to the Maof Clearing System risk fund by means of pledging government bonds and deposits. The total of the debentures pledged by the Bank to the Maof Clearing System in respect of the activity of the customers, the *nostro*, and risk fund as at 31 December 2011 was NIS 1,791 million (31 December 2010 – NIS 1,959 million).

The Bank participates in an arrangement for ensuring the finality of settlement in default situations in which there is an insufficient balance in the clearing account of one or more of the other participants, as a participant in the RTGS (*"Zahav"*) System, and a holder of a clearing account in the system and a member of the *Masav* payment system and the banking clearing system ("participant"). In the event of default, each non-defaulting participant ("surviving participant") is to bear the debit charges of the participant that defaulted, according to the relative share of the surviving participant divided, by the difference between 100% and the relative share of the participant that defaulted.

Note 14 – Liens and Restrictive Conditions (cont'd)

The relative share of the Bank at 31 December 2011 in the *Masav* system is 15.49% and in the bank clearing system – 23.5% (this percentage is updated every six months according to the relative weighting of debit charges of each participant that were passed through the payment system relevant to the previous six months). The total ceiling for participation for all participants is NIS 300 million in the clearing system and NIS 150 million in the bank clearing system. In the event of default, on the business day following the date of default, immediately after the system opens, the Bank of Israel will send a multi-party payment instruction debiting the clearing account of the defaulting participant and crediting the clearing accounts of the surviving participants with the amount that each surviving participant paid in the framework of the arrangement, with the addition of interest at the Bank of Israel rate. The default arrangement is not intended to deal with a situation of a known or probable insolvency. In the event of insolvency, the proceedings will be passed to the Banking Supervision Department.

The Bank and its consolidated companies enter into CSA (Credit Support Annex) agreements with foreign banks which are intended to reduce mutual credit risks created between the banks during trading in derivatives. Under the agreements a measurement is made on a periodic basis of the value of all derivatives transactions carried out between the parties and if the net exposure of one of the parties exceeds the predetermined limit that party is required to transfer to the other party deposits totaling the amount of exposure, until the next measurement date. At 31 December 2011, the Group had made deposits in favor of foreign banks totaling NIS 1,588 million (31 December 2010 – NIS 1,067 million).

The Bank and its consolidated companies enter into agreements with foreign banks under which amounts are deposited in the foreign banks for purposes of carrying out marketable futures transactions in exchanges abroad for them or their customers. As at 31 December 2011, the Group had deposited an amount of US$ 222 million in the above banks (31 December 2010 – US$ 147 million).

The Bank has signed a debenture, in accordance with the Bank has pledged by way of a first fixed charge and assignment by way of pledge, unlimited in amount, in favor of the Bank of Israel, all of the assets and rights in specific accounts held in the name of the Bank of Israel, in the Tel Aviv Stock Exchange Clearinghouse, in Euroclear Bank or in any other clearinghouse to which the Bank and the Bank of Israel must agree. The mortgaged assets in the accounts of Euroclear Bank, or in another account maintained in the clearinghouse outside Israel, are also mortgaged under a first ranking floating lien in favor of the Bank of Israel.

This pledge is to secure all the liabilities of the Bank in connection with credit that the Bank of Israel has extended or will extend and the placing of collateral to secure it, as detailed in the credit documents, except for credit according to a credit agreement between the Bank of Israel and the Bank and a secured debenture dated May 21, 2008.

On 21 May 2008, the Bank signed a debenture, by which the Bank pledged by way of a first floating charge, in favor of the Bank of Israel, its rights to receive monetary amounts and charges in shekels, which are due or will be due to the Bank from time to time from its customers, that are corporations (which were incorporated under the laws of the State of Israel) not being in arrears in repayment to the Bank of credits received from the Bank, in respect of credits in shekels of which the duration (average life) of each credit does not exceed three years, which were given or will be given by the bank to the above customers.

This pledge is to secure credits that the Bank of Israel will grant to the Bank for purposes of the Bank's activity as a supplier of liquidity services in shekels to the Continuous Linked Settlement Bank (CLS) Bank, with the addition of interest, costs and expenses involved in realizing the pledge, up to the amount of NIS 1.1 billion, in accordance with the terms of the credit agreement signed by the parties in this matter. Leumi did not avail itself of any such credit during 2010-2011.

Note 14 – Liens and Restrictive Conditions (cont'd)

	31 December 2011	31 December 2010
	(NIS millions)	
Sources of securities received which the Bank may sell or pledge, by fair value, excluding set-offs:		
Securities received in securities borrowing transactions against cash	**1,225**	1,190
Uses of securities received as collateral and securities of the Bank, by fair value, excluding set-offs:		
Securities loaned in securities lending transactions against cash	**442**	1,006

Apart from these securities, as at the date of the balance sheet, additional securities were given as collateral, shown under Securities above, which the lenders are not permitted to sell or pledge.

In September 2010, the Bank signed a deed of pledge, at the instructions of the Federal Reserve, under which it pledged monetary deposits in favor of Bank Leumi USA, in connection with loans given by Bank Leumi USA with collateral of obligations by Bank Leumi Le-Israel, in support of these obligations. The amount of the pledge at 31 December 2011 was US$ 92 million.

The Bank has given an undertaking of £120 million for Bank Leumi UK for use in liquidity stress scenarios in accordance with liquidity management directives published by the financial services supervisory authority (FSA) in the UK.

Note 15 – Employee Rights

A. Collective labor agreement regarding privatization

On 30 November, 2005 a special collective labor agreement was signed between management of the Bank and the employees' representatives in respect of the privatization process in the Bank.

The collective labor agreement confirms the implementation of the employees' option plan, the employees' right to acquire 3.873% of the Bank shares to which the employees are entitled at a discount of 25%, the advance payment at the rate of one month's salary for provisions on account of the annual bonus for 2005, and confirms existing collective labor agreements and arrangements in the Bank, as at present, for a period of five years as from 1 January, 2006.

The employees, on their part, undertook in the agreement to refrain from disputes in connection with the privatization process in the Bank.

This agreement was approved by the General Meeting on 2 February 2006.

On 17 November 2010, a special collective agreement was signed concerning the rights of employees, between the Bank and the representative body of employees of the Bank ("the Collective Agreement" or "the "Transaction") further to the authorization and resolution of the Board of Directors of the Bank. The Collective Agreement was approved by the Audit Committee, and thereafter, by the Board of Directors, on 21 November 2010, and by the General Meeting, on 28 December 2010. According to the Collective Agreement, the effectiveness of the consents set forth in paragraphs 5 and 7 to the abovementioned special collective agreement dated 30 November 2005 between the Bank and representatives of the employees ("the previous collective agreement") will be extended. Pursuant to the Collective Agreement, the consent that was in the previous collective agreement, to extend until 31 December 2010 the validity of the Employment Code and all collective agreements and arrangements, as well as all the agreements, procedures and practices granting rights to Bank employees, who are currently in the Bank, according to their individual status, as stated in Paragraph 5 of the previous collective agreement, was extended for a further period of four years – until 31 December 2014.

It was further provided in the collective agreement that the "industrial peace" undertaken by the representatives of the employees as stated in paragraph 7 of the previous collective agreement would continue to be in effect.

With regard to the effect of the option plan and the issue of shares to employees, see H. below.

B. Severance pay and pensions

(1) General

For employees that commenced their employment with the Bank since 1 January 1999 (hereinafter: "2nd generation employees") and had not yet received permanent employment status as at the signing date of the special collective bargaining agreement in 2000 covering a special pension arrangement, current deposits are made to a pension fund. The pension plan is a comprehensive cumulative pension plan with additional insurance for disability and death. The Bank will not have any pension liability in respect of these employees other than to supplement severance pay in accordance with the agreement.

Employees, who began working with the Bank before 1 January 1999 (hereinafter: ("1st generation employees") and have received permanent employment status before the date of signing the aforementioned agreement, that retire from the Bank at retirement age, except those mentioned above and in (3) below, may choose between the right to receive severance pay plus

Note 15 – Employee Rights (cont'd)

their accumulated provident fund, or the right to receive a pension in which case they relinquish their right to the severance pay and provident fund. The right to a pension is calculated at a pension rate of 2.67% per annum for the first 15 years of employment and of 1.5% for each additional year, up to a maximum rate of 70%.

Provisions for severance pay are calculated on the basis of the latest salary, at one month's salary per each year of employment. Funds allocated for liabilities for severance pay are deposited in provident funds.

Provisions for pensions are based on an actuarial calculation that takes into account the change in the retirement age according to the Retirement Age Law, 2004. The actuarial calculation was made according to the accrued benefits valuation method, taking into account various parameters including the probability, based on past experience, of the rate of utilization of the pension benefits and the rate of withdrawal of severance and remuneration benefits (the new pension distribution is that about 76% choose a pension, while the remainder chose severance pay and provident funds), and past experience regarding disability, etc.

The actuarial calculation is based on the updated provisions of the Chief Actuary in the Ministry of Finance with respect to mortality rates from February 2007, which were determined by the Commissioner of the Capital Market, Insurance and Savings for insurance companies, as a result of the change in the rate of improvement in life expectancy, and that were adopted for the population of the Bank's employees.

Calculation of the Bank's actuarial liability for pension payments is made using the capitalization rate determined by the Supervisor of Banks (4%) and on the assumption of a real increase in salary based on past experience and varying in accordance with the age of the employee. The rates of increase range from 0.9% to 7.2%.

The calculation is made under a comprehensive pension plan, which includes old age, disability and survivor pensions and also takes into account employees who have not yet completed the period required for receipt of pension benefits (15 years of service).

The balance sheet includes provisions based on the higher of the liabilities for severance pay plus provident benefits, and the pension liability. The Bank's pension liability for employees who have left and have opted for pension benefits, as well as that stated in (3) below, is covered by the pension provision, which is calculated based on the present value of the liability calculated by an actuary, as noted above.

(2) Benefits to "Leumi Alumni"

"Leumi Alumni" are entitled to receive, in addition to their individual choice of a pension and/or severance payments, additional benefits which consist mainly of a holiday gift and participation in the cost of additional welfare and social activities.

"Leumi Alumni" – persons who, regardless of their age, have concluded working with the Bank after 25 years of employment, or have concluded working with the Bank at the legal retirement age after at least 15 years of employment.

The accumulated amount at 31 December 2011 for expected costs in respect of the above entitlements in the period following the employment period according to actuarial calculation amounts to some NIS 105 million (31 December 2010 – NIS 100 million).

Note 15 – Employee Rights (cont'd)

(3) Early retirement for employees under personal employment contracts

(a) Under the employment contract with the Bank's President and Chief Executive Officer ("CEO") that was signed at the beginning of 1996 (and subsequently amended and signed in 2004) ("the contract"), the CEO is entitled to a pension immediately upon her retirement (whether due to resignation or dismissal) or to severance pay at the rate of 200% of the latest monthly salary for each year of work in the Bank plus the amounts that have accrued in the pension fund, at her choice. The rate of the CEO's pension is at the amount of 3% per annum.

It was further stipulated in the contract that either side is entitled to terminate the employment by giving 9 months advance notice, and the Bank has the right to require that the CEO continues work for the first three months of this period and that there will be a cooling-off period of 6 months from the date that the CEO actually ceases working in the Bank.

On 1 January 2012, the President and CEO notified the Bank of her intention to retire from her position. At the request of the Board of Directors, the CEO will continue working until the end of April 2012, and the period of advance notice shall commence in May 2012 for 9 months after cessation of work.

(b) The Bank signed personal contracts with members of Management of the Bank (1st generation) and with a group of senior executives of the Bank (deputy general managers, senior assistants to the general manager and assistants to the general manager), according to which the Bank has undertaken to pay an immediate pension, in the event of dismissal of such an employee, if their age plus the number of years of employment with the Bank amounts to 75, or 80 under the new contracts. The years of service of a member of Management (if the employee served at least 7 years as a member of Management) will be counted as additional years of seniority for purposes of the said aggregate years of service. The pension for members of Management will be calculated at the rate of 2.67% per annum for the first 15 years of employment plus 2% for each additional year of employment in which the individual did not serve as a member of Management, or 2.5% for each year of service as a member of Management, up to a maximum rate of 70%. The pension for senior executives is calculated at the rate of 2.67% per annum for the first 15 years of employment, 1.5% for each additional year until the signing of the contract and 2% in respect of each year thereafter, up to a maximum rate of 70%. Alternatively, the said employees are entitled to choose, in the event of dismissal, severance pay at the rate of 200% (and 250% if his age plus the number of years of employment with the Bank does not amount to 75, or 80 as mentioned) of his latest monthly salary multiplied by the number of years of employment, plus the amounts accumulated to his credit in the provident fund. In such case, the employee is not entitled to a pension.

An employee who voluntarily resigns will be entitled to severance pay at the rate of 100%, plus the funds accumulated to his credit in the provident fund.

The Bank and the said employees are entitled to terminate the employee-employer relationship by giving advance notice of six months.

Personal employment contracts of members of Management of the Bank were amended as from 31 December, 2003 as follows: an employee who retires voluntarily at the age of 64 years or more will be entitled, upon fulfillment of a number of conditions, to severance pay at a rate of 200% plus accrued amounts in his provident fund (a provision that was amended again in September 2006). An employee who, upon termination of the employee-employer relationship did not utilize his special jubilee vacation will be entitled to an additional month of advance notice. In the cooling-off period, which does not coincide with the period of advance notice, the employee will be entitled to a salary and to related benefits. Subject to the said amendment, the provisions of the individual employment contracts will remain in effect and will be binding on the parties for all effects and purposes. The financial statements include appropriate provisions to cover these commitments.

According to the personal contracts with members of the management of the Bank, who are not 1st generation or 2nd generation, in the event of dismissal, these members of management will not be entitled to a pension from the Bank, but to compensation amounting to 250% of the last monthly salary for each year of employment in the Bank, with the addition of monies accrued in the pension fund (and the employee is obliged to refund to the Bank an amount equal to the provisions made for him for severance pay). Any employee, as aforesaid, who voluntarily resigns will be entitled to 100% of severance pay, plus the monies in the pension fund (and the employee is obliged to refund to the Bank an amount equal to the provisions made for him for severance pay).

In 2009, the Bank approved personal employment contracts for a group of senior managers from among the 2nd generation in the Bank, who are entitled to a pension plan as stated in the first paragraph of Note 15.B (1) above. These managers are not entitled to a pension from the Bank. It was therefore stipulated in these personal contracts that the Bank undertook, in the event of dismissal, to pay compensation at the rate of 250% of the last monthly salary for each year of work in the Bank, together with provident fund allocations, subject to the transfer to the Bank of the provisions for severance pay. If a manager is dismissed whose age is 55 or more, and whose period of service in the Bank is 25 years or more, the manager will be entitled to chose, on dismissal, between compensation at the rate of 200% of the last monthly salary for each year of work in the Bank, together with provident fund allocations (subject to the transfer to the Bank of the provisions for severance pay), and receiving all the funds and rights in the compensation and provident fund, when until the date he will be entitled to receive them, under the terms of the rules of the fund and the provisions of the law, he will be entitled to receive a pension from the Bank.

The maximum additional expense that the Bank can incur in the event of the employees mentioned above being immediately dismissed amounts to NIS 379 million (including salary tax payable on the pension) (2010 – NIS 350 million). Since it is not likely that all the above mentioned employees will be dismissed immediately, the Bank recorded a provision at the rate of 25% of the above amount, in the amount of NIS 90 million (including salary tax) (2010 – NIS 89 million). The above amounts also include members of Management.

After amendment of the personal employment contracts of members of Management, as stated above, part of the said provision was attributed specifically to members of Management, the balance of which at 31 December 2011 was NIS 14 million (31 December 2010 – NIS 8 million).

(4) The Chairman of the Board of Directors of the Bank

The Audit Committee, the Board of Directors and the General Meeting of the Bank has approved the terms of employment of the Chairman of who is employed in a full-time position as Executive Chairman.

The Chairman's employment is for a period of three years, commencing 4 August 2010, ("**the employment period**"). If, at the end of the employment period, the Chairman elects for a further term of office, the conditions of engagement between the parties will continue to apply.

Note 15 – Employee Rights (cont'd)

However, in this event, the conditions regarding early notice and entitlement to adaptation grant will not apply.

The Bank and the Chairman have the option of discontinuing the engagement between them on giving early notice, in the following cases: (1) if the Chairman's employment is terminated during the employment period because of voluntary retirement, the early notice period will be up to 9 months, providing that it is not extended beyond the date of the end of the employment period; (2) if the Chairman's employment is terminated in the employment period as a result of voluntary retirement (except in exceptional circumstances in which compensation may be denied the Chairman) and if the Chairman's employment has terminated after the employment period (as far as chosen for an additional term of office) – the early notice period will last 6 months. It is clarified that the Bank will be authorized to demand that the early notice period will be actual employment, in whole or in part. In the early notice period, the Chairman will be entitled to a salary and the rest of the related conditions.

If the Chairman's employment is terminated for any reason whatsoever (except in exceptional circumstances in which compensation may be denied the Chairman), the Chairman will be entitled to compensation amounting to 150% of the last salary times the number of years (and/or part thereof) of his term of office as Chairman of the Board of Directors, in addition to the Chairman's entitlement to the monies and rights accrued in the severance pay fund and pension fund. If the Chairman's employment is terminated during the employment period as a result of compulsory retirement or if the Chairman's employment as Chairman is terminated at the end of the employment period, for any reason whatsoever – the Chairman will be entitled for a six-month period of adaptation, in which the Chairman will receive monthly salaries (include related conditions). The period of adaptation will commence after the end of the early notice period (if any). The Chairman further undertook to a six-month cooling-off period, in which he is entitled to a salary and the rest of the related conditions. It is clarified that in a period in which the cooling-off period overlaps the early notice period and/or the adaptation period, in whole or part, the Chairman will be entitled only to payment in respect of the early notice period or the adaptation period, as applicable.

C. Details of provisions and amounts funded

Reported amounts

Amounts of provisions and amounts funded for severance pay and pensions are included in the balance sheet as follows:

	31 December 2011	31 December 2010
	NIS millions	
Provision for severance pay	**3,051**	2,805
Amounts funded for severance pay (1)	**(3,155)**	(3,050)
Provision for pensions (a)	**4,320**	3,831
Amounts funded for pensions	**(155)**	(145)
Excess of provisions over amounts funded, net	**4,061**	3,441
Excess of provisions over amounts funded, net, included in "other liabilities" (a)	**4,288**	3,767
Excess of amounts funded included in "other assets"	**227**	326
Excess of provisions over amounts funded, net (2)	**4,061**	3,441

(a) Restated

Note 15 – Employee Rights (cont'd)

(1) The Bank and the consolidated companies may not withdraw amounts funded other than for the purpose of making severance payments.

(2) This surplus represents mainly the actuarial pension liability of the Bank for the pensioners of the Bank, and the cover for this liability is part of the Bank's assets and its current uses of funds.

Total liabilities for pensions to employees who commenced work in the Bank before 1 January 1999, totaled NIS 7,175 million at 31 December 2011. To cover this liability, severance monies are deposited in Central Severance Pay Funds in the amount of NIS 2,491 million as well as provident monies deposited in provident funds in the amount of NIS 3,667 million which are managed by the management company owned by the members of these funds, as stated in paragraph F below. Provident monies are set off from pension liabilities and are not shown in the balance sheet and are also not detailed in the above table. The difference between the above provisions and amounts funded is provided for by the Bank and included under liabilities in the Bank's balance sheet.

D. Long service bonuses

Employees of the Bank and some employees of consolidated companies are entitled, upon their attaining 20, 30 and 40 years of employment, to a monetary bonus in the amount of several monthly salaries ("jubilee grants") and to special vacation periods.

At the date of the balance sheet, there is a provision in the amount of NIS 674 million (in 2010 – NIS 642 million).

Calculation of the liability is made on an actuarial basis and takes into account, based on past experience, the probability that on the determining date, the employee will still be employed by the Bank. The said calculation is made using the capitalization rate published by the Supervisor of Banks (4%) and on the assumption of a real increase in salary based on past experience and varying in accordance with the age of the employee. The rates of increase range from 0.8% to 7.2%.

The provision for special service vacations is made on an actuarial basis taking into account past experience with respect to utilization of such vacations.

E. Provision for vacations

There is a provision of NIS 222 million under "Other Liabilities" for unutilized vacation pay (31 December 2010 - NIS 207 million). The provision is calculated on the basis of the latest salary plus related benefits.

F. Provident and severance pay funds of the employees of the Bank and Leumi Mortgage Bank

The Bank and Leumi Mortgage deposit provident monies for "1st generation" employees in the Bank Leumi and Leumi Mortgage Bank Employees Provident Funds, which are managed by a management company owned by the members of the funds.

The Bank provides the company with the services it requires to manage the funds, as permitted by law.

Commencing in 2008, these funds became non-pension payment provident funds, and provident monies funds cannot be withdrawn from these funds, unless they have been transferred to pension payment provident funds and subject to the conditions applying to the said funds.

In addition, as of 2011 the possibility of depositing monies in the Central Severance Pay Funds was restricted by law.

The management company has made arrangements to open severance pay accounts for the members, into which severance monies will be deposited by the Bank.

Note 15 – Employee Rights (cont'd)

G. Bonus Program for Senior Managers

The Board of Directors of the Bank approved a long-term bonus program for the Bank's senior managers: the Chairman of the Board of Directors (subject to the approval of the General Meeting), the President and Chief Executive Officer, and all the other members of the Bank's Management (the "Senior Managers") in March 2010 and an update of the program in September 2011 (the "Bonus Program") .

1. The bonus program determines the manner in which the annual bonus for the Senior Managers will be determined in respect of 2009 and onward. The bonus program is based on, *inter alia*, the annual net profit of the Leumi Group (the Bank and/or Leumi Group, whichever is relevant, is referred to hereinafter as the "Bank") in respect of ordinary operations only, the annual return on capital from ordinary operations after tax (the "return on capital"), the Bank's annual performance in relation to targets set by the Bank's Board of Directors and in relation to the other banking groups (the "other banks"), and it is also affected by the development, over time, of the Bank's business results.

2. The bonus of the senior managers will be determined as set out below:

2.1 Determination of the amount of the overall annual bonus to the senior managers – the amount of the overall bonus (the "overall bonus") will be determined by the Board of Directors on the basis of the adjusted rate of return, which is obtained by multiplying the actual return on capital by the Bank's weighted grade (divided by 100), as described in paragraph 2.3 below (the "adjusted rate of return").

In the context of the September 2011 update to the bonus program, the overall amount of the annual bonus to senior managers was updated (both positive and negative) in accordance with the increase in the number of members of Management, and in accordance with changes in the status of members of Management. As explained below, no change was made to the maximum potential overall bonus, which stands at NIS 30 million, and no change was made to the maximum negative bonus, which stands at NIS 20 million. In addition, no change or update was made to the share of the Chairman of the Board of Directors and the President and CEO.

Only an adjusted rate of return which is equal to or higher than 8% will create an entitlement to a (positive) bonus. In light of the abovementioned update to the bonus program, the overall amount of the bonus to senior managers (positive and negative) for 2012 onwards was raised by 9%, and in respect of the change during 2011, the overall amount of the bonus to senior managers (positive and negative) was raised by about 6%, as follows:

For 2011: if the adjusted rate of return is 8%, the overall amount of the bonus will be 0.53% of the adjusted net profit[1]. If the adjusted rate of return is 9%, the overall amount of the bonus will be 0.7208% of the adjusted net profit. If the adjusted rate of return is 10%, the overall amount of the bonus will be 0.901% of the adjusted net profit, and if the adjusted rate of return is 12% or more, the overall amount of the bonus will be 1.06% of the adjusted net profit.

