# LEUMI 2017

# REPORT ON RISKS

## As at June 30, 2017

The Report on Risks and the description of the main characteristics of regulatory capital instruments issued are included on the Bank's website: www.bankleumi.co.il and in the Magna website of the Israel Securities Authority: www.magna.isa.gov.il.

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

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## Report on Risks

We are pleased to present the Report on Risks as at June 30, 2017 (hereinafter: "Report on Risks"). The report on risks has been prepared in accordance with the directives of the Banking Supervision Department and their instructions regarding the disclosure requirements as detailed in the Basel Pillar 3 disclosure requirements and additional information on risks. In addition, the Report has been prepared pursuant to the instructions of the Banking Supervision Department concerning a bank's quarterly report, and does not include all the information required in the complete annual reports. It is to be read in conjunction with the Bank's Report on Risks as at December 31, 2016 (hereinafter: "Annual Report on Risks")

This report includes supplementary and related information to the consolidated financial statements of Bank Leumi Le-Israel B.M. regarding exposure to risks, their methods of management and capital adequacy. This report should be read together with the Report of the Board of Directors and Management and the financial statements as of June 30, 2017.

**David Brodet**

Chairman of the Board of Directors

**Rakefet Russak-Aminoach**

President and Chief Executive Officer

**Bosmat Ben Zvi**

Vice President

Chief Risk Officer

15 August 2017

## Purpose and principle of the disclosure

The report is intended to enable readers of the Bank's reports to evaluate significant information included therein with regard to the implementation of the working framework of the Basel Committee, capital, risk exposure, and risk assessment processes.

The information included in this report includes:

- Disclosure requirements published by the Basel Committee (Pillar 3 disclosure requirements).
- Disclosure requirements on risks based on other sources, including disclosure requirements published by the Financial Stability Board (FSB) via the Task Force for disclosure improvement (EDTF).
- Additional disclosure requirements by virtue of the requirements pursuant to the Reporting Regulations of the Bank of Israel and its directives (Additional information).

In order to denote the origin of the various disclosures, this report includes an index of the various disclosure tables, noting the origin of the disclosure as "Pillar 3" and "EDTF", respectively.

The report includes the following disclosure requirements:

- Regarding quantitative data included in previous Pillar 3 capital disclosure requirements or as part of additional disclosure requirements as mentioned above, comparative data for the corresponding periods in the previous reporting year were presented, as required in the provisions.
- The information is partially based on the financial data presented in the Bank's financial reports, which are used as the basis for the calculations of regulatory ratios in the required adjustments and, in part, on internal evaluations and models. In light of this, part of the information is considered as an unaudited estimate and/or represents information which is considered as forward looking information.
- Qualitative information is mostly detailed in the financial statements framework, excluding significant changes which occurred during the reporting period. In light of this, these statements should be read along with the Report on Risks and the annual statements for 2016. Furthermore, additional relevant information may be found in the chapter "Review of Risks" in the Report of the Board of Directors and Management.

## Forward-Looking Information

The Report on Risks includes, in addition to data relating to the past, information and estimations that relate to the future, which is defined in the Securities Law, 1968, as "forward-looking information". Forward-looking information relates to a future event or matter, the realization of which is not certain and is not solely within the 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", "scenarios", "stress scenarios", " evaluation", 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 Report on Risks 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 could be materially different.

The Bank does not undertake to publish updates of the forward-looking information in these reports. This does not detract from the Bank's reporting obligations according to any law.

## Summary of Disclosure Tables

**Below is a table summarizing the various disclosure requirements:**

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## Scope of Application

**A.** The consolidation of the consolidated companies and the recording of the equity value of the companies included on equity basis is according to generally accepted accounting principles and in accordance with Bank of Israel directives. As at June 30, 2017, there were no differences between the basis of consolidation according to accounting principles and the basis of supervisory consolidation for capital adequacy purposes.

The presentation in this report is in accordance with the requirements of the Basel Committee, which is based on the financial data presented in the financial statements, but in some parts is different from it – for example, in respect of capital deductions required from the banks, special treatment of the accounting impact of the efficiency plan on the Bank's capital and a specifically adjusted calculation in respect of special actuarial obligations.

**B.** The Group is supervised, on a consolidated basis, by the Bank of Israel's Banking Supervision Department. Likewise, the overseas subsidiaries of the Banking Group are supervised by the regulatory authorities in the countries in which they operate, most of whom adopted the working framework of the Basel Committee with certain changes regarding standards for capital adequacy, liquidity and leverage requirements.

The main regulatory restrictions on the transfer of liquid means or supervisory capital between the Group companies in Israel and abroad are:

1. The Bank of Israel does not restrict the placement of deposits by the Bank in the Group subsidiaries in Israel and abroad. However, it has placed restrictions on investments in equity and capital notes by the Bank in companies abroad. For every material investment, prior approval of the Bank of Israel