For 2012 onwards: if the adjusted rate of return is 8%, the overall amount of the bonus will be 0.545% of the adjusted net profit[1]. If the adjusted rate of return is 9%, the overall amount of the bonus will be 0.7412% of the adjusted net profit. If the adjusted rate of return is 10%, the overall amount of the bonus will be 0.9265% of the adjusted net profit, and if the adjusted rate

[1] The adjusted net profit will be calculated as the product of the Bank's Adjusted Rate of Return multiplied by the Bank's weighted capital (which is used for the calculation of the return on capital in the Consolidated Financial Statement in accordance with the public reporting directives) during the assessed year.

Note 15 – Employee Rights (cont'd)

of return is 12% or more, the overall amount of the bonus will be 1.09% of the adjusted net profit.

In any case, on calculation of the bonus, the adjusted rate of return will not exceed 15%.

To the extent the adjusted rate of return is within a range which is between the values described above, the size of the bonus will be determined in a linear manner between the two values. As stated, the overall amount of the bonus will in no case exceed NIS 30 million.

2.2 The overall bonus will be divided among the senior managers as described below in section 2.4. Thereafter, 10% of the total share of the senior managers (other than the Chairman of the Board and the CEO) of the overall bonus will be set aside and held as a reserve. This reserve will first be used for the payment of the positive differentials (to the extent that such exist) between the total bonuses to the Internal Auditor, the Chief Accountant and the Chief Risk Officer (CRO), decided upon by the Audit Committee as stated in section 2.4.3 below, and the total bonuses to which the above-mentioned officers would have been entitled if this bonus program were implemented with respect to them. The balance of the reserve following payment of the said bonus differentials will serve as a "CEO reserve" and will be divided among the senior managers (other than the Chairman of the Board and the CEO), in accordance with the CEO's recommendation - which shall be submitted for the Board of Directors' approval – in respect of outstanding performances of any of the said senior managers during the course of the assessed year.

2.3 Determination of the Bank's weighted score for the purpose of calculating the adjusted rate of return - the Bank's performance will be measured on the basis of five parameters, for which scores shall be given in a range of 70-120 for each parameter. The following are the parameters and the weights attributed to them: (a) 30% - a comparison of the actual return on capital for the assessed year, compared with a multi-year return of 10%; (b) 30% - a comparison of the actual return on capital for the assessed year compared with the adjusted return on capital (according to the weighted shareholders' equity for the year) at the other four large banks in Israel for the same assessed year; (c) 10% - a comparison of the Bank's capital adequacy (ratio of capital to risk assets) compared with the Bank's targets as established from time to time; (d) 10% - a comparison of the Bank's capital adequacy (ratio of capital to risk assets) compared with the weighted ratio (according to the weighted shareholders' equity for the year) at the other four large banks in Israel for the assessed year; (e) 20% - the Bank's adjusted BSC (Balance Score Card) score for the assessed year.

2.4 The method of calculating the personal bonus for each of the Senior Managers is as follows:

In the context of the bonus program update, the normative ratios[2] for allocating the overall bonus were adjusted to the change in the overall bonus amount. As no change or update was made to the share of the Chairman of the Board of Directors and the President and CEO, their normative share decreased relatively, as explained below:

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2.4.1 Chairman of the Board of Directors - the amount of the bonus for the Chairman of the Board of Directors will be determined on the basis of (1) the weighted personal score comprising 60% based on the Bank's BSC score and 40% based on the personal evaluation score given by the Board of Directors, and (2) the Chairman's relative normative[2] share of the overall bonus, determined by the Board of Directors, which in

[2] The relative normative share - the Senior Manager's share of the overall bonus, assuming that all of the Senior Managers received a grade of 100.

light of the bonus program update decreased from the rate of 16.7% to the rate of 15.56% for 2011, and to 15.31% for 2012 onward.

2.4.2 CEO - the amount of the bonus for the CEO will be determined on the basis of: (1) the weighted personal score comprising 60% based on the Bank's BSC score and 40% based on the personal evaluation score given by the Board of Directors, and (2) the relative normative share of the overall bonus, determined by the Board of Directors, which in light of the bonus program update decreased from the rate of 20.8% to the rate of 19.7% for 2011, and to 19.14% for 2012 onward.

2.4.3 The other senior managers - the amount of the bonus for the remaining senior managers will be determined on the basis of: (1) the weighted personal score comprising 60% based on the BSC score of the unit headed[3] by the senior manager and 40% based on the personal evaluation score given to the manager by the CEO. The following may be examined, among the criteria to be used for the purpose of determining the personal evaluation score for the senior management: the contribution to ongoing business activity and results; the contribution to controlling of the level of risk; reaching targets regarding compliance with laws, regulations and regulatory provisions; audit reports; contribution to the Bank's strategic planning and implementation, execution and promotion of strategic plans and targets; leading efficiency programs and compliance with targets derived from them; implementation, execution and promotion of significant investment and/or acquisition plans (including acquisitions which may reduce current profitability); leading, implementation, promotion and execution of projects regarding the maintenance of the quality of the environment and safety; leading, implementation and execution of various types of enforcement programs including processes and standards with which the company is required to comply (SOX, capital issues, etc.); and leading of projects and processes in the field of the Bank's ethics and guidelines.

(2) The relative normative share of the overall bonus established in advance by the Board of Directors, according to the CEO's recommendation, with, in light of the bonus program update, the relative normative share of the other Senior Managers increasing from 62.5% to 64.74% for 2011, and to 65.55% for 2012 onward.

The bonus to the Chief Internal Auditor, the Chief Accountant and the CRO will be determined separately by the Audit Committee, which may rely on, *inter alia*, the calculation according to this bonus program.

2.4.4 The weighted personal score (divided by 100) will be multiplied by the senior manager's relative normative share.

2.4.5 The overall bonus will be divided pro-rata among the senior managers according to the proportions obtained by the multiplication of the said parameters.

2.4.6 The bonus program was adjusted with respect to 14 senior managers (and for part of 2011, 15 senior managers). If the number of senior managers is less than 14, the program will be adjusted and the amount of the bonus reduced by the value of the normative bonuses of the senior managers who have been subtracted. If the number of

[3] Other than the BSC for the Senior Deputy CEO, for whom the overall BSC score of the Bank will be used.

senior managers exceeds 14, the program will be adjusted pursuant to a resolution of the Board of Directors.

3. Upon the occurrence of one of the following events during the assessed year, the Senior Managers will not be granted a positive annual bonus:

3.1 The adjusted rate of return for the assessed year is less than 8%.

3.2 Failure to comply with the ratio of capital to risk assets set out in Proper Conduct of Banking Business Directive No. 311, or in any other directive which replaces it.

Additionally, a senior manager will not be entitled to a positive annual bonus upon the occurrence of an event which would allow the Bank to dismiss him without severance pay, and such a senior manager will not be entitled to receive the balance of the as yet unpaid (net) positive bonus from previous years.

4. In the event that the Bank's adjusted rate of return is less than 7%, a negative bonus will be charged to the senior managers, as described below:

4.1 The overall negative bonus to all of the senior managers – The overall amount of the negative bonus was updated in the context of the bonus program update and rose from 1% to 1.09% of the "determinative return differential" as of 2012 (and in respect of 2011 it rose to 1.06%) as stated below, multiplied by the Bank's weighted capital.

The overall amount of the negative bonus in respect of a calendar year shall not in any event exceed NIS 20 million.

The determinative return differential shall be determined as follows:

4.1.1 If the actual rate of return on capital is negative, the determinative return differential will be calculated as follows: (1) the differential between the actual rate of return and 7%; (2) the Bank's weighted score will be adjusted through its deduction from a fixed number – 200 (such that a score of 70 will become a score of 130); and (3) the negative differential will be adjusted by multiplying it by the Bank's weighted score, adjusted as stated above.

4.1.2 If the actual rate of return on capital before the adjustment is higher than 7%, but less than 7% afterwards, the determinative return differential will be the differential between the adjusted rate of return and 7%.

4.1.3 If the actual rate of return on capital is positive and less than 7%, the determinative return differential will be the higher (in absolute values) of the calculations described in sub-sections (a) and (b) above.

However, it is noted that if the actual return after the adjustment is higher than 7%, no negative bonus will be calculated, even if the unadjusted rate of return is less than 7%.

4.2 Determination of the scope of the personal negative bonus rate for each of the senior managers:

Note 15 – Employee Rights (cont'd)

4.2.1 The weighted score of each senior manager will be determined in accordance with section 2.4 above. Because of the negative bonus, the weighted score will be converted into an adjusted weighted score, through its deduction from a fixed number – 200 (such that, for example, a score of 80 will become a score of 120). The reversal is required such that to the extent that a particular Senior Manager's score is lower, his share of the negative bonus will be greater.

4.2.2 The adjusted weighted score (divided by 100) will be multiplied by the particular senior manager's relative normative score, as described in section 2.4 above.

4.2.3 The negative bonus will be divided pro-rata among the senior managers according to the proportions obtained by the multiplication of the said parameters.

5. Payment of the bonus to be spread out over the long-term

5.1 The payment of a bonus for a particular year will be spread out over three years, as follows:

5.1.1 50% of the bonus will be paid close to the reporting of the financial results for the relevant year (the "bonus year").

5.1.2 25% of the bonus will be paid close to the reporting of the financial results for the year following the bonus year (the "second year").

5.1.3 25% of the bonus will be paid close to the reporting of the financial results for the year following the second year.

5.2 The deferred payments in respect of the bonus will be linked to the Consumer Price Index, such that the base index will be the CPI known at the time of the first payment.

5.3 A negative bonus which is determined in respect of a particular year will be offset from any positive bonus payment to which a senior manager will be entitled in a particular year in respect of previous years, and if necessary, it will be offset against any positive bonus to which the senior manager is entitled in later years. The amount of the negative bonus will be linked to the Consumer Price Index, beginning at the time of its having been charged.

6. Retirement of a Senior Manager

6.1 A senior manager who leaves the Bank for retirement[4], or who leaves the Bank other than on his own initiative, will receive, at the time of his retirement, the balance of the as yet unpaid (net) positive bonus in respect of previous years. In addition, the Board of Directors will conduct a detailed examination of his entitlement to a partial bonus in respect of the period during which he served, and will determine the amount of the bonus to be paid for such, if at all. The bonus amount, to the extent one is determined, will be paid in full at the closest time established for the purpose of the payment of the bonus to the senior managers. If the balance of the bonus in respect of the previous years is negative, it will be offset against amounts due to the senior manager from the Bank, beyond the amounts that are owed to him by law, provided that the offset amount does not exceed the bonus amounts that the senior manager received during the two years preceding his retirement, and against the bonus amount which is determined for him in respect of the period of his service in his position

[4] Including at an age when, according to the personal labor agreement between the manager and the Bank, the manager is entitled to resign and receive 200% severance pay.

during the retirement year. A senior manager who was dismissed due to the occurrence of an incident which allows him to be dismissed without severance pay will not be entitled to a positive annual bonus in respect of that year and will not be entitled to receive the balance of the as yet unpaid (net) positive bonus in respect of previous years.

6.2 A senior manager who leaves voluntarily (other than upon reaching retirement age) will not be entitled to the balance of the as yet unpaid positive bonus in respect of previous years and/or to the bonus in respect of the period of his service during the retirement year. If the bonus balance is negative, it will be offset against amounts due to the employee beyond the amounts to which he is entitled by law, provided that the offset amount does not exceed the bonus amounts that the senior manager received during the two years preceding his retirement.

7. The bonus program does not constitute a commitment on the part of the Bank to grant bonuses, and does not create any obligation and/or absolute right for any of the senior managers to receive bonuses in respect of 2011 or any other year.

8. The bonus for senior managers pursuant to this bonus program, to the extent that the senior managers are entitled to bonuses pursuant to this bonus program, does not constitute a part of the salary paid to any of the senior managers, and will not be taken into consideration for the purpose of deducting social benefits, severance pay, or retirement allowances, and will not be considered to be an accompanying condition of employment of any kind whatsoever for any of the senior managers.

9. The bonus program does not refer to bonuses for extraordinary activities. The Board of Directors reserves the right either to grant or not to grant, at its discretion, special bonuses in respect of extraordinary activities.

Appropriate provisions have been made in the financial statements.

10. Sale of Shares to Employees

In accordance with the agreements concerning the privatization of the Bank, and in accordance with agreements reached between the Accountant-General in the Finance Ministry and the employees of the Bank, an outline prospectus was published on 6 April 2011 for the offer by the State of Israel of the Bank's shares to employees of the Bank, Arab-Israel Bank Ltd., Leumi Mortgage Bank Ltd., and the Restaurant Association of Employees of Bank Le-Israel B.M. (registered association) ("the participants", "the outline prospectus").

On 17 May 2011, the purchase was completed by the participants, in accordance with and subject to arrangements and conditions detailed in the outline prospectus, of 6,339,730 shares held by the State of Israel representing 0.43% of the Bank's issued and paid-up share capital of the Bank, as at the date of publication of the outline prospectus. On 24 May 2011, the General Meeting of the Bank approved the offer of 9,442 shares to the Chairman of the Board of Directors of the Bank, and the grant of a loan by the Bank to purchase the shares. On 30 May 2011, the Bank was informed by the Ministry of Finance that on 29 May 2011, the sale of the shares to the Chairman of the Board of Directors was completed.

The price per share for purposes of the offer to participants according to the outline prospectus was NIS 13.20825 per share as at 19 January 2011, and this share price was linked to the Consumer Price Index using the "last known index" method, with the base index being the index for the month of December 2010, that was published on 14 January 2011.

Note 15 – Employee Rights (cont'd)

The share price was NIS 13.3002797 (The price of the shares purchased by the Chairman of the Board of Directors was NIS 13.37813).

The allocation of shares to the participants and the determination of the number of shares offered each participant, was made relative to the salary serving as a basis for social provisions for those participants for the month of January 2011, in accordance with the terms of the outline prospectus. The Chairman of the Board (as stated above) and the President and CEO of the Bank are included in the participants.

The shares will be blocked for a period of four years from the determining date (as defined in the outline prospectus), and will be deposited with a trustee.

In addition, the Audit Committee and the Board of Directors approved the granting of loans to the participants for the purchase of the shares offered in the outline prospectus.

The value of the benefit to the employees and to the Chairman of the Board of Directors in respect of the aforesaid purchase, which was assessed by an external valuer, includes a number of components, and amounts to some NIS 13 million. This amount was recorded as a salary expense. A benefit of NIS 13 million was recorded in a capital reserve.

To finance the purchase of the shares, the Bank extended loans to the employees amounting to some NIS 43 million, with repayment in one amount at the end of the blocked period of the shares, of which loans amounting to NIS 12 million are linked to the Consumer Price Index, bearing interest at 1.55%, and loans amounting to NIS 31 million are unlinked based on the prime rate less 0.75%. The loans are not under non-recourse conditions. The amount of the loans was deducted from the Bank's capital.

Note 16 - Assets and Liabilities Classified by Linkage Basis

Reported Amounts

	31 December 2011						
	Israeli currency		Foreign currency (a)				
	Unlinked	Linked to the CPI	In U.S. dollars	In Euro	In other currencies	Non-monetary items (b)	Total
	NIS millions						
Assets							
Cash and deposits with banks	38,666	326	9,441	1,535	3,003	73	53,044
Securities	19,846	7,985	10,711	5,262	1,580	2,552	47,936
Securities borrowed or purchased under agreements to resell	1,225	-	-	-	-	-	1,225
Credit to the public, net	132,948	52,423	38,825	6,778	10,263	83	241,320
Credit to governments	49	267	106	26	-	-	448
Investments in companies included on equity basis	4	-	-	-	-	2,266	2,270
Buildings and equipment	-	-	-	-	-	3,653	3,653
Assets in respect of derivative instruments	4,238	155	6,671	66	332	111	11,573
Other assets	2,671	7	994	23	58	632	4,385
Total assets	199,647	61,163	66,748	13,690	15,236	9,370	365,854
Liabilities							
Deposits of the public	145,719	25,915	78,084	18,791	10,719	176	279,404
Deposits from banks	1,425	213	2,688	410	320	-	5,056
Deposits from governments	39	186	275	19	-	-	519
Securities loaned or sold under agreements to repurchase	385	-	57	-	-	-	442
Debentures, bonds and subordinated notes	4,987	24,582	430	-	-	-	29,999
Liabilities in respect of derivative instruments	4,086	650	6,558	339	351	85	12,069
Other liabilities (e)	8,129	4,948	726	37	208	689	14,737
Total liabilities	164,770	56,494	88,818	19,596	11,598	950	342,226
Difference (c)	34,877	4,669	(22,070)	(5,906)	3,638	8,420	23,628
Effect of non-hedging derivative instruments:							
Derivative instruments (except options)	(14,491)	(4,472)	18,915	5,312	(5,264)	-	-
Options in the money, net (in terms of underlying asset)	(838)	-	(527)	716	649	-	-
Options out of the money, net (in terms of underlying asset)	9	-	260	(333)	64	-	-
Total	19,557	197	(3,422)	(211)	(913)	8,420	23,628
Effect of non-hedging derivative instruments:							
Options in the money, net (discounted par value)	(1,387)	-	(273)	873	787	-	-
Options out of the money, net (discounted par value)	937	-	(393)	(582)	38	-	-

(a) Including linked to foreign currency.
(b) Including derivative instruments whose underlying asset is a non-monetary item.
(c) Equity includes minority interest.

Note 16 - Assets and Liabilities Classified by Linkage Basis (cont'd)

Reported Amounts

	31 December 2010						
	Israeli currency		Foreign currency (a)				
	Unlinked	Linked to the CPI	In U.S. dollars	In Euro	In other currencies	Non-monetary items (c)	Total
	(NIS millions)						
Assets							
Cash and deposits with banks	19,244	373	5,694	2,854	1,882	5	30,052
Securities	23,484	7,336	12,531	8,130	1,174	3,136	55,791
Securities borrowed or purchased under agreements to resell	1,190	-	-	-	-	-	1,190
Credit to the public, net (b)	121,095	51,632	35,809	5,629	9,801	15	223,981
Credit to governments	-	262	117	-	-	-	379
Investments in companies included on equity basis	6	-	-	-	-	1,918	1,924
Buildings and equipment	-	-	-	-	-	3,638	3,638
Assets in respect of derivative instruments	4,489	12	2,236	267	492	1,221	8,717
Other assets (e)	1,455	40	760	30	37	328	2,650
Total assets	170,963	59,655	57,147	16,910	13,386	10,261	328,322
Liabilities							
Deposits of the public	127,333	25,999	68,334	18,790	9,080	48	249,584
Deposits from banks	980	302	833	155	421	-	2,691
Deposits from governments	55	328	266	11	-	-	660
Securities loaned or sold under repurchase agreements	762	-	244	-	-	-	1,006
Debentures, bonds and subordinated notes	4,832	21,159	948	-	-	-	26,939
Liabilities in respect of derivative instruments	4,319	1,127	2,281	440	626	1,192	9,985
Other liabilities (e)	8,747	3,984	406	23	141	545	13,846
Total liabilities	147,028	52,899	73,312	19,419	10,268	1,785	304,711
Difference (d)	23,935	6,756	(16,165)	(2,509)	3,118	8,476	23,611
Effect of non-hedging derivative instruments:							
Derivative instruments (except options)	(4,092)	(5,866)	13,252	2,176	(5,470)	-	-
Options in the money, net (in terms of underlying asset)	(1,605)	(8)	13	477	1,123	-	-
Options out of the money, net (in terms of underlying asset)	(1,083)	-	681	47	355	-	-
Total	17,155	882	(2,219)	191	(874)	8,476	23,611
Effect of hedging derivative instruments:							
Options in the money, net (discounted par value)	(2,540)	(16)	9	737	1,810	-	-
Options out of the money, net (discounted par value)	(3,839)	-	3,294	382	163	-	-

(a) Including linked to foreign currency.
(b) The general, supplementary and special provisions for doubtful debts were deducted proportionately from the different linkage bases in this item.
(c) Including derivative instruments whose underlying asset is a non-monetary item.
(d) Equity includes minority interest.
(e) Restated. See Note 1.S.2.

Note 17 - Assets and Liabilities Classified by Repayment Date and Linkage Basis (a)
Reported Amounts

31 December 2011

	Estimated future contractual cash flows											Balance sheet balance (d)		
	Upon demand and up to one month (e)	One month to three months (e)	Three months to one year (e)	One year to two years	Two years to three years	Three years to four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total cash flows	Without fixed maturity (b)	Total	Contractual rate of return (g)
	NIS millions													
Israeli currency – unlinked:														
Assets	72,978	19,097	40,555	19,179	12,898	9,182	7,174	22,493	14,185	4,851	222,592	1,619	199,647	5.16
Liabilities	115,287	9,854	20,030	12,733	2,541	1,077	1,225	4,499	300	179	167,725	351	164,770	4.16
Difference	(42,309)	9,243	20,525	6,446	10,357	8,105	5,949	17,994	13,885	4,672	54,867	1,268	34,877	
Derivative instruments (except options)	(6,383)	(3,991)	(3,241)	(511)	714	387	(538)	(271)	(12)	-	(13,846)	-	(14,491)	
Options (in terms of underlying asset)	(725)	37	(151)	27	3	23	-	-	-	-	(786)	-	(829)	
Israeli currency - linked to the CPI:														
Assets	910	1,491	9,380	9,471	7,297	5,879	4,676	18,864	13,629	4,068	75,665	45	61,163	3.59
Liabilities	5,284	1,731	10,181	7,192	6,453	8,245	5,361	15,735	2,790	1,599	64,571	1,230	56,494	4.03
Difference	(4,374)	(240)	(801)	2,279	844	(2,366)	(685)	3,129	10,839	2,469	11,094	(1,185)	4,669	
Derivative instruments (except options)	(911)	(128)	(2,317)	(685)	(1,001)	(232)	(250)	979	-	-	(4,545)	-	(4,472)	
Foreign currency- local operations (c):														
Assets	18,279	4,965	10,741	7,848	4,967	4,623	2,740	3,861	1,263	562	59,849	117	55,759	4.21
Liabilities	45,517	13,144	18,849	2,846	948	730	545	782	147	(4)	83,504	-	82,762	2.26
Difference	(27,238)	(8,179)	(8,108)	5,002	4,019	3,893	2,195	3,079	1,116	566	(23,655)	117	(27,003)	
Derivative instruments (except options)	7,294	4,863	7,510	1,196	287	(155)	788	(708)	12	-	21,087	-	21,640	
Options (in terms of underlying asset)	725	(37)	151	(27)	(3)	(23)	-	-	-	-	786	-	829	
Foreign currency - integrated foreign operations:														
Assets	15,656	4,478	9,202	2,982	2,013	2,474	1,914	1,519	574	104	40,916	23	39,915	1.91
Liabilities	20,392	6,169	6,634	1,349	519	52	1,948	348	19	4	37,434	48	37,250	1.05
Difference	(4,736)	(1,691)	2,568	1,633	1,494	2,422	(34)	1,171	555	100	3,482	(25)	2,665	
Financial instruments (excluding options)	-	(744)	(1,952)	-	-	-	-	-	-	-	(2,696)	-	(2,677)	

See notes on next page.

Note 17 - Assets and Liabilities Classified by Repayment Date and Linkage Basis (cont'd)(a)

Reported Amounts

31 December 2011

	Estimated future contractual cash flows											Balance sheet balance (d)		
	Upon demand and up to one month (e)	One month to three months (e)	Three months to one year (e)	One year to two years	Two years to three years	Three years to four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total cash flows	Without fixed maturity (b)	Total	Contractual rate of return (g)
	NIS millions													
Non-monetary items:														
Assets	-	-	-	-	-	-	-	-	-	-	-	9,370	9,370	
Liabilities	-	-	-	-	-	-	-	-	-	-	-	950	950	
Difference	-	-	-	-	-	-	-	-	-	-	-	8,420	8,420	
Total:														
Assets	107,823	30,031	69,878	39,480	27,175	22,158	16,504	46,737	29,651	9,585	399,022	11,174	365,854	4.29
Liabilities	186,480	30,898	55,694	24,120	10,461	10,104	9,079	21,364	3,256	1,778	353,234	2,579	342,226	3.22
Difference (f)	(78,657)	(867)	14,184	15,360	16,714	12,054	7,425	25,373	26,395	7,807	45,788	8,595	23,628	

31 December 2010 (h)

	Estimated future contractual cash flows											Balance sheet balance (d)		
	Upon demand and up to one month (e)	One month to three months (e)	Three months to one year (e)	One year to two years	Two years to three years	Three years to four years	Four years to five years	Five years to ten years	Ten years to twenty years	Over twenty years	Total cash flows	Without fixed maturity (b)	Total	Contractual rate of return (g)
	NIS millions													
Total:														
Assets	80,549	27,072	69,794	40,051	25,703	20,004	17,179	45,308	24,669	7,839	358,168	12,686	328,322	4.56
Liabilities	166,546	25,893	49,939	18,070	11,744	7,036	9,624	18,946	5,691	1,737	315,226	3,395	304,711	3.62
Difference (f)	(85,997)	1,179	19,855	21,981	13,959	12,968	7,555	26,362	18,978	6,102	42,942	9,291	23,611	

(a) In this Note, forecast contractual future cash flows in respect of assets and liabilities are shown according to linkage basis, in accordance with the remaining contractual period to maturity of each cash flow. The data is presented after deduction of provisions for doubtful debts.

(b) Including overdue amounts of NIS 525 million (31 December 2010 – NIS 806 million).

(c) Including linked to foreign currency.

(d) As included in Note 16, "Assets and Liabilities According to Linkage Basis", including off-balance sheet amounts in respect of derivatives.

(e) Credit with debitory account conditions is classified in accordance with the period of the credit facility: credit within limit of facilities of NIS 13.3 billion (31 December 2010 - NIS 10.7 billion). Over-limit credit in the amount of NIS 0.3 billion (31 December 2010 - NIS 0.4 billion) is classified as without repayment date.

(f) The above difference does not necessarily reflect the exposure to interest and/or linkage basis.

(g) The contractual rate of return is the interest rate discounting future anticipated contractual cash flows reported in this Note to the balance sheet figure.

(h) Restated.

Note: Total memorandum liabilities against which short-term credit was granted in the Bank amount to NIS 5.1 billion as at 31 December 2011 (31 December 2010 - NIS 5.9 billion).

Note 18 - Contingent Liabilities and Special Commitments

Reported Amounts

	31 December 2011			31 December 2010
	Contract balances	Balance of allowance for credit losses	Balance after allowance	Balance after allowance
	NIS millions			
A. Off-balance sheet financial instruments				
Balances of contracts or their stated amounts as at the end of the year				
Transactions in which the balance reflects a credit risk:				
Documentary credits	**2,060**	**5**	**2,055**	2,101
Credit guarantees	**7,360**	**82**	**7,278**	6,192
Guarantees to apartment purchasers	**11,461**	**24**	**11,437**	11,348
Other guarantees and liabilities	**15,698**	**219**	**15,479**	14,327
Unutilized credit card facilities (a)	**20,519**	**23**	**20,496**	18,999
Other unutilized revolving credit facilities and credit facilities in accounts on demand	**14,037**	**30**	**14,007**	13,586
Irrevocable commitments to provide credit which has been approved and not yet granted (a) (b)	**22,979**	**64**	**22,915**	20,340
Commitments to issue guarantees	**11,694**	**17**	**11,677**	9,428
Unutilized facilities for activity in derivative instruments	**4,386**	**-**	**4,386**	4,110
Approval in principle for safeguarding a rate of interest in Leumi Mortgage	**2,410**	**-**	**2,410**	3,969

(a) Restated.

(b) Of which: credit exposures in respect of the obligation to provide liquidity to securitization structures under the auspices of others not utilized in the amount of NIS 229 million (31 December 2010 – NIS 213 million). This commitment is only made in a situation where financing difficulties do not facilitate securitization. Currently and in the past the liquidity facility was not utilized. The lines provided by the Bank represent a small part of the overall volume of liquidity lines provided to those entities. The Bank does not provide these entities with any other kind of support.

	31 December 2011	31 December 2010
	NIS millions	
B. Off-balance sheet commitments for transactions based on extent of collections (a)		
Balance of credit from deposits on collection basis (b)		
Israeli currency unlinked	**1,326**	1,227
Israeli currency linked to the CPI	**5,189**	5,914
Foreign currency	**464**	409
Total	**6,979**	7,550

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

Cash flows in respect of collection commissions and interest margins on activities based on the extent of collections as at December 31

	Up to one year	One year to three years	Three years to five years	Five years to ten years	Ten years to twenty years	After twenty years	Total 2011	Total 2010
	NIS millions							
1. CPI linked sector (c)								
Cash flows of futures contracts	**27**	**48**	**46**	**102**	**50**	**2**	**275**	321
Expected future cash flows net of management estimate of early repayments	**30**	**50**	**44**	**100**	**46**	**-**	**270**	313
Discounted expected future cash flows net of management estimate of early repayments (d)	**29**	**47**	**39**	**79**	**31**	**-**	**225**	264
2. Unlinked shekel sector								
Cash flows of futures contracts	**3**	**4**	**4**	**8**	**2**	**-**	**21**	35
Expected future cash flows net of management estimate of early repayments	**3**	**4**	**4**	**8**	**2**	**-**	**21**	35
Discounted expected future cash flows net of management estimate of early repayments (d)	**3**	**4**	**3**	**6**	**2**	**-**	**18**	28

(a) Credit and deposits out of deposits returnable upon repayment of the credit (or the deposits) with interest margin or with collection commission (instead of interest margin).

(b) Standing loans and Government deposits given in respect thereof in the amount of NIS 417 million (31 December 2010 - NIS 536 million) are not included in this table.

(c) Including foreign currency sector.

(d) The present value of future flows was computed at the rate of 3.24% (2010 – 2.82%).

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

	2011	2010 (a)
	NIS millions	
B. Off-balance sheet commitments for transactions based on collection (cont'd)		
Information on loans granted during the year by mortgage banks:		
Loans from deposits on collection basis	**15**	33
Standing loans	**4**	5
C. Other contingent liabilities and special commitments:		
(1) Long-term rental contracts - rental of buildings, equipment and motor vehicles		
and maintenance in respect of commitments payable in following years		
First year	**216**	196
Second year	**178**	162
Third year	**157**	137
Fourth year	**141**	118
Fifth year	**98**	91
After five years	**510**	443
Total	**1,300**	1,147
(2) Commitments to purchase securities	**-**	204
(3) Commitments to invest in and acquire buildings and equipment	**321**	272
(4) Future deposits		
Transactions with depositors for purposes of receipt of large deposits at various future dates and at fixed interest rates determined in advance as of the date of the commitment		
Details of amounts of future deposits and deposit dates as determined in the terms of the transactions:		
First year	**17**	17
Second year	**17**	17
Third year	**17**	17
Fourth year	**12**	17
Fifth year	**3**	12
Sixth and subsequent years	**-**	3
Total future deposits	**66**	83

(a) Restated.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

D. Fair value of financial instruments

(1) General

This note includes information regarding the determination of the fair value of financial instruments according to directives of the Supervisor of Banks. Most of the financial instruments of the Bank do not have a market value because they do not have an active trading market. Their fair value is therefore determined on the basis of the present value of future cash flows, discounted at an interest rate that reflects the interest at which the Bank would have effected a similar transaction on the reporting date. The estimated fair value is calculated by means of estimating future cash flows and a subjective determination of the discount rate. Therefore, in respect of most financial instruments, the reported fair value does not necessarily indicate the realizable value of the financial instrument on the reporting date. The estimate of fair value is made on the basis of interest rates in effect on the reporting date and does not take into account interest rate fluctuations. Under different interest rates the fair value calculated may be significantly different. This is true especially in respect of financial instruments with interest at fixed rates or those which are non-interest bearing. Furthermore, the determination of fair value does not take into account commissions that will be received or paid over the course of business. Furthermore, the difference between the balance sheet value and the fair value may not be realized because in most cases the Bank may hold the financial instrument until maturity. Therefore, it should be noted that the data included in this note do not purport to reflect the value of the Bank as a going concern. Furthermore, because of the wide range of valuation techniques and estimates that can be applied in the calculation of fair value, caution must be exercised when comparing fair values of different banks.

(2) Principal methods and assumptions used in estimating the fair value of financial instruments

Financial assets:

Credit to the public - the fair value of credit to the public is determined on the basis of the present value of future cash flows discounted at an appropriate discount rate. The balance of credit was classified into a number of categories according to the operating segment and the credit rating of the borrowers. Future cash flows (principal and interest) were calculated in respect of each category according to the various linkage bases. These receipts were discounted at an interest rate that reflects the rate of risk and average margin inherent in that category of credit and the term of the credit.

The interest rate is usually determined according to the interest rate used in similar transactions on the reporting date.

The fair value of debit balances in current accounts was valued at book value.
The fair value of problematic debts was calculated at interest rates that reflect the inherent high credit risk. In any case these interest rates are not lower than the highest rate of interest used by the Group in its transactions in the same sector on the reporting date.

Additionally, a sensitivity analysis was implemented regarding the estimated fair value of the problematic loans to the discounted interest rate. The examination ascertained that an additional 1% discounted interest will decrease the estimated fair value of the problematic loans as of the end of 2011 by NIS 30 million.

The fair value of current account balances classified as problematic loans was calculated in accordance with an estimate of their average duration and based on maximum interest rates in the Bank.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

The future cash flows in respect of problematic debts were calculated after deducting the specific provisions for doubtful debts.

Deposits with banks and credit to governments - by the discounted future cash flows method, at interest rates at which similar transactions were executed on the reporting date.

Securities – Quoted securities at their market value. Unquoted securities, shares at cost and debentures according to a model which takes into account the present value of future cash flows discounted at the appropriate discount rate, and which also takes into account the probability of failure and market value.

Financial liabilities:

Deposits of the public - the balance of the deposits is classified according to a number of categories according to operating segments, adjustment basis and the terms of deposit. Future cash flows (principal and interest) were calculated in respect of each category. These payments were discounted at an interest rate that reflects the average interest rate the Group pays on similar deposits in the same category for the period remaining until maturity. The balance sheet amount of current accounts and deposits without a repayment date is considered to be an estimate of their fair value.

Deposits from banks and deposits from governments - the fair value estimated by the discounted future cash flows method, at the rate of interest at which the Group raises similar deposits on the reporting date.

Debentures, bonds and subordinated notes - at their fair value or by the discounted future cash flows method, at the rate of interest at which the Group raises similar deposits or at the rate at which it issues similar bonds on the reporting date.

Other financial assets and liabilities:

Derivative instruments:

Derivative instruments that have an active market were valued at market value and, when there are a number of markets in which the instrument is traded, the value is determined according to the most active market.

Derivative instruments that are not traded on an active market were valued on the basis of models the Bank uses in its current operations as at the reporting date, which take into account the risks inherent in the financial instrument.

Off-balance sheet financial instruments in which the balance reflects a credit risk:

The balance sheet value approximates the fair value, since the terms of transactions in the balance sheet do not differ materially from the terms of similar transactions on the reporting date.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

D. Fair values of financial instruments (cont'd)

(3) Balances and estimated fair value of financial instruments

	31 December 2011				31 December 2010			
	Balance sheet value				Balance sheet value			
	(a)	(b)	Total	Fair value	(a)	(b)	Total	Fair value
	NIS millions							
Financial assets								
Cash and deposits with banks	**16,044**	**37,000**	**53,044**	**52,968**	8,446	21,606	30,052	30,035
Securities	**47,936**	**-**	**47,936**	**47,936**	55,791	-	55,791	55,791
Securities borrowed or purchased under repurchase agreements	**1,225**	**-**	**1,225**	**1,225**	1,190	-	1,190	1,190
Credit to the public, net	**26,470**	**214,850**	**241,320**	**241,921**	22,901	201,080	223,981	226,263
Credit to governments	**49**	**399**	**448**	**478**	16	363	379	409
Assets in respect of derivative instruments	**11,573**	**-**	**11,573**	**11,573**	8,716	-	8,716	8,716
Other financial assets	**1,008**	**3**	**1,011**	**1,011**	670	-	670	670
Total financial assets	**104,305**	**252,252**	**356,557**	**357,112**	97,730	223,049	320,779	323,074
Financial liabilities								
Deposits of the public	**69,152**	**210,252**	**279,404**	**280,880**	63,403	186,181	249,584	251,210
Deposits from banks	**1,551**	**3,505**	**5,056**	**4,929**	1,391	1,300	2,691	2,692
Deposits from governments	**113**	**406**	**519**	**550**	225	435	660	688
Securities loaned or sold under agreements to repurchase	**385**	**57**	**442**	**442**	762	244	1,006	1,010
Debentures, bonds and subordinated notes	**-**	**29,999**	**29,999**	**31,520**	-	26,939	26,939	29,117
Liabilities in respect of derivative instruments	**12,069**	**-**	**12,069**	**12,069**	9,985	-	9,985	9,985
Other financial liabilities	**1,716**	**5,728**	**7,444**	**7,416**	2,804	4,328	7,132	7,107
Total financial liabilities	**84,986**	**249,947**	**334,933**	**337,806**	78,570	219,427	297,997	301,809
Off-balance sheet financial instruments								
Transactions in which the balance reflects a credit risk	**279**	**-**	**279**	**279**	367	-	367	367

(a) Financial instruments in respect of which the balance sheet value is an estimate of fair value - instruments that are stated in the balance sheet at their market value.
(b) Other financial instruments regarding which fair value was calculated.

Instruments incorporating options not separated from the host contract are not shown on a separate line but are included with the other monetary assets.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

D. Fair values of financial instruments (cont'd)

(4) Items measured for fair value on a recurring basis

	31 December 2011			
	Fair value measurements using			
	Prices quoted in an active market (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Book value
	(NIS millions)			
Assets:				
Securities available for sale:				
Israeli government bonds	18,361	1,414	-	19,775
Foreign government bonds	3,451	214	10	3,675
Bonds of Israeli financial institutions	335	62	-	397
Bonds of financial institutions abroad	982	6,759	113	7,854
MBS/ABS	372	1,335	737	2,444
Others in Israel	172	432	-	604
Others abroad	407	775	72	1,254
Shares available for sale	1,006	-	-	1,006
Total securities available for sale	25,086	10,991	932	37,009
Securities held for trading:				
Bonds held for trading	8,772	609	-	9,381
Shares held for trading	361	-	-	361
Total securities held for trading	9,133	609	-	9,742
Assets in respect of derivative financial instruments:				
Interest contracts	95	6,575	91	6,761
Foreign currency contracts	75	4,192	181	4,448
Share contracts	245	39	-	284
Commodity and other contracts	22	58	-	80
Total assets in respect of derivative financial instruments:	437	10,864	272	11,573
Other	1,921	-	-	1,921
Total assets	36,577	22,464	1,204	60,245
Liabilities:				
Liabilities in respect of derivative financial instruments:				
Other interest contracts	96	6,715	298	7,109
Foreign currency contracts	77	4,070	439	4,586
Share contracts	245	44	-	289
Commodity and other contracts	22	63	-	85
Total liabilities in respect of derivative financial instruments	440	10,892	737	12,069
Other	1,443	221	-	1,664
Total liabilities	1,883	11,113	737	13,733

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

D. Fair values of financial instruments (cont'd)

(5) Changes in items measured for fair value on a recurring basis included in Level 3

	31 December 2011					
	Changes in items measured for fair value included in Level 3					
	Fair value at beginning of the year	Total realized and unrealized profits (losses)	Net acquisitions, issues and extinguish-ments	Transfers to or from Level 3	Fair value at 31 December 2011	Unrealized profits (losses) in respect of instruments held at 31 December 2011
	(NIS millions)					
Assets:						
Bonds available for sale:						
Foreign government bonds	18	-	(8)	-	10	(9)
Bonds of financial institutions abroad	112	1	-	-	113	1
MBS/ABS	856	30	(149)	-	737	1
Others in Israel	21	6	-	(27)	-	-
Others abroad	70	1	1	-	72	-
Total bonds available for sale	1,077	38	(156)	(27)	932	(7)
Assets in respect of derivative financial instruments	135	21	112	4	272	180
Total assets	1,212	59	(44)	(23)	1,204	173
Liabilities:						
Liabilities in respect of derivative financial instruments	1,102	(454)	88	1	737	48
Total liabilities	1,102	(454)	88	1	737	48

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

E. The Group's activity in derivative instruments

General

The above activity involves taking risks, mainly those discussed below:

- Credit risk measures the maximum loss which will be incurred if the other party fails to discharge its obligations under the transaction. To cover this risk collateral is required from the client commensurate with the risk on the transactions. The collateral is included in the total amount of collateral required in respect of the client's obligations. For transactions which include the writing of options or the purchase/sale of contracts that are traded on a stock exchange, the clients are required to deposit at least the liquid collateral required by those stock exchanges.

- Market risks include risks due to changes in interest rates and changes in foreign exchange rates, the CPI and stock exchange prices. The market risks relating to transactions in derivatives are part of the total of the market risk relating to financial instruments. Activity in derivatives is carried out within the limits of exposure to market risks determined by the boards of directors of the Group companies.

- Liquidity risk which results from the uncertainty with respect to the price which the Bank will need to pay to cover the transaction. This risk exists mainly with respect to instruments with a low trade volume or a low trade volume of the underlying asset. This risk is taken into account in determining the collateral to be obtained.

- This activity does not refer to derivative instruments embedded in other activities.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

F. Activity in derivatives - scope, credit risks and repayment dates

a. Scope of activity

	31 December 2011				
	Interest rate contracts		Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts
	Shekel – index	Other			
	NIS millions				
(1) Nominal					
a) Hedged instruments (a)					
Swaps	-	3,241	-	-	-
Total	-	3,241	-	-	-
Of which: interest-rate swap contracts in which the banking institution agreed to pay a fixed rate of interest	-	3,078	-	-	-
b) ALM derivatives (a)(b)					
Futures contracts	-	19,030	-	463	1,175
Forward contracts	11,598	16,691	138,561	-	1,098
Exchange-traded options					
Put options	-	6	5,190	9,330	-
Call options	-	6	5,185	9,330	-
Other options					
Put options	15	18,127	34,910	1,023	720
Call options	-	14,938	30,234	1,038	681
Swaps	914	183,325	18,308	8,055	1,168
Total	12,527	252,123	232,388	29,239	4,842
Of which: interest-rate swap contracts in which the banking institution agreed to pay a fixed rate of interest	-	91,476	-	-	-
c) Other derivatives (a)					
Swaps	-	-	-	-	-
Total	-	-	-	-	-
d) Credit derivatives and foreign exchange spot contracts					
Credit derivatives in which the banking institution is a guarantor	-	-	-	-	-
Credit derivatives in which the banking institution is a beneficiary	-	-	-	-	-
Foreign exchange spot contracts	-	-	12,490	-	-
Total	-	-	12,490	-	-
Aggregate Total	12,527	255,364	244,878	29,239	4,842

(a) Excluding credit derivatives and spot foreign currency exchange contracts.

(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

F. Activity in derivatives - scope, credit risks and repayment dates (cont'd)

a. Scope of activity (cont'd)

	31 December 2011				
	Interest rate contracts		Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts
	Shekel – index	Other			
	NIS millions				
(2) Gross fair value of derivative instruments					
a. Hedged derivatives (a)					
Gross positive fair value	-	9	-	-	-
Gross negative fair value	-	195	-	-	-
b. ALM derivatives (a)(b)					
Gross positive fair value	103	6,648	4,449	284	80
Gross negative fair value	322	6,600	4,622	289	85
c. Other derivatives (a)					
Gross positive fair value	-	-	-	-	-
Gross negative fair value	-	-	-	-	-
d. Credit derivatives					
Credit derivatives in which the banking institution is a guarantor					
Gross positive fair value	-	-	-	-	-
Gross negative fair value	-	-	-	-	-
Credit derivatives in which the banking corporation is a beneficiary					
Gross positive fair value	-	-	-	-	-
Gross negative fair value	-	-	-	-	-

(a) Except credit derivatives.
(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

F. Activity in derivatives - scope, credit risks and repayment dates (cont'd)

a. Scope of activity (cont'd)

	31 December 2010				
	Interest rate contracts		Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts
	Shekel – index	Other			
	NIS millions				
(1) Nominal amount of derivative instruments					
a. Hedged instruments (a)					
Swaps	-	2,563	-	-	-
Total	-	2,563	-	-	-
Of which: interest-rate swap contracts in which the banking institution agreed to pay a fixed rate of interest	-	2,354	-	-	-
b. ALM derivatives (a)(b)					
Futures contracts	-	14,594	-	499	756
Forward contracts	7,160	9,010	155,524	-	276
Exchange-traded options					
Put options	-	-	5,104	8,908	9
Call options	-	-	5,031	8,908	11
Other options					
Put options	15	17,584	34,802	4,914	19
Call options	-	16,610	33,896	4,920	23
Swaps	980	121,111	18,533	412	646
Total	8,155	178,909	252,890	28,561	1,740
Of which: interest-rate swap contracts in which the banking institution agreed to pay a fixed rate of interest	-	61,573	-	-	-
c. Other derivatives (a)					
Swaps	-	-	-	-	-
Total	-	-	-	-	-
d. Credit derivatives and foreign exchange spot contracts					
Credit derivatives in which the banking institution is a guarantor	-	-	-	-	1,593
Credit derivatives in which the banking institution is a beneficiary	-	-	-	-	741
Foreign exchange spot contracts	-	-	14,108	-	-
Total	-	-	14,108	-	2,334
Aggregate Total	8,155	181,472	266,998	28,561	4,074

(a) Excluding credit derivatives and spot foreign currency exchange contracts.

(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

F. Activity in derivatives - scope, credit risks and repayment dates (cont'd)

a. Scope of activity (cont'd)

	31 December 2010				
	Interest rate contracts		Foreign currency contracts	Contracts in respect of shares	Commodities and other contracts
	Shekel – index	Other			
	NIS millions				
(2) Gross fair value of derivative instruments					
a. Hedged derivatives (a)					
Gross positive fair value	-	32	-	-	-
Gross negative fair value	-	43	-	-	-
b. ALM derivatives (a)(b)					
Gross positive fair value	42	2,895	4,439	1,223	80
Gross negative fair value	336	2,973	5,373	1,221	82
c. Other derivatives (a)					
Gross positive fair value	-	1	-	-	-
Gross negative fair value	-	-	-	-	-
d. Credit derivatives					
Credit derivatives in which the banking institution is a guarantor					
Gross positive fair value	-	-	-	-	4
Gross negative fair value	-	-	-	-	13
Credit derivatives in which the banking corporation is a beneficiary					
Gross positive fair value	-	-	-	-	1
Gross negative fair value	-	-	-	-	-

(a) Excluding credit derivatives.
(b) Derivatives constituting part of the assets and liabilities of the Bank not intended for hedging.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

F. Activity in derivatives - scope, credit risks and repayment dates (cont'd)

b. Credit Risk in Respect of Derivative Instruments according to Counterparty to the Contract

31 December 2011	Stock Exchang	Banks	Dealers/ brokers	Governments and central banks	Others	Total
	NIS millions					
Balance sheet balances of assets derived from derivative instruments (a) (b)	**132**	**7,258**	**479**	**-**	**3,704**	**11,573**
Off-balance sheet credit risk in respect of derivative instruments (c)	**-**	**672**	**1**	**64**	**4,130**	**4,867**
Total credit risk in respect of derivative instruments	**132**	**7,930**	**480**	**64**	**7,834**	**16,440**

31 December 2010	Stock Exchang	Banks	Dealers/ brokers	Governments and central banks	Others	Total
	NIS millions					
Balance sheet balances of assets derived from derivative instruments (a) (b)	280	4,864	373	-	3,200	8,717
Off-balance sheet credit risk in respect of derivative instruments (c)	1,182	25,081	1,776	-	10,596	38,635
Total credit risk in respect of derivative instruments	1,462	29,945	2,149	-	13,796	47,352

(a) There were no net accounting arrangements.

(b) Of which a balance sheet amount of stand-alone derivative instruments in the sum of NIS 11,573 million (31 December 2010 – NIS 8,717 million) included under other assets.

(c) Off-balance sheet credit risk in respect of derivative instruments (including in respect of derivative instruments with negative fair value) as calculated for purposes of limitations on debts of borrowers.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

F. Activity in derivatives - scope, credit risks and repayment dates (cont'd)

c. Details of Repayment Dates – Nominal Values: Year-end balances

	31 December 2011				
	Up to three months	From three months to one year	From one year to five years	Over five years	Total
	NIS millions				
Interest contracts:					
Shekel – index	**2,810**	**5,209**	**3,558**	**950**	**12,527**
Other	**35,199**	**50,183**	**84,988**	**84,994**	**255,364**
Foreign currency contracts	**152,528**	**72,772**	**8,859**	**10,719**	**244,878**
Contracts in respect of shares	**23,751**	**4,876**	**612**	**-**	**29,239**
Commodities and other contracts	**3,774**	**632**	**436**	**-**	**4,842**
Total	**218,062**	**133,672**	**98,453**	**96,663**	**546,850**

	31 December 2010				
	Up to three months	From three months to one year	From one year to five years	Over five years	Total
	NIS millions				
Interest contracts:					
Shekel – index	748	4,631	2,690	86	8,155
Other	25,385	30,898	60,745	64,444	181,472
Foreign currency contracts	168,439	80,432	7,250	10,877	266,998
Contracts in respect of shares	18,617	8,995	949	-	28,561
Commodities and other contracts	1,320	2,017	737	-	4,074
Total	214,509	126,973	72,371	75,407	489,260

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

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G. In the course of business, legal claims have been filed against the Bank and certain consolidated companies, including petitions for approval of class actions.

In the opinion of the Management of the Bank and the managements of the consolidated companies, based on legal opinions regarding the chances of the claims succeeding, including the petitions for approval of class actions, appropriate provisions have been recorded in the Financial Statements, insofar as required, to cover damages resulting from the said claims.

In the opinion of the Management of the Bank and the managements of the consolidated companies, the total additional exposure arising from legal claims filed against the Bank and against the consolidated companies on various subjects, the amount of each of which exceeds NIS 2 million, and regarding which the chances of the claims succeeding are not remote, amounts to some NIS 215 million.

(1) The following are details of claims in material amounts:

A. On 12 September 2006, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Bank Hapoalim B.M. and Israel Discount Bank Ltd. The amount claimed in the class action for which approval has been requested is NIS 7 billion, while in the body of the claim, it is contended that the damage to the claimant group amounts to NIS 10 billion. No specific sum of the amount of the claim has been clearly attributed to any of the respondents. According to the petitioner, the respondent banks charged their customers with interest for unlinked shekel credit, a commission for credit allotment and fixed management fees with regard to debitory current accounts at identical rates and amounts, as a result of a prohibited restrictive arrangement. On 21 January 2008, the Tel Aviv District Court approved the pursuance of the claim as a class action. The Bank submitted a petition for leave to appeal the ruling to the Supreme Court. In the context of the appeal proceedings, the Attorney General submitted his position on 27 May 2010, the essence of which is that the decision of the District Court cannot remain as is, since identical prices between banks themselves do not provide a basis for a reasonable possibility of the existence of a restrictive arrangement, and that in his opinion the matter should be returned to the District Court for the completion of clarification and the handing down of a new decision. On 21 November 2011, the Attorney-General submitted a further opinion dealing with the implications of the decision by the Anti-Trust Commissioner dated 26 April 2009, under the heading "Restrictive Arrangements between Bank Hapoalim, Bank Leumi, Bank Discount, Bank Mizrahi, and the First International Bank, concerning the Transfer of Information relating to Commissions" ("the decision"). The essence of this additional position is that in the view of the Attorney General the decision justifies the approval of a class action. It should be noted that the Attorney General also referred to the decision in the footnotes to his position of May 2010, where it stated that this decision refers to commissions, whereas the decision that is the subject of the appeal refers to interest rates. Proceedings in the District Court are suspended until the handing down of a decision on the request for approval of the appeal submitted by the Bank.

B. On 23 November 2006, a claim and a petition to approve the claim as a class action were filed in the Jerusalem District Court against the Bank and against Bank Hapoalim B.M. and Israel Discount Bank Ltd. The petitioners allege that in respect of credit to the household sector, the banks collect interest at a rate that is much higher than that collected from the commercial sector and from the corporate sector. The petitioners claim that this is exploitation of monopolistic power and that there is a real concern that the lack of competition between the respondents, regarding all matters concerning the households

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sector, is the result of a restrictive arrangement between the parties. It is also alleged that this is misleading consumers regarding the normal price for credit service to the household.

The alleged damage is NIS 5.6 billion according to one method, and NIS 5.2 billion according to a second method. The estimated damage attributed to the Bank’s customers is at least NIS 1.6 billion. The Bank filed its response to the petition for the approval of the claim as a class action. The District Court granted a stay of these proceedings in this request until the Supreme Court renders a decision regarding the petition for leave to appeal filed by the Bank with respect to the decision to approve as a class action the claim described in paragraph A. above.

C. On 3 January 2008, 260 identical claims were filed in the Tel Aviv-Jaffa Magistrates’ Court against the Bank and receivers who had been appointed by the court. The amount of the claims ranges from some NIS 787,000 to some NIS 1,350,000. Pursuant to the Court’s ruling, the proceedings for all of the abovementioned claims were combined, and they will be heard as one claim. The aggregate amount of the claims is some NIS 276 million. The plaintiffs are the purchasers of vacation apartments in the Nofit Hotel in Eilat. According to the plaintiffs, the Bank and the receivers were negligent in supervising the project and refrained from financing the guarding fees, and, as a result, the plaintiffs suffered significant damages, including a decline in the value of the apartments. These claims are in addition to five other claims that were filed against the Bank on the same grounds, and are being heard separately. The total amount of all the claims in connection with this project is some NIS 288.6 million. On 10 August, 2009, the Tel Aviv-Jaffa District Court rejected one of the additional claims submitted against the Bank, which had been submitted separately by 3 purchasers and was identical to the abovementioned 260 claims. The plaintiffs appealed the ruling. The court ordered a stay of proceedings in the claims until a judgment had been given in the appeal submitted on the aforesaid ruling. On 17 June 2010, the appeal was dismissed, and following this, the Bank filed a petition to dismiss the aforesaid 260 claims. On 20 June 2010, the Court handed down a decision which determined that there were grounds for dismissing the claims, and requested the parties' response. The plaintiffs have notified the court of their desire to continue the proceedings. The plaintiffs filed petitions to amend the claims, and the Bank filed a petition to dismiss the claims outright under the finality of judgment rule. No hearing has taken place yet on these petitions.

D. On 1 April, 2007, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, additional banks, and entities that purchased the control of the mutual fund managers from the banks. The amount claimed against the Bank is estimated by the petitioners at some NIS 131 million.

According to the petitioners, the Bank, beginning in 2004, charged the fund managers under its control, or that were under its control before it sold them to third parties, brokerage commissions with respect to the execution of securities and foreign currency transactions, at a rate higher than the rate it charged other entities, and in doing so, acted unlawfully. The Bank has filed its response to the petition for the approval of the claim as a class action.

E. On 26 June, 2007, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, for a claim in the amount of NIS 200 million. The plaintiff claims that, prior to the reform of bank commissions, the Bank charged its customers commissions that were higher than agreed in the list of tariffs. In those cases where a partial sale of securities was carried out during the quarter for which the minimum commission per security set out in the list of tariffs was charged, and at the end of the quarter there remained a balance of the securities bearing the same name, the Bank charged commission on them according to the rate also set out in the list of tariffs. The plaintiff also argues that the Bank's documents and announcements do not reflect the amounts of the management fee commissions that are actually charged during a single quarter, and that the Bank breached its duty of fair disclosure, and that its notices are even misleading. The Bank has filed its response to the petition for the approval of the claim as a class action. On 8 September 2011, the District Court dismissed the petition for approval of the claim as a class action. On 6 November 2011, the petitioner submitted notice of appeal to the Supreme Court against the above verdict.

F. On 25 September 2007, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, in the amount of some NIS 435 million, which includes 8 different causes of action. Following a petition for dismissal submitted by the Bank, the Court ruled that 7 of the 8 causes of action be stricken from the petition for approval, and ruled that the plaintiffs had to give notice of the cause of action with which they chose to continue proceedings. The plaintiffs gave notice that proceedings would continue on the cause of action relating to the method of calculating management fees at the end of the quarter. According to the claim, whenever the amount of securities management fees calculated at the end of a quarter is less than the minimum fee per deposit set out in the list of tariffs, the minimum fee per deposit should only be charged if the total amount of securities management fees charged during the quarter is less than the minimum fee per deposit. As the Bank calculated the minimum fee amount at the end of a quarter, without taking into account management fee amounts charged during the quarter, it had not acted in accordance with the tariff rules, and contrary to the manner in which they were to be interpreted. The amount attributed by the plaintiffs on these grounds amounts to some NIS 30 million. On 12 June 2011, a judgment was handed down by the Tel Aviv District Court dismissing the petition for approval as a class action. On 8 September 2011, the plaintiff filed an appeal with the Supreme Court against the above verdict.

G. On 6 May 2008, a claim and a petition to approve it as a class action were filed in the Tel Aviv-Jaffa District Court. According to the plaintiff, the Bank charges its customers' accounts with the legal expenses incurred in handling said customers' debts, without obtaining the approval of any legal tribunal, and in violation of the directives of the Supervisor of Banks – "Proper Banking Management Directives – Charging Customers for Attorneys' Fees." Additionally, when the Bank charges its customers' accounts with legal expenses (both those approved by a legal tribunal and those that have not been so approved), the Bank collects interest on such expenses at the interest rate applicable to the account (which in many cases is excess interest on arrears) and not at the interest and linkage rates which the Bank is permitted to collect in accordance with the Adjudication of Interest and Linkage Law, 1961. The requested remedy is the reimbursement of all excess amounts charged by the Bank, without an indication of the amount, although it is alleged that "this is a vast amount" and that the lawsuit is filed in the name of all the Bank's customers whose accounts were charged with legal expenses during the seven years preceding the filing of the petition to approve the class action. The Bank has submitted its response to the petition for approval of the claim as a class action. On 18 October 2009, the District Court approved the claim as a class action. On 15 November 2009, the District Court gave an order postponing the execution of its decision for approval of the claim as a class action, until the decision of the Supreme Court in the petition for leave of appeal against the said decision, filed by the Bank on 18 November 2009. On 27 July 2011, the Bank's petition to grant leave of appeal against the decision of the District Court approving

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the claim as a class action, was dismissed in the Supreme Court, and hearings in the claim were returned to the District Court.

H. On 28 September 2008, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Bank Hapoalim, Israel Discount Bank and the Bank Otzar Hachayal the amount of some NIS 672 million. According to the allegations, the Bank secretly collects an illegal commission from customers engaged in continuous trading of options on the Tel Aviv-25 stock index (such options consisting of a right to buy or sell the basket of shares comprising the Tel Aviv-25 Index at a given time and at a given price); the banks take advantage of the fact that the amounts pass from the stock exchange to those holding the options through the Banks, and an exercise commission of 0.5% is collected from the amounts received by customers who are the holders of expiring options which entitle their holders to a payment. The calculation of the amount due to the option holder is not simple because the expiration index is not an exact amount and is not published in any official publication, and so the customer does not know exactly what amount is due to him and cannot know that a commission has been deducted from the amount that he receives. The ground for the action is based on the fact that the Banks did not announce that they collect an exercise commission, that they did not include this commission in their agreements with the customers and that they made a false representation to the customers, according to which the only commission that they collect is the sale and purchase commission. The banks do specify the commission that is collected in a separate notice that they send at later stages, after the transactions have been carried out, but according to the plaintiffs, customers like them do not follow these notices and are not capable of analyzing them. The defined group consists of customers who contracted with portfolio managers in connection with the trading of Tel Aviv-25 Index options. According to the plaintiffs, they used a narrow definition of this group of customers in order to argue that it is easier to hide the charging of commissions from this group (relative to the group of customers who do not trade through portfolio managers). The relief requested is the damage which is common to all the customers of the banks in respect of the amount of the exercise commissions collected during the past seven years. The Bank has submitted its response to the petition for approval of the claim as a class action. Evidentiary hearings have taken place, and summaries submitted by the plaintiffs and the Bank.

I. On 29 October 2009, a claim for declaratory judgments was filed in the Central District Court to the effect, *inter alia*, that the seven respondent banks (the Bank, Bank Hapoalim, Israel Discount Bank, the First International Bank of Israel, Mizrahi Bank, Mercantile Discount Bank and Union Bank) are not entitled to charge the petitioners with "default" interest differentials, as defined in the claim, and that the amount of the default interest differentials must be reduced from an amount of NIS 841 million to an amount of NIS 37 million. Alternatively, they request a ruling that the banks are entitled to charge the petitioners with interest differentials in accordance with the Adjudication of Interest and Linkage Law, 1961 only, this being with regard to the petitioners' debt that had accrued from 12 May 2003 and thereafter. The petitioners claim is, *inter alia,* that the "default interest" is nothing other than "agreed compensation" as defined in Section 15(A) of the Contracts Law (Remedies), 1970, which a court may reduce "if it finds that the compensation was determined without any reasonable relation to the damage that had been foreseeable as being the reasonable result of a breach at the time the contract was made"; that the reduction of the default interest amounts is also required in accordance with the interpretation of the loan agreement and according to the intention of the parties; that the charging of the petitioners with default interest will constitute unjustified enforcement of the loan agreement; that the banks' insistence on charging the petitioners with default interest constitutes a lack of good faith; and that the banks' charging of default interest will constitute unjust enrichment on their part. The claim does not make a monetary attribution of a specific claimed share of each of the banks in the amount of the default interest differentials, but details are provided of each bank's participation in the financing, with the Bank's share being claimed to be 24%. On 11 February 2010, a monetary claim of NIS 829 million was submitted, to replace the claim for declaratory judgments that was dismissed. A statement of defense has been submitted, preliminary statements of testimony have been submitted, and evidence is being heard in the claim.

J. On 26 November 2008, a claim and a petition to approve it as a class action were filed in the Tel Aviv District Court against the Bank, the First International Bank of Israel Ltd., Union Bank of Israel Ltd. and Bank Mizrahi Tefahot Ltd. The claim is based on damages claimed in the amount of about NIS 68,125,000 (according to the plaintiff's calculations), which was incurred by all the customers of the banks from whose profits tax was deducted at source from interest in respect of bonds and/or dividends in respect on shares, from 1 January 2003 until the day the claim was filed. According to the claim, the banks over-deducted tax, by deducting tax at source in respect of commissions collected from the income received. According to the plaintiff's calculation, the banks should have deducted the commissions from the income on which tax was deducted at course, and only then carried out the deduction at source. The plaintiff bases his claim on Section 17 of the Income Tax Ordinance, which classifies commissions as an expense incurred in the production of income during the tax year, which is to be taken into account in the calculation of taxable income. According to the plaintiff's claim, by acting as stated the banks violated their duties of caution, trust and fair disclosure towards the group, which applies to them under the Banking Law, the Consumer Protection Law and the Damages Ordinance, as well as the duty of good faith applying to them. It is also claimed that the banks caused the group damage and monetary loss and that their behavior is tantamount to negligence, breach of statutory duties and unjust enrichment.

K. On 3 May 2010, a petition for approval of a class action was filed in the Central District Court claiming an amount of some NIS 209 million as of the date the claim was filed. The plaintiff is interested in representing all those holding debentures of Heftziba Hofim Ltd. ("Heftziba Hofim"), prior to the suspension of their trading at the beginning of August 2007. The petitioner claims that during the years 2006-2007, prior to the end of each quarter, the Bank granted loans in amounts of tens of millions of shekels to a company wholly owned by Mr. Boaz Yonah. According to the petitioner's claim, these funds were transferred for a short period of time to the account of Heftziba Hofim, and helped it to make momentary false presentations to the public regarding its true financial condition. The petitioner claims that as a result of cooperation by the Bank and the false representations made to the public, the investments of those holding debentures of Heftziba Hofim were eventually written off. The Bank's response has been filed to the petition for approval of the claim as a class action.

(2) In addition, there are legal claims pending against the Bank, including petitions for the approval of class actions, as detailed below. In the opinion of the Management of the Bank, based on legal opinions with regard to the chances of these legal proceedings, it is not possible, at this stage, to estimate the chances of the claims, and therefore no provision has been recorded in respect thereof.

A. On 30 June, 2008, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Israel Discount Bank and Bank Hapoalim, ("the Banks").

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It is claimed that the Banks had an illegal restrictive arrangement regarding the rates of the commissions they collect from their customers, that they abused their monopolistic power (the Banks constituting, it is argued, an oligopoly), and that they unlawfully enriched themselves at the expense of their customers. It is claimed, as an estimate, that had the rates not been coordinated between the Banks, the commissions would have been significantly lower, by at least 25%. The total aggregate amount of the damage is estimated in the amount of NIS 3.5 billion, with the heading of the petition indicating the amount of the claim as NIS 3 billion. No specific attribution has been made of the damage claimed from each of the Banks, but the petition mentions that the Bank's relative share of banking activity in Israel is estimated at some 30%. The Bank submitted its response to the petition for approval of the claim as a class action. The hearing in this file was incorporated with a later claim (see description of the same in paragraph B. below). On 29 November 2009, the Court decided to stay proceedings in the claim for two years (subject to the provisions set out in that decision) in view of the respondents' intention to submit a petition for leave to appeal the Commissioner's determination of 26 April 2009 in the Restrictive Practices Court. It was also decided that after this period of time, a hearing would be held to decide whether there were grounds for extending the stay of proceedings. On 23 February 2012, the Court decided to continue the stay of proceedings until the decision of the Restrictive Practices Court on the appeal filed against the Commissioner's determination.

B. On 27 April 2009, a petition to approve a class action was filed in the Tel Aviv-Jaffa District Court against the Bank, Bank Hapoalim, Israel Discount Bank, Mizrahi Tefahot Bank and the First International Bank. The petition is based on the Antitrust Commissioner's determination of 26 April 2009. The petitioners allege that in accordance with the determination, the banks made restrictive arrangements for the exchange of information on commissions, to the detriment of competition between them, and which caused damage to the members of the group whose representation is sought in the petition, and that such was reflected in overpayments of commissions. The petitioners estimate the amount of the class action against all the respondents at NIS 1 billion. The petition does not make any clear attribution of a specific claimed amount to each of the respondents. Proceedings in the petition for approval have been stayed for two years, as stated in the decision of 29 November 2009, described in paragraph A. above. On 23 February 2012, the Court decided to continue the stay of proceedings until the decision of the Restrictive Practices Court on the appeal filed against the Commissioner's determination.

C. On 27 March 2011, a petition for approval of a class action was filed in the Tel-Aviv District Court against the Bank. The petitioners' claim is that the Bank gave unilateral credit facilities, and charged commissions for them, and also charged interest exceeding the rate of interest stipulated for the highest band for that credit limit, contrary to Proper Conduct of Banking Business Directive No. 325. The aggregate damage, from the date that the aforementioned Directive No. 325 came into force, is estimated by the petitioner at some NIS 90 million. After the Bank submitted its response to the petition for approval as a class action, the plaintiff submitted a petition to withdraw from it. No decision has yet been made regarding the request for withdrawal. On 19 March 2012, the plaintiff submitted another petition for approval as a class action against the Bank, claiming that the Bank classifies credit unilaterally as temporary credit and by so doing charges commissions and interest that are prohibited by law.

D. On 13 July 2011, a petition was filed in the Tel-Aviv District Court for approval of a class action against Automatic Bank Services Ltd. (hereinafter: "ABS") and against Bank

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

Hapoalim B.M., Bank Leumi Le-Israel B.M., First International Bank of Israel B.M., and Israel Discount Bank B.M. ABS is a service company jointly owned by the banks mentioned above, whose activities include operating an independent network of automatic teller machines (ATM). It is claimed in the petition that when withdrawing cash from an ATM operated by ABS, the user is not provided with fair disclosure that in addition to the commission charged by ABS for the withdrawal, he will be charged additional commission by the bank in which his account is held. In addition, it is claimed in the petition that the banks are not authorized to charge its customers additional commission, after they were already charged for the withdrawal by ABS. The total amount claimed in the class action, in the opinion of the petitioners, is NIS 153.3 million, with the addition of linkage differentials and interest. There are no details of the distribution between the defendants.

E. On 6 September 2011, a petition for approval as a class action was filed in the Tel Aviv District Court against the Bank regarding the non-payment of interest and linkage differentials on credit amounts due to the customer in respect of charges collected excessively by the Bank. The total damage for the group is estimated by the petitioner at an amount of about NIS 40 million, for a period of seven years preceding the date of filing the claim, based on hypothetical assumptions regarding the number of accounts held at the Bank, an average rate of the number and amounts of incorrect charges to an account per year, and the amount of interest and linkage differentials estimated in the case.

F. On 11 December 2011**,** a petition for approval as a class action was filed in the Tel Aviv District Court against the Bank for the amount of NIS 74 million in connection with the collection of commission for handling cash when a bank employee deals with banknotes amounting to more than NIS 10 thousand. The commission amount appearing in the Bank's list of tariffs is 0.15% of the value of the transaction. The petitioner claims that the Bank is only entitled to collect commission on the amount exceeding ten thousand shekels and not from the first shekel, as practiced by the Bank.

(3) The following are details of claims and petitions for approval of class actions in material amounts that were filed against subsidiaries of the Bank (hereinafter, “the subsidiaries”). In the opinion of the Management of the Bank, and in reliance on the opinion of the management of each of the subsidiaries, which is based on the opinion of subsidiaries' legal advisors as to the chances of these proceedings, appropriate provisions have been included in the financial statements, insofar as required, to cover damages resulting from such claims:

A. On 21 June, 2000, a petition for approval of a class action was filed against Leumi Mortgage Bank Ltd. (hereinafter – "Leumi Mortgage Bank") in the Tel Aviv-Jaffa District Court. The amount of the claim for which approval as a class action has been requested is estimated by the petitioners at some NIS 100 million.

The petitioners claim that, in the context of an appraisal of the structure of a property for insurance purposes, Leumi Mortgage Bank or its representative prepared an excessive valuation of the buildings, resulting in overpayment of premiums by Leumi Mortgage Bank customers. In accordance with the decision of the District Court, the hearing on the claim has been stayed until the appeals regarding the matter reviewed in Note 4.A below are decided.

B. On 2 December 2006, a petition to approve a class action was filed against Leumi Mortgage Bank and Migdal Insurance Company Ltd. (“Migdal”) regarding the partial

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payment of life insurance compensation. The estimated amount of the claim according to the petitioner is NIS 150 million.

According to that alleged in the petition, borrowers taking out loans from Leumi Mortgage Bank were able to join a life insurance arrangement for borrowers in which the insurer was Migdal; included in the borrowers joining the said life insurance are borrowers who, when an insurance event occurred, received partial insurance compensation at a rate lower than the amount of the insurance and of the balance of the loan; contrary to the amount promised to the borrowers. The parties reached a compromise arrangement in the suit, and on 7 September 2010, the Tel-Aviv District Court approved the arrangement with certain changes. On 28 October 2010, an appeal was filed by the representative of the plaintiff with the Supreme Court regarding professional fees for the representative of the plaintiff, and the special compensation for the plaintiff ordered by the District Court. In accordance with a decision of the court of 9 January 2011, the executed part of the arrangement will be implemented in the first stage, which will not be affected by the results of the appeal.

C. On 5 April 2009, a petition for approval of a class action was filed with the Tel Aviv-Jaffa District Court against Standard & Poor’s Ma’alot Ltd., World Currencies Ltd., the Bank Leumi le-Israel Trust Company, Eran Fuchs, Rony Biram, Yaakov Harpaz and Excellence Investments Ltd. The amount claimed against all the respondents in the class action stands at NIS 84 million. The complaint makes no clear attribution of a specific claimed amount against any of the respondents. The petition for approval refers to debentures issued by World Currencies Ltd., backed up by notes issued by Lehman Brothers Bankhaus Ag. The petitioner claims that on the collapse of Lehman Brothers, the price of the debenture collapsed and trading was suspended. Regarding the Trust Company, which served as the trustee for the holders of the debentures issued by World Currencies, the petitioner alleges that it did not take various actions to prevent or reduce, according to the petitioner, the damage he alleges was caused to the debenture-holders.

D. On 23 June 2009, a petition for approval of a class action was filed with the Tel Aviv-Jaffa District Court against Standard & Poors Ma’alot Ltd., Keshet Debentures Ltd. (“Keshet”), Bank Leumi le-Israel Trust Company ("the Trust Company"), Aaron Biram, Eran Fuchs, Moti Ma’aravi, Rami Ordan, Excellence Nessuah Underwriting (1993) Ltd. and Expert Financing Ltd. The amount claimed against all the respondents in the class action stands at some NIS 286 million. The complaint makes no clear attribution of a specific claimed amount against any of the respondents. The petition for approval refers to debentures issued by Keshet, backed up by notes issued by Lehman Brothers Bankhaus Ag. The petitioner claims that on the collapse of Lehman Brothers, the price of the debenture collapsed and trading was suspended. Regarding the Trust Company, which served as the trustee for the holders of the debentures issued by World Currencies, the petitioner alleges that it did not take various actions to prevent or reduce, according to the petitioner, the damage he alleges was caused to the debenture-holders. The company has filed its response to the petition for approval of the claim as a class action.

E. On 19 August 2007, a petition for approval of a class action was filed in the Jerusalem District Court against Leumi Mortgage Bank, together with the text of the class action claim regarding the joining of an "additional borrower" to some of the loans granted by Leumi Mortgage Bank. The amount of the class action is estimated, according to the petitioners, at over NIS 5 million.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

The petitioners are claiming that Leumi Mortgage Bank demanded the joining of an "additional borrower" within the framework of a loan taken out. According to the petitioners, the additional borrower is not a borrower at all but a fiction, and in fact he is a guarantor of the loan.

On 10 November 2011, the Jerusalem District Court approved the withdrawal of the petitioners from the petition and ordered the dismissal of the petition for approval as a class action, and the dismissal of the personal claim of the petitioners.

(4) In addition, claims and petitions for approval of class actions set out below are pending against the subsidiaries. In the opinion of the Management of the Bank, in reliance on the opinion of the management of each of the subsidiaries, which is based on the opinion of the legal advisors of the subsidiaries with regard to the chances of these legal proceedings, it is not possible, at this stage, to estimate their chances, and therefore no provision has been recorded (except as stated in paragraph A. above).

A. On 17 July 1997, a petition for approval of a class action in an amount exceeding NIS 1 billion was filed with the Tel Aviv-Jaffa District Court against Leumi Mortgage Bank together with other mortgage banks in connection with the collection of life insurance and property insurance commissions from borrowers. According to the petitioners, in the context of taking out the loan, they were added to life insurance or property insurance policies taken out through the respondent banks. As alleged by them, part of the insurance premiums reached the respondent banks unlawfully.

On 17 November 1997, the Court struck off the monetary claim. Nevertheless, the Court decided that a claim could be heard for declaratory relief relating to causes of action that had arisen before 10 May 1996. The Court ruled that the causes of action that could be heard in this framework related to the "restrictive arrangement and various insurance issues." Appeals were submitted to the Supreme Court against this decision by all the parties to the claim.

Pursuant to arbitration proceedings between the parties, a compromise arrangement between the parties was filed with the court, in accordance with which all the banks responding to the petition will pay a total amount of NIS 17 million as a donation to selected public charities, and a further amount of NIS 3 million as remuneration and professional fees to the petitioners and their representatives, thus ending all legal proceedings in the claim. Leumi Mortgage's share of the payment amounts to 27.601%. Leumi Mortgage Bank made a provision in an amount covering its share in accordance with the said arrangement. The compromise arrangement was approved in the rulings of the court on 7 August 2011, 12 July 2011, and 5 December 2011.

B. On 6 September 2011, a petition for approval of a class action was filed in the Tel Aviv District Court concerning the rate of interchange fees in credit card settlement agreements. The claim was filed against LeumiCard and the Bank, and against C.A.L., Discount Bank, First International Bank, IsraCard, and Bank Hapoalim, with the petitioners claiming that damages could reach an amount of approximately NIS 4.8 billion against all defendants. The claim was fixed for a total of NIS 1 billion. The petitioners claim that the interchange fee in actual use was exaggerated, causing the excessive payment of settlement fees by vendors, and the loading of these excess costs on the price of products and services eventually paid by the consumer.

Reported Amounts

C. On 7 September 2011, a petition for approval of a class action was filed against Leumi Mortgage Bank, Mizrahi Tefahot Bank Ltd. and Bank Hapoalim B.M. The amount of the class action claimed against all the respondent banks is approximately NIS 927 million as at 1 January 2010, and the amount of the class action against Leumi Mortgage Bank is about NIS 327 million. The petitioners claim that the respondent banks charged housing-loan borrowers "compound interest in advance", contrary to the law and to the loan agreements, which stipulate that only the unpaid balance of principal will bear interest. The reliefs claimed are payment of compensation and/or reinstatement of damage caused to borrowers and the amounts charged unlawfully, and the granting of a court order against the respondent banks to change the way they act in all areas related to charging and collecting interest.

D. On 19 January 2012, Leumi Card received a claim and a petition for approval of a class action that had been filed in the Tel-Aviv District Court against Leumi Card, IsraCard Co., and Duval Computers and Internet Co. Ltd. As alleged, Leumi Card and IsraCard showed negligence in their alleged duty to supervise the data security level of vendors clearing through them. According to the claim, as a result of a deficient level of security in certain internet sites, there was an information leak of credit card numbers. The claimants are credit card holders, whose details, they allege, were leaked and thus their privacy was compromised. The claimants estimate the amount of the claim at about NIS 75 million.

H. The Bank is a guarantor for members of some of the provident funds that were managed by Leumi Capital Market Services Ltd. (formerly Leumi Gemel Ltd.), whose operations were sold to Prizma Provident Funds Ltd. (“Prizma”). The guarantee secures the repayment of the original principal amounts that were deposited which, at 31 December 2011, amounted in nominal values to NIS 2,998 million. The value of the assets of the aforesaid funds as of 31 December 2011 amounted to NIS 5,681 million. In addition, this guarantee does not apply to deposits in accounts that were opened in the above funds from 22 January 2007. As of 31 December 2011, the amounts accumulated in the provident funds credited to the aforesaid members and which are lower than the total of their nominal deposits are about NIS 586 thousand. The fair value of the above liabilities at 31 December 2011 is not material.

Against the aforesaid liability, Prizma undertook that that, in the event the guarantees or any part of them are realized, it would pay the Bank participation in an amount not exceeding NIS 35 million per calendar year, this amount being linked to the Israeli CPI of 30 October 2006 - and until the payment date. A participation amount that is not utilized in a certain year will not be carried forward to future years.

I. Consolidated companies of the Bank which serve as trust companies, as well as a number of banking subsidiaries, perform trust operations. Such operations include, mainly, trusteeship over funds, securities and real estate; the handling of donations, gifts and bequests; acting as agent in regard to deposits and loans; handling of share transfers; and management of investment accounts. Some of these companies also act as trustees for debenture holders.

J. Letters of indemnity

(1) The Bank has undertaken in advance to grant directors and the other officers of the Bank indemnification in respect of monetary liability which may be imposed on them and in respect of reasonable litigation expenses in connection with the offer for sale and issues of the Bank's securities according to a prospectus published in 2002, the privatization of the Bank, and the prospectuses and issues guaranteed by the Bank of the wholly owned subsidiary, Leumi International Investments N.V. (hereinafter - “LII”) as from 1997. In addition, the Bank undertook to indemnify the trustees in connection with the LII issue in 2005.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

(2) The Bank has undertaken in advance to indemnify Leumi Finance Co. Ltd., a fully controlled subsidiary (hereinafter – “the company”), in order for it to carry out the indemnifications which the company gave directors and its officers and the lawyers dealing with the issues on behalf of the Company, in respect of monetary liability that may be imposed on them and reasonable litigation expenses in connection with the issue of debentures and other products by the Company to the public that the Company publishes from time to time. The indemnification is limited to the amounts of the issues executed by the Company.

(3) The Bank has undertaken in advance to indemnify the office holders in the Bank and personal managerial contract holders in the Bank who are not officers of the Bank (“the managerial contract holders”) with respect to the duties they fulfill with the Bank and in the subsidiaries and other companies on behalf of the Bank and in respect of a list of events as is the generally accepted practice in the banking system in Israel, including, inter alia, the routine banking activity of the Bank, an offer of securities to the public pursuant to a prospectus and reports to the public and to the supervisory authorities. The actual fulfillment of the indemnity commitment is subject to the two following conditions being met: (1) the maximum amount in respect of the actual realization of the indemnity to all the officers of the Bank and to the officers of the subsidiaries and the managerial contract holders, in respect of monetary liability which may be imposed on any of them and in respect of reasonable legal fees, in connection with the above events, will not exceed in aggregate 10% (ten percent) of the shareholders' equity of the Bank as defined in the directives of the Supervisor of Banks, as reflected in the last financial statements of the Bank published immediately prior to the date of the actual indemnification; (2) the maximum amount in respect of the actual realization of the indemnity does not impair the minimum capital requirement in accordance with the directives of the Supervisor of Banks. The obligation for indemnification is also for reasonable litigation expenses incurred as a result of an investigation or proceeding that ended without an indictment being filed and without a financial liability being imposed as an alternative to criminal proceedings, or that ended without an indictment being filed but with a financial liability being imposed as an alternative to criminal proceedings for an infraction that does not require proof of criminal intent, or in connection with a monetary sanction the letter of indemnity includes a further obligation for indemnification for expenses and/or payment to the injured party of a breach in accordance with and subject to that stipulated in the Streamlining of Enforcement Proceedings in the Securities Authority Law (Legislative Amendments), 2011 ("the Streamlining of Enforcement Proceedings Law").

The obligation for indemnification will be in effect only after exhaustion of the rights of the officer toward a third party (e.g. an insurer).

In addition, the Bank granted exemption from liability to officers in the Bank and personal contract holders for damage as a result of breach of their obligation of caution vis-à-vis the Bank.

The Bank also undertook in advance to indemnify the legal advisor to the Board of Directors of the Bank in respect of legal services provided to the Board of Directors, to the Bank and to the Directors as legal advisor to the Board of Directors, in a similar wording to the indemnity given to officers. The Bank gave the legal advisor to the Board of Directors an exemption from liability in connection with the provision of the said legal services.

(4) The Bank has undertaken to indemnify employees of the Bank for expenses and/or payment to the injured party of a breach or subject to that stipulated the Streamlining of Enforcement Proceedings Law, in accordance with the usual terms in letters of indemnity given by the Bank.

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

(5) The Bank has undertaken to indemnify external advisors in respect of an obligation or loss including in respect of other legal expenses in connection with the services they receive from the Bank.

(6) Letters of indemnity have been given to past insurers in respect of the application of Israeli law to certain matters of subsidiary companies of the Bank domiciled abroad. The last letter of indemnity was given concerning the bankers' policy and a policy to insure directors and other officers that expired on 30 June 2006. The letters of indemnity are still relevant for open claims referring to the Bank's subsidiary companies domiciled abroad, made up until June 2006.

(7) The Bank has undertaken to indemnify York Global Finance I Pte. Ltd. and corporations on its behalf that carried out the acquisition (jointly hereinafter: “the buyer”) pursuant to the transaction for the sale of the activities and the share capital of the member companies of the Psagot Ofek Group, which was carried out subsequent to the reform in the capital market. The indemnity is in respect of any direct damage (net of any tax advantage) that may accrue to the buyer as a result of the claims by third parties that are attributed to the period prior to the date on which the transaction was consummated, from a breach of specific representations provided in the agreement, and from the tax liability that refers to the period preceding the date on which the transaction was consummated, where the indemnity in respect of tax liabilities is directly imposed on the holders of units in the trust funds is stipulated on the issuance of a ruling or a definitive decision by a court and/or a competent authority, pursuant to which the one or more of the sellers must bear these liabilities
It should be noted that the debts of York Global Finance I Pte. Ltd. in the framework of the agreement to sell the asets of Psagot Ofek Group, were transferred and assigned to “Psagot Ofek Investment House (Financse) Ltd.

In addition, the Bank has undertaken to guarantee the financial liabilities of the member companies of the Psagot Ofek Group (the sellers) vis-à-vis the buyer in accordance with the sale agreement.

In addition, the Bank has undertaken to indemnify Harel Mutual Fund Management Ltd. (hereinafter: "Harel"), in accordance with a transaction for the sale of the assets of Leumi Pia, in the event that a monetary obligation will be imposed on Harel in connection with the examination by the Israel Securities Authority and in connection with obligations and liabilities of the Bank vis-à-vis the tax authorities.

(8) The Bank has undertaken to indemnify Tamir Fishman Trusteeships 2004 Ltd. (“Tamir Fishman”) in connection with the option plan and the plan to offer shares to employees of the Bank, Leumi Mortgage Bank Ltd., Arab-Israel Bank Ltd. and the Bank Leumi le-Israel Employees Restaurant Association (“the companies”). The companies are obliged to indemnify Tamir Fishman for any damage and /or expense and/or loss actually borne by Tamir Fishman (including lawyers' fees) following a final judgment verdict against Tamir Fishman in favor of any third party whomsoever, in connection with or as a result of the fulfillment of its duties in accordance with the trust agreements signed pursuant to the above plans, and in accordance with any law (no maximum indemnification has been determined.).

(9) The Bank has undertaken to indemnify Visa International (Europe) and Mastercard in respect of its fulfillment of the obligations of Bank Leumi Romania S.A. concerning “Visa” and “Mastercard” credit card activity, whichever is applicable (No maximum indemnification has been determined.). In addition, the Bank has undertaken to indemnify Visa Europe regarding the fulfillment of the obligations of Leumi Card Ltd relating to "Visa" type credit card activity and in

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connection with opening new accounts by Leumi Card Ltd. for the purposes of multi-currency clearing. Further, the Bank has undertaken to indemnify Visa Europe in respect of the obligations of Leumi UK, Leumi Luxembourg and the Arab-Israel Bank Ltd. relating to their "Visa" type credit card activity (no maximum indemnification has been determined.).

(10) The Bank and its subsidiaries, from time to time and in circumstances generally accepted in the normal course of business, are accustomed to give letters of indemnification limited in amount and period and those unlimited in amount and period.

(11) From time to time, the Bank provides subsidiary companies with letters of indemnity, limited and unlimited as to amount and period, to secure indemnities granted by them to officers due to risks applicable to officers in the companies, and for purposes of the subsidiary companies complying with regulatory directives. In addition, the Bank has given letters of indemnity to Bank employees and to officers of subsidiaries in respect of a list of events which are specified therein.

K. Credit Cards

(1) In the separation agreement for ownership of Israel Credit Cards Ltd. (hereinafter – “ICC”) between Leumi Financial Holdings Ltd. (a company wholly owned by the Bank) (hereinafter - “Leumi Holdings”) and Israel Discount Bank Ltd. (hereinafter - “Discount Bank”) that was signed on 3 January 2000, Leumi Holdings undertook to indemnify Discount Bank for various amounts that ICC and/or Diners Club Israel Ltd. (hereinafter - “Diners”) may be obliged to pay for defined events, including for legal claims according to a defined list (including class actions). The indemnity is limited in amount and payment thereof is subject to various conditions.

(2) On 31 August 2006, a decision was rendered by the Antitrust Tribunal (hereinafter: "the tribunal") in the framework of Antitrust File 4630/01 which determined the appropriate methodology for calculating cross-commission (the issuer's commission) (hereinafter - “the methodology decision”), paid by those using the acquiring services to the issuers of Visa cards, following a request filed with the Tribunal to approve the restrictive arrangement signed between the Bank, Leumi Card Ltd. (“Leumi Card”), Israel Discount Bank Ltd., ICC, and First International Bank of Israel Ltd.

In the methodology decision, the Tribunal determined the costs to be taken into account when calculating the issuer's commission and also determined that the percentage of the said costs are to be decided by an external independent expert, based on the relevant data furnished to him.

On 1 February 2007, the Bank, Leumi Card and the others requesting the approval filed an appeal in the Supreme Court against the methodology decision. On 27 December 2009, the Supreme Court handed down a ruling approving an agreement between those requesting the approval of the Antitrust Commissioner (hereinafter: "the Commissioner"), according to which the clarification of the claims of those requesting the approval of an appeal regarding the methodology for the determination of the cross-commission would be deferred to a hearing within the framework of another appeal (if any) on the ruling that may be handed down in connection with the cross-clearing arrangement signed on 30 October, 2006 (as set forth below).

On 30 October 2006, an arrangement was reached between Isracard Ltd., Leumi Card Ltd. and ICC and the banks controlling each one of these companies (hereinafter "the parties requesting approval"), to regulate the cross-clearing for the Visa credit card and Mastercard (hereinafter - “the arrangement”). The arrangement, which is in force for six and a half years, allowed for the first time cross-clearing for the Visa and Mastercard brand names by the three major credit card

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companies in Israel, as distinguished from the cross-clearing arrangement as practiced till then, which only arranged the Visa segment. The arrangement, *inter alia*, included determinations with regard to the issuer's commission rates, the blueprint for a gradual reduction in the issuer's commission over the term of the arrangement, and a gradual reduction in the categorical structure as currently practiced in relation to the rate for the issuer's commission. Further, the arrangement included an outline, pursuant to which, at the end of period of the arrangement, should the parties wish, they will take steps to continue the cross-clearing among them, as well as rules intended to assure that fair competition is maintained and the preclusion of cross-subsidization of the competition between the credit card companies.

On 30 October 2006, the arrangement was submitted for the approval of the Tribunal and for the receipt of a provisional permit. On 31 October 2007, the Tribunal decided to grant a temporary permit for the arrangement. The temporary permit was extended from time to time and remains valid.

A number of objections were submitted on behalf of five companies to the approval of the arrangement. In addition, MasterCard International was joined to the process and informed the Tribunal that it supports approving the arrangement

In accordance with the decision of the Tribunal on 11 November 2007, an expert was appointed whose duties are to calculate the issuer's commission proposed according to the decision.

On 1 January 2009, the expert's opinion was submitted to the Tribunal and to the parties, determining the manner of implementing the methodology determined (hereinafter: the interim report"). When the said expert was prevented from continuing his duties in implementing the methodology decision, an economist of the Antitrust Commission was appointed as an alternative expert.

On 23 May 2011, an opinion of the Chief Economist of the Antitrust Authority ("the economist's opinion") was submitted to the Tribunal. The average rate of interchange commission as calculated in the opinion on behalf of the Court is lower than that used currently in accordance with the arrangement submitted for approval by the Tribunal. The petitioners for approval (Leumi Card, C.A.L., IsraCard, and their controlling banks) dispute some of the decisions and assumptions in the economist's opinion, and in September 2011 three expert opinions were filed with the Tribunal on their behalf indicating errors appearing in the economist's opinion, and that the issuer's commission is significantly higher than the percentage calculated in the said opinion.

On 7 August 2011, a decision of the Tribunal was handed down according to which the period of the temporary permit given to the petitioners for approval of the arrangement was extended until 31 December 2011, provided that the average rate of cross-commission (which stood at the time at 0.975%) would not exceed 0.875% as of 1 November 2011. In accordance with the decision of the Tribunal, as of 1 November 2011, the cross-commission was reduced to the average rate of 0.875%. At the request of the petitioners for approval, the Tribunal extended the validity of the temporary permit until a decision on approving the arrangement or until the end of February 2012, whichever the earlier.

Further to contacts between the petitioners for approval and the Commissioner in an attempt to reach understandings in connection with the arrangement and in order to save a significant amount of the time of the Court, as well as the resources of the parties to the proceedings, the petitioners for approval and the Commissioner arrived at a compromise agreement (hereinafter: "the compromise agreement"), which deals mainly with ending the arguments between the parties

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concerning the proper rate of cross-commission and approving an amended cross-clearing arrangement between the petitioners for approval which will be in effect until 31 December 2018.

In the framework of the compromise agreement, the parties agreed to an average rate of issuer's commission to be in force for the period of the agreement, and on an outline for reducing this rate over the years, so that from 1 July 2014 until the end of the period of the agreement. The average rate of issuer's commission would be 0.7%. Additionally, in the framework of the compromise agreement, the petitioners for approval waived the possibility of appealing the methodology decision, and subject to approval of the compromise agreement and its terms, they withdrew their objections to the interim report and the manner of its implementation in the economist's opinion.

On 28 December 2011, the Commissioner and the petitioners for approval filed a petition for granting validity to the compromise agreement.

In accordance with the petition submitted by the petitioners for approval with the recommendation of the Commissioner, the Tribunal, on 29 February 2012, extended the validity of the temporary permit given to the compromise agreement, until 2 April 2012 or until a decision on the petition to grant validity by a decision of the court to the compromise agreement, whichever the earlier.

On 7 March 2012, the decision of the Antitrust Tribunal was handed down approving the compromise agreement.

The said compromise agreement is expected to materially affect both Leumi Card’s income as an issuer and also its expenses as a clearer in the coming years. Total issuer's commissions received by the Bank in 2011 amounted to NIS 74 million, compared with NIS 75 million during the corresponding period last year.

(3) The Bank has undertaken with regard to Visa International to take full responsibility for the proper execution by Leumi Card of all the provisions and requirements included in the Articles of Visa International as in effect from time to time, to perform all actions necessary in order to fulfill its commitment and to notify Visa International immediately in writing regarding any material change in the agreement between the Bank and Leumi Card.

(4) The Bank has undertaken with regard to World MasterCard and to all other Mastercard members to take full responsibility for the carrying out all Leumi Card's obligations under the Articles of World MasterCard and its principles and to indemnify these entities for any loss, cost, expense or debt in respect of an infringement of Leumi Card's aforesaid obligations.

(5) During the normal course of business, legal claims have been submitted against Leumi Card, including a request for approval of a class action. In the view of management of the Bank, based on an opinion of the management of Leumi Card, which is based on the opinion of Leumi Card’s legal advisors regarding the chances of the claims, including the request for approval of a class action, the financial statements include appropriate provisions, where required, to cover damages resulting from such claims.

L. Israel Corporation Ltd.

(1) Legal claims been made against certain consolidated companies of the Israel Corporation Ltd. contending that personal and property damage suffered by the plaintiffs resulted from the

Note 18 - Contingent Liabilities and Special Commitments (cont'd)

Reported Amounts

pollution of the Kishon River, which the plaintiffs contend, the abovementioned consolidated companies had a part therein and also, there are legal proceedings against a consolidated company, laws have been passed and orders issued relating to the activities of this company. issued.

The managements of the above companies, based on the opinions of their legal advisors, cannot estimate the amount of the exposure from the said claims and demand, if any, and therefore, no provision has been made in this regard in the financial statements of the Israel Corporation Ltd. and of its consolidated companies.

(2) A consolidated company of the Israel Corporation is dependent on receiving services from infrastructure companies in order to carry on its activities.

For further details of these matters, see the financial statements of the Israel Corporation Ltd. as at 31 December 2011.

M. On 26 April 2009, a ruling of the Antitrust General Director was received by the Bank pursuant to Section 43(A)(1) of the Antitrust Law, 1988, according to which restrictive trade agreements, relating to the transfer of information regarding commissions, had existed between the Bank, Bank Hapoalim B.M., Israel Discount Bank Ltd., Mizrahi Tefahot Bank Ltd. and the First International Bank of Israel Ltd., during the period from the beginning of the 1990s until the commencement of the Antitrust Authority's investigation of the matter, in November 2004. This is a civil ruling, which constitutes *prima facie* evidence of the matters therein determined in any legal proceedings. The Bank has decided to appeal the ruling in the Antitrust Tribunal which is currently pending. At this stage, the effects of the ruling cannot be assessed.

N. As published, the US authorities ("the authorities") are conducting investigations against foreign banks in connection with activities of the banks with customers who are US taxpayers ("US customers"), on suspicion of a breach of US law. In the context of the said investigations, which are also being conducted against the Group, various demands have been submitted by the authorities to companies belonging to the Group in connection with customers identified by the authorities and banking services they received from the Group, and the Group is cooperating with the authorities in giving them information which it is permitted to give by law. At this stage, it is not possible to predict the damage that may be caused to the Group, and it is not possible to estimate or evaluate its amount.

O. In recent weeks, the Israel Securities Authority has conducted an administrative investigation under section 52.AP(A)(2) of the Securities Law, in connection with the publication of a profit warning by the Bank on 14 November 2011 and in connection with an issue of subordinated notes by Leumi Finanjce in accordance with the Shelf Offer Report published on 9 November 2011.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies

Reported Amounts

General

The State of Israel became a shareholder of the Bank on 31 October 1993, under the Bank Shares Arrangement and the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (the "Bank Shares Law"). As determined in the Bank Shares Law, the transfer of the shares in the Bank to the State and the exercise of the rights by virtue of the shares under this Law do not require a permit under the Banking (Licensing) Law, 1981.

On 31 December 2011 and on 15 March 2012, the State of Israel held 6.028% of the issued share capital and 6.46% of the voting rights in the Bank, following the sale of 5% of the issued share capital and voting rights in the Bank by the State on 19 January 2011 (see "Sale of Shares in the Bank by the State" below), and the sale of about 0.43% of the issued share capital and voting rights in the Bank by the State to employees of the Group on 17 May 2011 (see "Sale of Shares to Employees " below).

Bank Shares under Arrangement Law (Temporary Provision), 1993 (hereinafter "the Bank Shares Law")

The Bank Shares Law authorized the Shares Committee of the Bank to use for and on behalf of the State the voting rights by virtue of the State's holdings in the Bank.

On 19 March 2012, the Banking Law (Legislative Amendments), 2012 was published in the Official Gazette (*Reshumot*). The law amends the Banking Law (Licensing), the Banking Ordinance, and clause 37 of the Securities Law, so as to regulate, inter alia, the proposal of directors, appointments and their term of office, in a banking corporation without a controlling core (hereinafter: **"the Amendment"**). In light of the Amendment and the end of the term of office of the Shares Committee of the Bank on 23 March 2012, the Bank is defined as of 24 March 2012, in accordance with the provisions of the law, as a bank with no controlling core.

Below is a short description of the legal position before the Amendment came into effect, and before the Bank became a bank with no controlling core:

The last Shares Committee of the Bank was appointed by virtue of the provisions of the Bank Shares (Arrangement Shares) (Temporary Provision) Law (Appointment of Other Committees and Terms of Office) Directives, 2009, and, as stated in a resolution of the Public Committee for Bank Shares in the Arrangement, its term of office ended on 23 March 2012.

On 24 May 2011, the Annual General Meeting of the Bank was held, with an agenda including, *inter alia*, the election of four directors to the Board of Directors of Bank. Prior to 24 May 2011, all of the directors serving on the Board of Directors of the Bank had been appointed in accordance with the Bank Shares Law, with all the incumbent directors having been proposed at general meetings of the Bank by the Bank's Shares Committee, and the committee voting for them by virtue of the State's shares in the Bank. At the meeting, two directors, who had been proposed for election at the General Meeting by Shlomo Eliahu Holdings Ltd., and two directors who had been proposed for election at the General Meeting by the Bank's Shares Committee, were elected. The Supervisor of Banks confirmed that he has no objection to the appointment as directors of all the candidates elected at the meeting.

From this, it may be learned that, as long as over 50% of the directors of the Bank are appointed by recommendation of the Shares Committee in accordance with the Bank Shares Law, the State of Israel holds over 50% of one of the means of control of the Bank and in accordance with the presumption regarding the definition of control in the Securities Law, it was a controlling owner of the Bank, subject

Reported Amounts

to the restrictions determined in the Bank Shares Law. It should be noted that there is also another interpretation. To the best of the Bank's knowledge, none of the holders of the means of control received a control permit. It should be further noted that Shlomo Eliahu Holdings holds 9.59% of the issued and paid-up of the Bank and the State of Israel through M.I. Properties holds some 6.03% of the issued and paid-up share capital of the Bank.

Sale of Shares in the Bank by the State

On 9 June 2010, the Minister of Finance requested the Knesset Finance Committee to approve the sale of up to 10.46% of the State's holdings in the Bank to financial entities for marketing to investors in Israel and abroad, as part of one or more competitive procedures ("block trade"). On 3 November 2010, the Finance Committee decided to approve the said request in principle, although any sale would be subject to the approval of the sub-committee of the Finance Committee for Confidential Matters. The said approval was in effect for six months commencing 30 November 2010.

On 19 January 2011, the Bank was informed by the Ministry of Finance of the completion of the sale in a competitive procedure (off-stock exchange) of 73,677,561 ordinary shares of NIS 1.00 par value each (constituting 5% of the Bank's issued share capital) owned by the State to UBS Limited, for consideration of NIS 17.611 per share (aggregate proceeds of NIS 1,297.5 million). Following the sale, 95,179,941 ordinary shares of NIS 1.00 par value each of the Bank, constituting 6.46% of the Bank's issued share capital, remain in the hands of the State.

On 17 May 2011, the Bank was informed by the Finance Ministry of the completion of the off-stock exchange sale of 6,339,730 ordinary shares of NIS 1.00 par value each of the Bank (constituting 0.43% of the issued share capital of the Bank) owned by the State, to the employees of the Bank Group, in consideration of NIS 13.3002797 per share (a total of NIS 84.3 million). In addition, on 30 May 2011, the Bank was informed by the Ministry of Finance that on 29 May 2011 it had completed the off-stock exchange sale to the Chairman of the Board of Directors of the Bank of 9,442 state-owned ordinary shares of NIS 1.00 par value each of the Bank (constituting 0.0006% of the Bank's issued capital), in consideration of NIS 13.37813 per share (aggregate total of NIS 126.3 thousand), following the approval of the Annual General Meeting held on 24 May 2011. The sale of the shares to employees, as aforesaid, is subject to the provisions of the outline prospectus published by the Bank on 6 April 2011.

Following the above mentioned sales, 88,830,769 ordinary shares of NIS 1.00 par value each of the Bank, constituting 6.028% of the issued capital of the Bank, was still held by the State.

It should be noted that, pursuant to the provisions of the outline prospectus, during the blocked period of the shares and as long as the State's shareholding percentage in the Bank exceeds 5%, an irrevocable power of attorney is given to the State to vote by virtue of the shares sold as aforesaid, and to make use of the right to appoint directors by virtue of the shares.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

Reported Amounts

A. Balances on consolidated basis

	31 December 2011										
	Interested Parties							Related parties held by the Bank			
	Shareholders		Directors and CEO (a)(b)		Others (f)		Interested party at time of transaction	Companies included on equity basis		Others (g)	
	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)	Highest balance (c)	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)
	NIS millions										
Assets:											
Securities (d)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**9**	**10**
Credit to the public	**-**	**-**	**1**	**1**	**-**	**-**	**20**	**155**	**160**	**3,193**	**3,876**
Allowance for credit losses	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(1)**	**(1)**	**(15)**	**(58)**
Credit to the public, net	**-**	**-**	**1**	**1**	**-**	**-**	**20**	**154**	**159**	**3,179**	**3,818**
Investments in companies included on equity basis (d)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2,270**	**2,350**	**-**	**-**
Other assets	**-**	**-**	**-**	**-**	**3**	**9**	**-**	**29**	**29**	**85**	**85**
Liabilities:											
Deposits of the public	**97**	**101**	**5**	**6**	**18**	**18**	**-**	**1,573**	**1,573**	**843**	**2,950**
Deposits from banks	**-**	**-**	**-**	**-**	**-**	**400**	**-**	**31**	**31**	**-**	**-**
Debentures, bonds and subordinated notes	**-**	**-**	**1**	**1**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Other liabilities	**-**	**-**	**-**	**-**	**25**	**25**	**-**	**178**	**178**	**90**	**113**
Credit risk in off-balance sheet items (e)	**-**	**-**	**2**	**2**	**40**	**40**	**-**	**145**	**156**	**1,284**	**1,564**

(a) Including their spouses and minor children and corporations controlled by them.
(b) At 31 December 2011, the directors and the CEO held NIS 353,088 par value of shares in the Bank.
(c) The highest balance based on end-of-month balances.
(d) For details, see Note 3 - Securities and Note 6 - Investments in companies included on equity basis.
(e) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of single borrower debt limitations.
(f) Including corporations included on equity basis in which an interested party holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.
(g) Including corporations in which the Bank holds 10% or more of the issued share capital or the voting rights or is entitled to appoint 10% or more of their directors or is entitled to appoint the CEO, and other corporations in which related parties hold 25% or more of the issued share capital or the voting rights or of the authority to appoint directors.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

Reported Amounts

B. Balances on consolidated basis (cont'd)

	31 December 2010									
	Interested Parties						Related parties held by the Bank			
	Shareholders		Directors and CEO (a)(b)		Others (f)		Companies included on equity basis		Others (g)	
	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)	Balance as at 31 December	Highest balance (c)
	NIS millions									
Assets:										
Securities (d)	-	-	-	-	-	-	-	-	10	10
Credit to the public	-	-	-	3	-	-	88	525	3,387	3,650
Investments in companies included on equity basis (d)	-	-	-	-	-	-	1,924	2,196	-	-
Other assets	-	-	-	-	10	18	27	53	34	92
Liabilities:	-	-	-	-	-	-	-	-	-	-
Deposits of the public	95	105	6	11	17	17	627	1,758	1,329	1,329
Deposits from banks	-	-	-	-	312	590	27	27	-	-
Debentures, bonds and subordinated notes	-	-	-	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	7	21	138	418	88	256
Credit risk in off-balance sheet items (e)	-	-	3	3	74	74	218	380	1,288	2,038

(a) Including their spouses and minor children and corporations controlled by them.
(b) At 31 December 2010, the directors and the CEO held NIS 425,922 par value of shares in the Bank.
(c) The highest balance based on end-of-month balances.
(d) For details, see Note 3 - Securities and Note 6 - Investments in companies included on equity basis.
(e) Credit risk in respect of off-balance sheet financial instruments as calculated for purposes of single borrower debt limitations.
(f) Including corporations included on equity basis in which an interested party holds 25% or more of the issued share capital or the voting rights or is entitled to appoint 25% or more of their directors.
(g) Including corporations in which the Bank holds 10% or more of the issued share capital or the voting rights or is entitled to appoint 10% or more of their directors or is entitled to appoint the CEO, and other corporations in which related parties hold 25% or more of the issued share capital or the voting rights or of the authority to appoint directors.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

Reported Amounts

C. Condensed results of operations with interested and related parties

2011

	Interested parties			Related parties held by the Bank	
	Shareholders	Directors and CEO	Others	Companies included on equity basis	Others
	NIS millions				
Net interest income (expense)					
Before allowance for credit losses (a)	**(5)**	**-**	**(28)**	**(11)**	**100**
Allowance for credit losses	**-**	**-**	**-**	**-**	**(1)**
Operating and other income	**-**	**-**	**72**	**2**	**22**
Operating and other expenses (b)	**-**	**(24)**	**(1)**	**(73)**	**(14)**
Total	**(5)**	**(24)**	**43**	**(82)**	**107**

2010

	Interested parties			Related parties held by the Bank	
	Shareholders	Directors and CEO	Others	Companies included on equity basis	Others
	NIS millions				
Net interest income (expense)					
Before provision for doubtful debts (a)	(2)	-	2	(8)	49
Provision for doubtful debts	-	-	-	-	-
Operating and other income	-	-	57	8	14
Operating and other expenses (b)	-	(30)	-	(19)	(15)
Total	(2)	(30)	59	(19)	48

(a) See details in paragraph E below.
(b) See details in paragraph D below.

Note 19 - Interested Parties and Related Parties of the Bank and its Consolidated Companies (cont'd)

Reported Amounts

D. Benefits to interested parties

	2011		2010	
	Directors and CEO		Directors and CEO	
	Total benefits	Number of recipients	Total benefits	Number of recipients
	NIS millions			
Interested parties employed in the Bank or on its behalf (a) (b)	**9**	**2**	15	3
Directors not employed in the Bank or on its behalf (b)	**12**	**18**	11	17

(a) Directors and officers have been insured by the Bank under a policy for insuring the liability of directors and other officers of the Bank and investee companies. The aggregate insurance premium amounted to NIS 3,001 thousand (2010 – NIS 3,531 thousand).

(b) Does not include salary tax.

E. Results of financing activity (before provision for doubtful debts) in transactions by the Bank and consolidated companies with interested parties and related parties

	2011		2010		2009	
	Consolidated	Of which: companies included on equity basis	Consolidated	Of which: companies included on equity basis	Consolidated	Of which: companies included on equity basis
	NIS millions		NIS millions		NIS millions	
a) Income on assets						
Credit to the public	**135**	**7**	101	9	182	13
b) Income on liabilities						
Deposits of the public	**(53)**	**(19)**	(29)	(19)	(47)	(41)
Deposit with banks	**(10)**	**(1)**	(7)	(1)	-	-
c) Income on derivative financial instruments						
Net income (expense) in respect of ALM derivative instruments	**(26)**	**1**	(30)	2	(227)	(155)
d) Other						
Financing commissions	**8**	**1**	5	1	3	-
Other financing income	**2**	**-**	1	-	2	-
Net interest income (expense) before allowance for credit losses	**56**	**(11)**	41	(8)	(87)	(183)

Note 20 - Net Interest Income before Expenses for Credit Losses

Reported Amounts

	2011	2010	2009
	NIS millions		
A. Income on assets (a)			
Credit to the public	**15,742**	6,442	10,956
Credit to governments	**27**	13	31
Deposits with Bank of Israel and cash	**870**	122	142
Deposits with banks	**779**	(613)	897
Bonds (d) (e)	**2,405**	(951)	1,557
Interest income from securities borrowed or purchased under repurchase agreements	**47**	23	7
Total income on assets	**19,870**	5,036	13,590
B. Expenses on liabilities (a)			
Deposits of the public	**(12,111)**	4,416	(4,915)
Deposits from governments	**(30)**	(4)	(45)
Deposits from Bank of Israel	**-**	-	1
Deposits from banks	**(277)**	(96)	(133)
Debentures, bonds and subordinated notes	**(1,876)**	(1,648)	(1,774)
Interest expense from securities loaned or sold under repurchase agreements	**(46)**	(13)	(9)
Total expenses on liabilities	**(14,340)**	2,655	(6,875)
C. Income on derivative financial instruments and hedging activities			
Non-effective part of hedge ratios (b)	**-**	4	-
Net income (expenses) in respect of ALM derivatives (c)	**1,055**	(1,795)	(1,217)
Net income in respect of other derivatives	**7**	15	13
Total from derivatives and hedging activities	**1,062**	(1,776)	(1,204)
D. Other			
Financing commissions	**399**	384	345
Other financing income (d)	**559**	1,134	1,167
Total other	**958**	1,518	1,512
Total net interest income before provision for doubtful debts	**7,550**	7,433	7,023
Of which: net exchange rate differences	**(11)**	18	(57)

(a) Including effective component of hedge relationships.
(b) Excluding effective component of hedge relationships.
(c) Derivative instruments which constitute part of the Bank's assets and liability management system and were not designated for hedging relationships.
(d) Collections and interest reductions in respect of problem debts in 2010 in the amount of NIS 565 million, 2009 - NIS 380 million).
(e) Including positive/(negative) interest and exchange rate differences in respect of mortgage-backed bonds (MBS) in the amount of NIS 157 million (2010 - NIS (31) million, 2009 - NIS 127 million).

Note 20 - Net Interest Income before Expenses for Credit Losses (cont'd)

Reported Amounts

	2011	2010	2009
	NIS millions		
E. Details of operating results of investments in debentures			
Interest on debentures, on accrual basis:			
Held to maturity	-	(7)	36
Available for sale	2,061	(849)	1,376
Held for trading	344	(95)	145
Total, included in interest income on assets	2,405	(951)	1,557
Other financing income (expenses):			
Gain on sale of debentures available for sale	315	271	499
Losses on sale of debentures available for sale (b)	(50)	(9)	(205)
Realized and unrealized profits from adjustments to fair value of debentures held for trading, net (a)	78	147	232
Total, included in other financing income (expenses)	343	409	526
Total from investments in debentures	2,748	(542)	2,083
F. Net effect of hedging derivative instruments on income from financing activity			
Interest income in respect of assets	(6)	(6)	-
Interest expenses in respect of liabilities	4	4	2

(a) Of which part of the profits (losses) related to bonds held for trading still held as of balance sheet date in the amount of NIS (36) million (2010 - NIS (19) million, 2009 - NIS 84 million).

(b) Including provision for impairments not of a temporary nature.

Note 21 – Operating Commissions

Reported Amounts

	2011	2010	2009
	NIS millions		
Ledger fees (c)	**837**	847	872
Conversion differences	**287**	293	289
Handling of credit	**368**	337	249
Commissions for distribution of financial products (a)	**197**	188	135
Foreign trade activities	**126**	127	115
Income from transactions in securities and certain derivative instruments	**793**	872	862
Credit cards	**856**	818	767
Net income from servicing credit portfolios	**41**	45	49
Management, operations, and custody for institutional entities (b)	**53**	55	48
Management fees and commissions on life assurance and on housing	**41**	49	47
Other commissions	**103**	108	107
Total operating commissions	**3,702**	3,739	3,540

(a) Mainly distribution fees of mutual funds.
(b) Mainly operations of provident funds.
(c) Reclassified.

Note 22 – Profits (Losses) from Investments in Shares (a), net

Reported Amounts

	2011	2010	2009
	NIS millions		
Profits on sale of shares available for sale	**86**	71	600
Losses on sale of shares available for sale (b)	**(312)**	(30)	(18)
Realized and unrealized losses from adjustments to fair value of shares held for trading, net (c)	**140**	1	8
Dividend on shares available for sale and held for trading shares	**74**	174	117
Total from investments on shares	**(12)**	216	707

(a) Including mutual funds.
(b) Including provision for impairment not of a temporary nature.
(c) Of which part of the profits (losses) related to shares held for trading still held as of balance sheet date in the amount of NIS (1) million (2010 - NIS (11) million, 2009 - NIS (2) million).

Note 23 – Other Income

Reported Amounts

	2011	2010	2009
	NIS millions		
Profits from severance pay funds	-	70	237
Other, net (a)	46	86	79
Total other income	46	156	316

(a) Reclassified.

Note 24 - Salaries and Related Expenses

Reported Amounts

	2011	2010	2009
	NIS millions		
Salaries	2,950	2,941	2,753
Severance pay, provident fund, continuing education fund, pension, vacation and long service bonus	682	652	523
Expense (income) deriving from share-based payment transactions	13	(24)	32
National Insurance and VAT on salaries	623	617	578
Other related expenses	199	188	161
Adjustment of provisions for related expenses as a result of changes in salaries in the current year (a)	600	302	(151)
Total salaries and related expenses	5,067	4,676	3,896
Of which: Salaries and related expenses abroad	597	511	528

(a) Restated.

Note 25 - Other Expenses

Reported Amounts

	2011	2010	2009
	NIS millions		
Marketing and advertising	283	260	215
Legal, audit and professional consultancy	377	324	276
Communications - postage, telephone, delivery services, etc.	161	157	150
Computers (a)	222	218	196
Office expenses	84	82	79
Insurance	20	22	14
Training	27	27	27
Other (b)	400	514	393
Total other expenses (c)	1,574	1,604	1,350

(a) The item includes outsourcing expenses and does not include the Bank's computer expenses as the Operations Division is a part of the Bank and its expenses are recorded and classified under the various expense headings.
(b) Regarding directors' fees of the Bank included in this item, see Note 19.D.
(c) Reclassified.

Note 26 – Provision for Taxes on Operating Profit

Reported Amounts

A. Composition

	2011	2010	2009
	NIS millions		
Current taxes -			
In respect of current year	728	1,249	1,090
In respect of prior years	(2)	58	(65)
Total current taxes	726	1,307	1,025
Add (deduct) changes in deferred taxes -			
In respect of current year	18	(68)	66
In respect of prior years (a)	(326)	-	181
Total deferred taxes	(308)	(68)	247
Provision for taxes on income	418	1,239	1,272
Of which provision for taxes abroad	29	95	47

(a) Including a change in tax rate NIS 326 million (31 December 2009 – 146 million).

B. Reconciliation between the theoretical amount of tax applicable if the operating profit were liable for tax at the statutory rate of tax in Israel, and the provision for taxes on the operating profit appearing in the statement of profit and loss:

	2011	2010	2009
Statutory tax rate applying to a banking corporation	34.48%	35.34%	36.21%
	NIS millions		
Tax at the statutory tax rate (a)	760	1,063	1,191
Tax (tax saving) resulting from:			
General and supplementary provisions for doubtful debts	-	(11)	(1)
Other non-deductible expenses	103	60	14
Income of foreign consolidated companies	(106)	114	(10)
Income of Israeli consolidated companies	(15)	(46)	(44)
Depreciation adjustment differences	15	(4)	(3)
Tax exempt and at preferred rates	(20)	(18)	(15)
Timing differences for which deferred taxes have not been recorded	2	(13)	(1)
Change in deferred taxes due to change in tax rates (a)	(326)	36	152
Taxes in respect of prior years (a)	(2)	58	(30)
Other	7	-	19
Provision for taxes on operating profit	418	1,239	1,272

(a) Restated – see Note 1.S.2

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Note 26 – Provision for Taxes on Operating Profit (cont'd)

Reported Amounts

C. On 27 June 2006, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) Order, 2006 was published in the Government Gazette (Reshumot), setting the rates of salary tax and profit tax applying to financial institutions at 15.5% . The amendment came into force on 1 July 2006.

On 1 July 2009, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) Order (Temporary Provision), 2009 was published in the Government Gazette (*Reshumot*), raising the rates of salary tax and profit tax applying to financial institutions from 15.5% to 16.5%, from 1 July 2009 to 31 December 2010.

On 31 December 2009, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) Order (Temporary Provision) (Amendment), 2009 was published in the Government Gazette (*Reshumot*), reducing the rates of salary tax and profit tax applying to financial institutions from 16.5% to 16%, from 1 January 2010 to 31 December 2010.

On 24 February 2011, the Value Added Tax (Tax Rate for Non-Profit Organizations and Financial Institutions) Order (Temporary Provision), 2011 was published in the Government Gazette (*Reshumot*), determining that the rates of salary tax and profit tax applying to financial institutions from 1 January 2011 to 31 December 2012 would be 16%.

The company tax rate in Israel in 2010 was 25% and in 2011, 24%. A body of persons is taxable on inflation-adjusted capital gains at the company tax rate with effect from the year of sale.

On 5 December 2011, a Law to Change the Tax Burden (Legislative Amendments), 2011 (hereinafter – the Law) was passed by the Knesset. Pursuant to the Law, with effect from 2012, *inter alia,* the plan to reduce company tax rates was canceled, the company tax rate was raised to 25% with effect from 2012, and the rate of tax on inflation-adjusted capital gains and the taxation on inflation-adjusted betterment were raised respectively.

The said change resulted in an increase in deferred tax balances of about NIS 326 million, and, at the same time, to an increase in net profit in 2011, which was recorded in taxes on income.

The Bank, as a “financial institution” for the purposes of the Value Added Tax Law, pays profit tax. As mentioned above, the rate of profit tax in 2010, 2011 and 2012 is 16% and in 2013 and thereafter 15.5%. Profit tax constitutes an expense for company tax purposes and, therefore, the tax rate that applies to the Bank for the tax year 2010 was 35.34%, for the tax year 2011the tax rate is 34.48%, in the tax year 2012, the rate will be 35.34%, and in tax year 2013 and thereafter, the tax rate will be 35.06%.

D. On 26 February 2008 the Amendment to the Income Tax (Adjustments for Inflation) Law, 1985 was passed by the Knesset. The Amendment limits the application of the Law to the years 1985-2007 and determined transition instructions regarding the end of its applicability.

E. Final assessments have been issued to the Bank for all years up to and including the tax year 2007. The main consolidated companies have final assessments for the years up to and including 2007.

F. Amendment 11 to the Income Tax (Inflationary Adjustments) Law states, *inter alia*, that all taxpayers subject to the said Amendment are required to pay tax on profits from securities traded on a stock exchange as at the date of their realization. The Amendment is effective for the years 1999-2007.

In the opinion of the tax authorities and the banks, taxation of securities on the basis of their realization is not appropriate for the activity of financial institutions.

Note 26 – Provision for Taxes on Operating Profit (cont'd)

Reported Amounts

In view of this, on 6 June 1999 the tax authorities submitted to the banks a draft proposed amendment to Article 6 of the said Law, according to which financial institutions will be taxed on the basis of the increase in value of the securities in accordance with the manner of presentation of the securities in the financial statements of the financial institutions.

Notwithstanding the limitation of the application of the Income Tax (Inflationary Adjustments) Law as described in paragraph D above, the Bank, in coordination with the tax authorities, is continuing to act on the basis of the proposed Law and its tax provisions are made accordingly.

G. The amount of the inflationary adjustment of buildings, the depreciation of which will not be recognized as an expense for future tax purposes, and in respect of which it has been determined that no reserve for deferred taxes is to be made, is as follows:

	31 December 2011	31 December 2010	31 December 2009
	NIS millions		
Balance at the beginning of the year	**162**	176	190
Change in the current year (a)	**(11)**	(14)	(14)
Balance at the end of the year	**151**	162	176

(a) This includes amounts not recognized as deductible in respect of depreciation and amounts amortized in respect of assets sold.

H. Certain consolidated companies have losses and other deductions which were claimed for tax purposes and in respect of which no future tax saving was included in the balance sheet, amounting in the consolidated companies to some NIS 139 million (31 December 2010 – about NIS 55 million). Utilization of these amounts in the future will be possible if the consolidated companies for which the amounts are recorded have taxable income.

Note 26 – Provision for Taxes on Operating Profit (cont'd)

Reported Amounts

I. Components of deferred tax assets and deferred tax liabilities are as follows:

	31 December 2011	31 December 2010	31 December 2011	31 December 2010
	NIS millions		Average tax rate in percent	
Deferred tax assets				
From specific provision for doubtful debts	**916**	203	**36%**	36%
From provision for unutilized vacations and long service bonus	**312**	257	**35%**	30%
From excess of provision for severance pay	**1,373**	992	**35%**	30%
From interest not credited to current income	**74**	79	**38%**	37%
From tax loss carry forward	**61**	55	**32%**	11%
From activity abroad	**-**	7	**34%**	35%
From adjustment of depreciable non-monetary assets	**32**	36	**20%**	21%
Other – from non-monetary assets	**48**	46	**23%**	22%
Share-based payment transactions	**6**	-	**35%**	-
Total	**2,822**	1,675		
Deferred tax reserve				
Surplus reserves over funds for severancy pay and pensions	**(2)**	(5)	**30%**	30%
From securities	**(91)**	(179)	**37%**	34%
From investments in investee companies	**(168)**	(162)	**10%**	11%
From adjustment of depreciable non-monetary assets	**(209)**	(147)	**31%**	28%
Other – from monetary assets	**(26)**	(25)	**34%**	34%
Other – from non-monetary assets	**(48)**	(62)	**28%**	23%
Total	**(544)**	(580)		
Deferred taxes receivable, net	**2,278**	1,095		
Deferred taxes included: (a)				
In "Other assets"	**2,396**	1,225		
In "Other liabilities"	**(118)**	(130)		
Deferred tax assets, net	**2,278**	1,095		

(a) The balances of deferred taxes are shown in the consolidated balance sheet in accordance with the classification of the net balance in the books of the Bank and its consolidated companies.

J. Deferred taxes have been calculated at the statutory tax rate applying to the companies at the time of utilization.

K. Changes in deferred taxes amounting to NIS 882 million in 2011 derive mainly from recording a tax asset in respect of the collective allowance and securities available for sale which were charged to separate items in shareholders' equity (2010 – NIS (76) million; 2009 - NIS (524) million) derive from securities available for sale and have been charged to a separate item in shareholders' equity.

L. Under an arrangement with the tax authorities from 14 April 2005, the Bank is entitled as from 2004 to set off, against the tax liability in Israel in respect of income of a subsidiary abroad, a cumulative amount of up to US$ 67 million or the tax liability in Israel, the lower of the two. The amounts not yet set off from the tax liability and in respect of which a future tax saving was not recorded in the balance sheet as of 31 December, 2011 is about US$ 54 million. Utilization of these amounts in the

Note 26 – Provision for Taxes on Operating Profit (cont'd)

Reported Amounts

future will be possible if the total tax rate to which the Bank is subject on its income in Israel is higher than the tax rate to which the foreign subsidiary is subject.

Note 27 - Net Profit after Taxes from Extraordinary Items

Reported Amounts

	2011	2010	2009
	NIS millions		
Net gain on realization of investments in investee companies and sale of activities (a)	**-**	220	-
Elimination of extraordinary provisions in connection with fixed assets	**4**	-	-
Net gain (loss) from sale of buildings	**(2)**	4	36
Net profit before taxes	**2**	224	36
Provision for taxes on profit from extraordinary items:			
Current taxes	**-**	41	8
Operating profit after taxes	**2**	183	28

(a) In 2010, the profit derived mainly from the sale of Paz Oil Company Ltd. – see Note 6.C above.

Note 28 – Operating Segments and Geographic Areas

Description of Operating Segments

The Bank in Israel is organized in five business lines, operating through five divisions, each headed by a member of the Management of the Bank. Each business line specializes in providing service to segments of customers with similar characteristics and needs. This specialization allows for the provision of a high level of professional service. In addition, there are a number of management units providing various services to the business divisions.

The subsidiary companies in Israel and abroad have been assigned to the relevant business line in accordance with the nature of their activities and the characteristics of their customers.

Principal Operational Segments

Pursuant to Bank of Israel directives, an operational segment is a component which has three characteristics:

1. It engages in business activities from which it is likely to produce income and bear expenses (including income and expenses from transactions with other segments in the Bank);

2. Its operating results are regularly examined by the Management and the Board of Directors in order to make decisions relating to the allocation of resources to the segment and the appraisal of its performance;

3. There is separate financial information with regard to the segment.

The principal operational segments that have been determined under the directives of the Bank of Israel in accordance with the above characteristics are as follows:

1. Households - providing banking services to households and private customers.

2. Small Businesses - providing banking services to small businesses and local authorities.

3. Corporate Banking - providing banking and financial services to major and international companies in the economy for their operations in Israel and abroad.

4. Commercial Banking - providing banking and financial services to middle market companies in the economy and to interested parties in these companies.

5. Private Banking - providing domestic and global financial services and solutions comprehensive to private customers resident in Israel and overseas with large financial asset portfolios.

6. Financial Management and Capital Market - nostro and trading rooms activities and provision of services to institutional customers and foreign financial institutions. Includes the results of activity of investments in (real) companies included on equity basis.

7. Others* - activities not assigned to other segments.

* This includes other activities of the Group, none of which constitutes a profit segment under the directives of the Supervisor of Banks.

Segmented operations also include inter-segmental activity, such as services provided to customers in another segment and also activities (deriving from products) such as mortgage loans, credit cards, capital market, and real estate.

Note 28 – Operating Segments and Geographic Areas (cont'd)

Allocation to a specific operational segment is carried out according to quantitative criteria and additional criteria, such as: size of the *obligo* with regard to business customers, and financial wealth with regard to private customers. Criteria such as the nature of a corporation's business operations and the volume of its business, such as activity volume, international trade volume, complex and special transactions, complex projects and construction financing, can change the segmental allocation of a specific customer.

As mentioned above, the Bank is organized in five business lines, and its policy is to allocate the customers, as much as possible, to the business line/operational segment appropriate for them, in accordance with their characteristics and activities. It should however be emphasized that segmental allocation is determined according to the sector in which the customer's account is actually operated; and until segmentation is carried out between the segments, i.e. until the customer receives service from the segment to which he should be allocated under the above criteria, there is no change to the segmental classification, and the financial results in respect of the customer are recorded in the segment in which his account is actually operated.

Financial Measurement System

To provide administrative support for operations according to segments, a profit-center operating and administrative system exists in the Bank according to business lines and additional cross-sections (the "Bachan" system).

The objectives of the system are:

- Measurement of profitability of the different profit centers;
- Measurement of the volume of business activity of the different profit centers according to various classifications;
- Measurement of performance against targets in the work plan;
- Uniformity in analyzing business activity;
- Overall control of business activity and profitability from such activity;
- Directing the branches and other business units to achieving the Bank's targets, including profitability targets;
- To provide a tool for allocating the Bank's resources in a rational manner, on the basis of cost-benefit analysis;
- To provide a basis for appraisal and remuneration.

The basis of the system in the Bank is the "data warehouse" that centralizes all the Bank's transactions and, with the aid of an appropriate index, enables transactions to be sorted and classified between the different profit centers.

The data presented below regarding operational segments includes the Bank's data in accordance with the principles of the "Bachan" system explained below, while the data for the segments of the subsidiaries in Israel and abroad has been taken from their financial statements, and as defined by them.

In measuring the profitability of overseas subsidiaries, exchange rate differentials, net of tax, arising from financing investments in overseas subsidiaries, are allocated to the net interest income of the overseas units.

Note 28 – Operating Segments and Geographic Areas (cont'd)

Income

Net Interest Income

The profit center is credited with interest received from loans that it granted or is debited with interest that is paid on deposits it raised.

At the same time, the profit center granting the loan is debited, and the profit center receiving the deposit is credited, with transfer prices. Transfer prices are usually determined in accordance with market prices with certain adjustments, and generally reflect the risk-free return or marginal costs of raising funds with the same linkage sector and currency and for a similar term. The effects of exchange rate differentials between the shekel/foreign currencies, including adjustments from translating data of overseas units, and also changes in the CPI on surplus uses and/or sources of funds are attributed in the Group to the financial management segment. Under the method described above, the profit centers bear credit risks but do not bear market risks.

The profit and loss account of each of the segments also takes into account the capital allocated to the segment. Each profit center is credited for Tier I capital allocated to it in respect of the risk assets in accordance with risk-free return, and is charged for the additional cost of Tier II capital. Under this method the Bank's available capital is credited with interest equal to the marginal cost of raising funds in accordance with the segment that it is financing, or invested in the capital market. The income from management of the nostro is reflected in the financial management and capital markets segment.

Provisions for doubtful debts are charged to the profit center in which the customer's account is managed. The same applies to the additional provision required pursuant to the directives of the Bank of Israel.

Operating Income
All operating income (commissions and other operating income) that the Bank charges its customers and/or its subsidiaries for various services is credited to the profit center in which the customer's account is managed. Income from nostro securities, profits of the severance pay fund and dividends received by the Bank are credited to the financial management and capital market profit center.

Expenses

Expenses are attributed to the lines of business (divisions of the Bank) in accordance with the sectoral association of the customers dealt with by those lines of business.

In a few cases, where the line of business deals with a number of operating segments, the expenses of the lines of business are attributed to the relevant segments and products on the basis of the pricing of multi-dimensional transactions.

Pricing is a system in which the cost of transaction is calculated taking into account the type of transaction, the type of customer executing it and the channel in which the transaction was carried out.

Measuring the return on capital

As part of the intensification of measurement of the performance of units and its adjustment to the unique risk characteristics for each unit, measurement is made of the rate of return on risk-adjusted capital (RORAC) of operating segments and their contribution to the Group's profit (economic value added - EVA), taking into account the cost of capital according to the multi-year return approved by the Board of Directors. The allocation of capital to risk components among the segments was done in accordance with the various risk characteristics inherent in each segment, in accordance with Basel II.

Note 28 – Operating Segments and Geographic Areas (cont'd)

From 2010, the allocation of First Pillar capital (in respect of credit, market and operational risks) is according to Basel II – the standardized - credit risks - approach on the basis of weighted risk assets in the units, operational and market risks (as of 31 December 2011) according to the standardized measurement method.

Second Pillar Capital is allocated to the units divided into its various components according to models designed by the Bank.

Until the end of 2009, risk capital was allocated to the various sectors according to its relative share of each segment in the total weighted risk assets of Leumi Group in accordance with the provisions of Basel I.

The profit of the operating segments is adjusted for the risk capital in each segment. The risk-adjusted return adjusted was calculated as a ratio of the adjusted profit to the average shareholders' equity allocated to the sector, which constitutes a part of the risk capital allocated (Tier 1 capital, Tier 2 capital and the balance of the capital in respect of extreme scenarios and retained earnings).

For each segment, the profit is calculated, taking into account the cost of Tier 1 and Tier 2 risk capital allocated to each segment. At the Group level, the value added for the shares (EVA) is the net profit, amended as aforesaid, less the cost of the shareholders' equity, according to the required long-term return over the shareholders' equity, as determined by the Board of Directors.

Note 28 – Operating Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments

Statement of profit and loss for the year ended 31 December 2011

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	NIS millions							
Net interest income (loss) before provision for doubtful debts								
From outside entities -	**1,739**	**1,135**	**2,851**	**2,204**	**(60)**	**(319)**	**-**	**7,550**
Intersegmental -	**882**	**(189)**	**(1,092)**	**(671)**	**501**	**555**	**14**	**-**
Total	**2,621**	**946**	**1,759**	**1,533**	**441**	**236**	**14**	**7,550**
Operating and other income:								
From outside entities -	**1,686**	**511**	**452**	**434**	**453**	**171**	**29**	**3,736**
Intersegmental -	**221**	**(52)**	**(115)**	**(37)**	**12**	**32**	**(61)**	**-**
Total	**1,907**	**459**	**337**	**397**	**465**	**203**	**(32)**	**3,736**
Total income	**4,528**	**1,405**	**2,096**	**1,930**	**906**	**439**	**(18)**	**11,286**
Provision for doubtful debts	**69**	**89**	**312**	**218**	**(31)**	**77**	**-**	**734**
Operating and other expenses	**3,904**	**829**	**631**	**1,047**	**688**	**1,323**	**(75)**	**8,347**
Operating profit (loss) before taxes	**555**	**487**	**1,153**	**665**	**249**	**(961)**	**57**	**2,205**
Provision for (benefit from) taxes on operating profit	**170**	**167**	**389**	**228**	**74**	**(415)**	**(195)**	**418**
Operating profit (loss) after taxes	**385**	**320**	**764**	**437**	**175**	**(546)**	**252**	**1,787**
Group equity in after-tax operating profits of companies included on equity basis, net of tax effect	**-**	**-**	**-**	**-**	**-**	**148**	**-**	**148**
Net operating profit Before attribution to non-controlling interests	**385**	**320**	**764**	**437**	**175**	**(398)**	**252**	**1,935**
Attributable to non-controlling interests	**(28)**	**(2)**	**(4)**	**(1)**	**(2)**	**(9)**	**-**	**(46)**
Attributable to shareholders of the banking coporation	**357**	**318**	**760**	**436**	**173**	**(407)**	**252**	**1,889**
Net profit from extraordinary activities after taxes before attribution to non-controlling interests	**-**	**-**	**-**	**-**	**-**	**-**	**2**	**2**
Net profit for the period Before attribution to non-controlling interests	**385**	**320**	**764**	**437**	**175**	**(398)**	**254**	**1,937**
Attributable to non-controlling interests	**(28)**	**(2)**	**(4)**	**(1)**	**(2)**	**(9)**	**-**	**(46)**
Attributable to shareholders of the banking coporation	**357**	**318**	**760**	**436**	**173**	**(407)**	**254**	**1,891**
Return on capital	**8.54%**	**22.85%**	**9.27%**	**11.32%**	**21.99%**	**(9.96%)**	**70.67%**	**8.27%**

Note 28 – Operating Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2011 (cont'd)

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	NIS millions							
Average balance of assets	80,419	19,465	77,596	49,894	11,248	97,642	5,551	341,815
Including: investments in companies included on equity basis	5	-	-	-	-	2,142	-	2,147
Average balance of liabilities	128,256	19,030	35,180	44,043	37,393	53,447	1,200	318,549
Average balance of risk assets	57,268	17,651	99,423	51,073	9,424	38,168	5,444	278,451
Average balance of assets of mutual funds and training funds	53,540	2,199	1,281	4,240	6,390	261	-	67,911
Average balance of securities	50,806	5,702	82,702	40,831	68,071	179,121	-	427,233
Average balance of other assets under management	5,897	244	221	702	224	-	5	7,293
Margin on credit-granting activities	1,327	710	1,383	1,029	84	9,419	16	13,968
Margin on deposit-taking activities	1,142	193	65	313	290	(12,955)	108	(10,844)
Other	152	43	311	191	67	3,772	(110)	4,426
Total interest income before expenses in respect of credit losses	2,621	946	1,759	1,533	441	236	14	7,550

Note 28 – Operating Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2010 (a)

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	NIS millions							
Net interest income (loss) before provision for doubtful debts								
From outside entities -	1,448	1,064	1,689	1,721	(50)	1,553	8	7,433
Intersegmental -	769	(158)	379	(251)	457	(1,198)	2	-
Total	2,217	906	2,068	1,470	407	355	10	7,433
Operating and other income:								
From outside entities -	1,732	493	454	431	451	449	101	4,111
Intersegmental -	237	(56)	(122)	(38)	10	4	(35)	-
Total	1,969	437	332	393	461	453	66	4,111
Total income	4,186	1,343	2,400	1,863	868	808	76	11,544
Provision for doubtful debts	169	147	(71)	341	8	(6)	(4)	584
Operating and other expenses	3,702	795	616	1,035	725	1,062	16	7,951
Operating profit (loss) before taxes	315	401	1,855	487	135	(248)	64	3,009
Provision for taxes on operating profit	110	144	655	183	44	28	75	1,239
Operating profit (loss) after taxes	205	257	1,200	304	91	(276)	(11)	1,770
Group equity in after-tax operating profits of companies included on equity basis, net of tax effect	-	-	-	-	-	420	-	420
Net operating profit (loss) Before attribution to non-controlling interests	205	257	1,200	304	91	144	(11)	2,190
Attributable to non-controlling interests	(28)	(1)	(2)	(1)	(4)	(3)	-	(39)
Attributable to shareholders of the banking coporation	177	256	1,198	303	87	141	(11)	2,151
Net profit from extraordinary activities after taxes before attribution to non-controlling interests	-	-	-	-	-	182	1	183
Net profit for the period Before attribution to non-controlling interests	205	257	1,200	304	91	326	(10)	2,373
Attributable to non-controlling interests	(28)	(1)	(2)	(1)	(4)	(3)	-	(39)
Attributable to shareholders of the banking coporation	177	256	1,198	303	87	323	(10)	2,334
Return on capital	4.41%	18.74%	14.32%	8.14%	12.67%	8.01%	(2.05%)	10.29%

(a) Reclassified.

Note 28 – Operating Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2010 (cont'd) (a)

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	NIS millions							
Average balance of assets	71,397	18,462	73,946	46,667	10,797	99,173	5,009	325,451
Including: investments in companies included on equity basis	8	-	-	-	-	1,944	-	1,952
Average balance of liabilities	123,480	16,929	33,291	38,418	39,429	49,272	1,604	302,423
Average balance of risk assets	52,890	17,185	92,380	48,387	9,174	37,775	4,892	262,683
Average balance of assets of mutual funds and training funds	49,162	2,027	1,098	3,541	5,358	402	-	61,588
Average balance of securities	50,421	5,236	86,063	39,332	67,070	139,243	-	387,365
Average balance of other assets under management	6,607	301	201	563	253	-	118	8,043
Margin on credit-granting activities	1,120	668	1,463	988	69	2,152	1	6,461
Margin on deposit-taking activities	832	121	46	227	249	697	(1)	2,171
Other	265	117	559	255	89	(2,494)	10	(1,199)
Total interest income before expenses in respect of credit losses	2,217	906	2,068	1,470	407	355	10	7,433

(a) Restated.

Note 28 – Operating Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2009 (a)

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	NIS millions							
Net interest income (loss) before provision for doubtful debts								
From outside entities -	1,064	1,036	3,028	1,747	(203)	333	18	7,023
Intersegmental -	1,017	(180)	(1,136)	(336)	638	13	(16)	-
Total	2,081	856	1,892	1,411	435	346	2	7,023
Operating and other income:								
From outside entities -	1,701	459	937	418	438	460	150	4,563
Intersegmental -	233	(59)	(120)	(39)	16	3	(34)	-
Total	1,934	400	817	379	454	463	116	4,563
Total income	4,015	1,256	2,709	1,790	889	809	118	11,586
Provision for doubtful debts	281	228	579	383	35	11	-	1,517
Operating and other expenses	3,472	739	568	932	676	368	26	6,781
Operating profit before taxes	262	289	1,562	475	178	430	92	3,288
Provision for taxes on operating profit	73	101	549	164	57	140	188	1,272
Operating profit (loss) after taxes	189	188	1,013	311	121	290	(96)	2,016
Group equity in after-tax operating profits (losses) of companies included on equity basis, net of tax effect	-	-	-	-	-	86	(5)	81
Net operating profit								
Before attribution to non-controlling interests	189	188	1,013	311	121	376	(101)	2,097
Attributable to non-controlling interests	(28)	-	-	-	(5)	(3)	-	(36)
Attributable to shareholders of the banking coporation	161	188	1,013	311	116	373	(101)	2,061
Net profit from extraordinary activities after taxes before attribution to non-controlling interests	-	-	-	-	-	-	28	28
Net profit for the period								
Before attribution to non-controlling interests	189	188	1,013	311	121	376	(73)	2,125
Attributable to non-controlling interests	(28)	-	-	-	(5)	(3)	-	(36)
Attributable to shareholders of the banking coporation	161	188	1,013	311	116	373	(73)	2,089
Return on capital	3.68%	16.75%	14.71%	9.11%	19.20%	14.60%	(17.46%)	10.78%

(a) Restated.

Note 28 – Operating Segments and Geographic Areas (cont'd)

Reported Amounts

A. Information on operational segments (cont'd)

Statement of profit and loss for the year ended 31 December 2009 (a) (cont'd)

	Households Sector	Small Business Sector	Corporate Sector	Commercial Sector	Private Banking Sector	Financial Management Sector	Other	Total consol-idated
	NIS millions							
Average balance of assets	64,612	17,608	77,712	46,794	11,109	94,455	6,499	318,789
Including: investments in companies included on equity basis	8	-	-	-	-	1,871	88	1,967
Average balance of liabilities	125,750	15,690	34,411	33,569	41,759	45,762	1,600	298,541
Average balance of risk assets	57,304	14,687	90,120	44,690	7,908	33,441	5,472	253,622
Average balance of assets of mutual funds and training funds	37,588	1,541	709	2,915	4,091	472	-	47,316
Average balance of securities	44,395	3,282	66,751	32,776	59,782	101,678	-	308,664
Average balance of other assets under management	7,433	373	256	616	296	-	92	9,066
Margin on credit-granting activities	1,023	643	1,435	964	64	5,992	(15)	10,106
Margin on deposit-taking activities	834	91	44	217	260	(6,469)	77	(4,946)
Other	224	122	413	230	111	823	(60)	1,863
Total interest income before expenses in respect of credit losses	2,081	856	1,892	1,411	435	346	2	7,023

(a) Restated.

Note 28 – Operating Segments and Geographic Areas (cont'd)

Reported Amounts

B. Information on activity by geographic area (a)

31 December 2011

	Israel	U.S.A.	U.K.	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consoli-dated
	NIS millions								
Total income (b)	**10,001**	**872**	**519**	**241**	**(423)**	**113**	**(37)**	**1,285**	**11,286**
Net profit (loss)	**1,489**	**213**	**102**	**53**	**23**	**(21)**	**32**	**402**	**1,891**
Total assets	**325,272**	**21,765**	**9,051**	**4,259**	**779**	**1,230**	**3,498**	**40,582**	**365,854**
Credit to the public	**214,356**	**14,785**	**7,696**	**2,312**	**336**	**812**	**1,023**	**26,964**	**241,320**
Deposits of the public	**245,948**	**16,783**	**5,683**	**4,960**	**2,069**	**726**	**3,235**	**33,456**	**279,404**

31 December 2010

	Israel	U.S.A.	U.K.	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consoli-dated
	NIS millions								
Total income (b)	10,412	517	80	270	187	5	73	1,132	11,544
Net profit (loss)	2,613	(94)	(29)	34	(4)	(181)	(5)	(279)	2,334
Total assets	294,216	18,523	8,223	4,574	954	1,268	564	34,106	328,322
Credit to the public	200,360	12,544	6,899	2,544	287	900	447	23,621	223,981
Deposits of the public	223,142	14,083	5,612	3,362	2,175	692	518	26,442	249,584

31 December 2009

	Israel	U.S.A.	U.K.	Switzerland	Luxembourg	Romania	Others	Total outside of Israel	Total consoli-dated
	NIS millions								
Total income (b)	9,818	678	425	244	275	146	-	1,768	11,586
Net profit (loss)	1,956	17	50	37	6	(7)	30	133	2,089

(a) The classification was done based on the location of the office.
(b) Net interest income before (expenses for credit losses) and operating and other income.

Note 29 - Earmarked Deposits, Credit and Deposits from Earmarked Deposits

Reported Amounts

	31 December 2011	31 December 2010
	NIS millions	
Credit and deposits from earmarked deposits		
Total credit to the public	**220**	317
Earmarked deposits		
Deposits of the public	**8**	10
Deposits from banks	**24**	34
Deposits from the Government	**278**	422
Total	**310**	466

Note 30 - Condensed Financial Statements of the Bank

Reported Amounts

A. Balance sheet of the Bank as at 31 December 2011

	31 December 2011	31 December 2010
	NIS millions	
Assets		
Cash and deposits with banks	**93,879**	68,133
Securities	**41,253**	48,219
Securities borrowed or purchased under agreements to repurchase	**1,225**	1,190
Credit to the public (a)	**154,385**	152,307
Allowance for credit losses (a)	**(2,777)**	(8,886)
Credit to the public, net	**151,608**	143,421
Credit to governments	**440**	365
Investments in investee companies	**16,870**	15,278
Buildings and equipment	**3,154**	3,173
Assets in respect of derivative instruments (a) (b)	**11,348**	8,594
Other assets (a) (b)	**2,943**	1,487
Total assets	**322,720**	289,860
Liabilities and equity capital		
Deposits of the public	**257,530**	232,074
Deposits from banks	**9,589**	4,479
Deposits from governments	**373**	515
Securities loaned or sold under agreements to resell	**385**	762
Subordinated notes	**7,719**	7,683
Liabilities in respect of derivative instruments (a)	**11,860**	9,808
Other liabilities (a) (b)	**11,890**	11,246
Total liabilities	**299,346**	266,567
Shareholders' equity	**23,374**	23,293
Total liabilities and shareholders' equity	**322,720**	289,860

(a) Comparative figures have been reclassified in order to comply with the new method of reporting in the current period. Comparative figures in respect of credit to the public and the allowance for credit losses were not restated pursuant to implementation of the new directives and are not comparable to current figures.

(b) Restated – see Note 1.S.2

Note 30 - Condensed Financial Statements of the Bank (cont'd)

Reported Amounts

B. Condensed statements of profit and loss

for the year ended 31 December 2011

	2011	2010	2009
	NIS millions		
Net interest income before allowance for credit losses	**5,322**	5,826	5,254
Allowance for credit losses	**600**	340	1,269
Net interest income after allowance for credit losses	**4,722**	5,486	3,985
Operating and other income	**2,631**	2,612	3,211
Operating and other expenses	**6,198**	5,807	4,836
Operating profit before taxes	**1,155**	2,291	2,360
Provision for taxes on operating profit	**198**	858	1,069
Operating profit after taxes	**957**	1,433	1,291
Bank's equity in after-tax operating profits of investee companies, net of related tax effect	**932**	718	770
Net operating profit	**1,889**	2,151	2,061
After-tax profit from extraordinary items	**2**	183	28
Net profit	**1,891**	2,334	2,089

(a) Reclassified.
(b) Restated – see Note 1.S.2.

Note 30 - Condensed Financial Statements of the Bank (cont'd)

Reported Amounts

C. Statements of cash flows

for the year ended 31 December 2011

	2011	2010	2009
	NIS millions		
Cash flows from operating activities			
Net profit for the year	**1,891**	2,334	2,089
Adjustments required to show cash flows from operating activities:			
Bank's share in undistributed profits of investee companies including extraordinary profits less dividend received	**(482)**	(693)	(677)
Other, net (including provisions for doubtful debts and impairment of securities)	**953**	552	418
Net cash inflow from operating activities	**2,362**	2,193	1,830
Cash flows from activities in assets			
Additional investments in shares of consolidated companies	**(691)**	-	(235)
Other	**(13,814)**	(15,311)	7,373
Net cash outflow from (used in) activities in assets	**(14,505)**	(15,311)	7,138
Cash flows from activities in liabilities and capital			
Issue of debentures and subordinated notes	**-**	2,375	1,000
Dividend paid to shareholders	**(900)**	(500)	-
Other	**32,486**	5,095	8,238
Net cash inflow from activities in liabilities and capital	**31,586**	6,970	9,238
Increase (decrease) in cash	**19,443**	(6,148)	18,206
Balance of cash at beginning of year	**46,241**	52,389	34,183
Balance of cash at end of year	**65,684**	46,241	52,389

D. Information on the basis of nominal values for tax purposes

	31 December 2011	31 December 2010
	NIS millions	
Total assets	**320,801**	287,917
Total liabilities	**299,300**	266,037
Shareholders equity	**21,501**	21,880
Net profit for the year ended (a)	**1,871**	2,132

(a) Not including profits (losses) of companies included on equity basis, as required under generally accepted accounting principles in Israel.

CONDENSED FINANCIAL STATEMENTS OF MAJOR SUBSIDIARIES IN ISRAEL AND ABROAD

Bank Leumi USA

Chairman of the Board: S.Levine *
Chief Executive Officer and President: A. Eyal

Condensed Consolidated Balance Sheet as at 31 December 2011
(U.S. $ millions)

	2011	2010
Assets		
Cash and deposits with banks	**873**	460
Securities	**679**	951
Loans	**3,827**	3,498
Buildings and equipment	**16**	16
Other assets	**285**	296
Total assets	**5,680**	5,221
Liabilities and Equity Capital		
Deposits	**4,855**	4,225
Other liabilities	**218**	405
Capital notes	**90**	90
Capital resources	**517**	501
Total liabilities and capital resources	**5,680**	5,221

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2011
(U.S. $ millions)

	2011	2010
Income from financing operations before allowance for credit losses	**133**	131
Expenses in respect of credit losses	**9**	36
Income from financing operations after allowance for credit losses	**124**	95
Operating and other income	**43**	69
Operating and other expenses	**137**	137
Operating profit before taxes	**30**	27
Provision for taxes	**10**	11
Net profit	**20**	16

* Appointed Acting Chairman of the Board of Directors on 30 June 2011.
Until that date T. Glueck served as Chairman of the Board of Directors of the Bank.

Leumi Private Bank

Chairman of the Board: G. Maor
General Manager: A. Zaindenberg

Condensed Consolidated Balance Sheet as at 31 December 2011
(CHF millions)

	2011	2010
Assets		
Cash and deposits with banks	**236**	349
Loans	**569**	668
Securities	**237**	227
Other assets	**32**	34
Total assets	**1,074**	1,278
Total Customers' Investments (off-balance sheet)	**3,564**	4,227

	2011	2010
Liabilities and Equity Capital		
Deposits from banks	**94**	126
Deposits and other accounts	**813**	919
Subordinated capital notes	**50**	50
Capital resources and reserves	**117**	183
Total liabilities and capital resources	**1,074**	1,278

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2011
(CHF millions)

	2011	2010
Net interest income	**22**	22
Other operating income	**33**	40
Operating and other Expenses	**50**	53
Operating profit before taxes	**5**	9
Provision for taxes	**1**	3
Net profit	**4**	6
Dividend Paid	**70**	-

* Until 3 January , 2012, the name of the bank was Leumi (Switzerland) Ltd.

Bank Leumi (UK) plc

Chairman of the Board: Z. Itskovitch *
Director and General Manager: L. Weiss

Condensed Consolidated Balance Sheet as at 31 December 2011
(Pounds sterling millions)

	2011	2010
Assets		
Cash and deposits with banks	**146**	145
Loans	**1,304**	1,254
Securities	**70**	87
Equipment and buildings	**5**	6
Other assets	**14**	12
Total assets	**1,539**	1,504
Liabilities and Equity Capital		
Deposits	**985**	1,043
Deposits from banks	**350**	262
Subordinated capital notes	**73**	73
Other liabilities	**12**	17
Capital resources	**119**	109
Total liabilities and capital resources	**1,539**	1,504

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2011
(Pounds sterling millions)

	2011	2010
Net interest income before provision for doubtful debts	**28**	28
Expenses (income) in respect of credit losses	**(1)**	9
Net interest income after provision for doubtful debts	**29**	19
Operating and other income	**15**	16
Operating and other expenses	**28**	27
Operating profit before taxes	**16**	8
Provision for taxes	**4**	2
Net profit	**12**	6

* Appointed executive chairman of the Bank on 1 March 2011.
Untill 31 December 2010, Mr. E. Raff served as Chairman of the Board of Directors of the Bank.

Bank Leumi (Luxembourg) S.A.

Chairman of the Board: Z. Itskovitch
General Manager: G. Karni *

Condensed Balance Sheet as at 31 December 2011
(Euro millions)

	2011	2010
Assets		
Cash and deposits with banks	**478**	330
Securities	**58**	116
Credit to the public	**68**	60
Other assets	**7**	9
Total assets	**611**	515
Liabilities and Shareholders' Equity		
Deposits of the public	**413**	453
Deposits from banks	**153**	22
Other liabilities	**6**	7
Total liabilities	**572**	482
Shareholders' equity	**39**	33
Total liabilities and shareholders' equity	**611**	515

Condensed Statement of Profit and Loss for the Year Ended 31 December 2011
(Euro millions)

	2011	2010
Net Interest income	**6**	7
Operating and other income	**6**	5
Operating and other expenses	**7**	7
Net profit	**5**	5

* Appointed general manager of the Bank on 1 October 2011.
Until that date, Mr. Y. Moskovitz served as Chairman of the Board of Directors of the Bank.

Bank Leumi Romania

Chairman of the Board: Z. Itskovitch
Director and General Manager: L. Mitrache

Condensed Consolidated Balance Sheet as at 31 December 2011
(RON millions) *

	2011	2010
Assets		
Cash and deposits with banks	**305**	237
Loans	**713**	818
Securities	**80**	65
Equipment and buildings	**18**	17
Other assets	**12**	13
Total assets	**1,128**	1,150
Liabilities and Equity Capital		
Deposits	**633**	625
Deposits from banks	**280**	288
Subordinated capital notes	**-**	-
Other liabilities	**19**	17
Capital resources	**196**	220
Total liabilities and capital resources	**1,128**	1,150

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2011
(RON millions)

	2011	2010
Net interest income before expenses in recpect of credit losses	**70**	71
Expenses in respect of credit losses	**54**	80
Net interest income (loss) after expenses in respect of credit losses	**16**	(9)
Operating and other income	**21**	36
Operating and other expenses	**61**	80
Net profit (loss)	**(24)**	(53)

*RON 1 = NIS 1.1429

Leumi Mortgage Bank Ltd.

Chairman of the Board: D. Bar-Lev *
General Manager: J. Burshtein

Condensed Balance Sheet as at 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Assets		
Cash and deposits with banks	**10**	10
Credit to the public (a)	**56,808**	51,579
Allowance for credit losses (a)	**(511)**	(496)
Credit to the public, net	**56,297**	51,083
Buildings and equipment	**76**	69
Other assets (b)	**149**	134
Total assets	**56,532**	51,296
Liabilities and Shareholders' Equity		
Deposits of the public	**4,756**	5,525
Deposits from banks	**43,825**	38,409
Deposits from the government	**24**	28
Debentures	**11**	16
Subordinated notes	**4,757**	4,285
Other liabilities (a)(b)	**389**	391
Total liabilities	**53,762**	48,654
Shareholders' equity	**2,770**	2,642
Total liabilities and shareholders' equity	**56,532**	51,296

Condensed Statement of Profit and Loss for the Year Ended 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Net interest income before income in respect of credit losses	**471**	406
Income in respect of credit losses	**(16)**	(42)
Net interest income after income in respect of credit losses	**487**	448
Operating and other income	**114**	129
Operating and other expenses (a)	**304**	290
Operating profit before taxes	**297**	287
Provision for taxes on operating profit	**94**	111
Net profit	**203**	176

(a) Comparative figures have been reclassified in order to adjust to method of presentation in the current period. Comparative figures in respect of credit to the public and the allowance for credit losses have not been restated as a result of the implementation of the new regulations and are not comparable with current figures.

(b) Restated

* Until 31 December 2010, Mr. A. Zaldman served as Chairman of the Board of Directors.

The Arab Israel Bank Ltd.

Chairman of the Board: S. Sussman *
General Manager: D. Gitter

Condensed Balance Sheet as at 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Assets		
Cash and deposits with banks	**1,336**	1,144
Securities	**571**	616
Credit to the public (a)	**3,774**	3,466
Allowance for credit losses (a) (b)	**(51)**	(173)
Credit to the public, net	**3,723**	3,293
Buildings and equipment	**62**	57
Other assets (b)	**69**	53
Total assets	**5,761**	5,163
Liabilities and Shareholders' Equity		
Deposits of the public	**3,892**	3,437
Deposits from banks	**1,056**	1,025
Subordinated notes	**158**	156
Other liabilities (b)	**231**	208
Total liabilities	**5,337**	4,826
Shareholders' equity	**424**	337
Total liabilities and shareholders' equity	**5,761**	5,163

Condensed Statement of Profit and Loss for the Year Ended 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Net interest income before expenses in respect of credit losses	**270**	241
Income in respect of credit losses	**6**	24
Net interest income after expenses in respect of credit losses	**264**	217
Operating and other income	**109**	104
Operating and other expenses (b)	**220**	204
Operating profit before taxes	**153**	117
Provision for taxes on operating profit (b)	**44**	42
Net profit	**109**	75
Dividend Paid	**-**	60

(a) Comparative figures have been reclassified in order to adjust to method of presentation in the current period. Comparative figures in respect of credit to the public and the allowance for credit losses have not been restated as a result of the implementation of the new regulations and are not comparable with current figures.

(b) Restated

* On 31 March 2012, Mr. Z. Nahari will replace Mr. S. Zussman as Chairman of the Bord of Directors of the Company.

Leumi Partners Ltd.

Chairman of the Board: Z.Nahari *
General Manager: Y. Bloch

Condensed Consolidated Balance Sheet as at 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Assets		
Cash and deposits with banks	**126**	64
Securities	**1,076**	1,596
Investment in companies included on the equity basis	**410**	167
Fixed assets	**4**	5
Other assets	**7**	18
Total assets	**1,623**	1,850
Liabilities and Shareholders' Equity		
Loans from banks	**-**	60
Other liabilities	**27**	101
Subordinated notes	**1,150**	1,072
Shareholders' equity	**446**	617
Total liabilities and shareholders' equity	**1,623**	1,850

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Net interest income (loss)	**(5)**	2
Operating and other income (expenses)	**(166)**	212
Operating and other expenses	**39**	42
Operating profit before taxes	**(210)**	172
Provision for taxes on operating profit	**(46)**	48
Net operating profit after taxes	**(164)**	124
Company's equity in the net profit (loss) of companies included on the equity basis	**56**	36
Net profit	**(108)**	160

* On March 2012, Mr. K. Haber will replace Mr. Z. Nahari as the Chairman of the Bord of Directors of the Bank.

Leumi Card Ltd.

Acting Chairman of the Board: B. Lederman
General Manager: T. Yassur *

Condensed Consolidated Balance Sheet as at 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Assets		
Cash and deposits with banks	**58**	63
Receivable in respect of credit card activity (a)	**8,095**	7,722
Allowance for the credit losses (a)	**(69)**	(38)
Debts in respect of credit card activity, net	**8,026**	7,684
Investment in companies included on the equity basis	**4**	7
Equipment	**175**	151
Other assets (b)	**51**	22
Total assets	**8,314**	7,927
Liabilities and Shareholders' Equity		
Credit from banks	**1,338**	1,141
Payables in respect of credit card activity (b)	**5,723**	5,692
Other liabilities (a)	**161**	112
Total liabilities	**7,222**	6,945
Shareholders' equity	**1,092**	982
Total liabilities and shareholders' equity	**8,314**	7,927

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Income from credit card transaction	**789**	749
Net interest income before provision for doubtful debts	**149**	127
Provision for doubtful debts (a)	**15**	31
Operating and other expenses (b)	**681**	627
Net operating profit before taxes	**242**	218
Provision for taxes on operating profit	**65**	60
Net profit	**177**	158
Dividand Paid	**-**	10

(a) Comparative figures have been reclassified in order to adjust to method of presentation in the current period. Comparative figures in respect of credit to the public and the allowance for credit losses have not been restated as a result of the implementation of the new regulations and are not comparable with current figures.

(b) Restated

* Untill 1 March 2011, Mr. D. Cohen served as General Manager of the Company.

Leumi Finance Company Ltd.

Chairman of the Board: M. Eisenthal
General Manager: O. Shulman

Condensed Balance Sheet as at 31 December 2011
Reported amounts (NIS millions) (a)

	2011	2010
Assets		
Cash and deposits with banks	**18,306**	14,760
Other assets	**1**	2
Total assets	**18,307**	14,762
Liabilities and Shareholders' Equity		
Debentures and subordinated notes	**18,149**	14,598
Other liabilities	**-**	7
Total liabilities	**18,149**	14,605
Shareholders' equity	**158**	157
Total liabilities and shareholders' equity	**18,307**	14,762

Condensed Statement of Profit and Loss for the Year Ended 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Net interest income	**20**	17
Operating and other expenses	**2**	2
Operating profit before taxes on income	**18**	15
Provision for taxes on income	**6**	5
Net profit	**12**	10
Dividend Paid	**11**	9

(a) The Financial Statements were prepared by the company in accordance with International Financial Reporting Standards (IFRS).

Leumi Leasing and Investments Ltd.

Chairman of the Board: E. Katzav
General Manager: T. B. Davidovitch

Condensed Consolidated Balance Sheet as at 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Assets		
Cash and deposits with banks	**119**	74
Investments	**-**	-
Credit to the public	**981**	1,003
Other assets	**12**	5
Total assets	**1,113**	1,082
Liabilities and Shareholders' Equity		
Deposits from banks	**168**	174
Other liabilities	**4**	2
Total liabilities	**171**	176
Shareholders' equity	**941**	906
Total liabilities and shareholders' equity	**1,113**	1,082

Condensed Consolidated Statement of Profit and Loss for the Year Ended 31 December 2011
Reported amounts (NIS millions)

	2011	2010
Net interest income before expenses in respect of credit losses	**58**	53
Other income	**2**	1
Impairment of investment	**(1)**	(12)
Net income before expenses in respect of credit losses	**59**	42
Expenses in respect of credit losses	**3**	2
Net income after provision for doubtful debts	**56**	40
Operating expenses	**11**	11
Operating profit before taxes	**45**	29
Provision for taxes on operating profit	**10**	12
Net profit	**35**	17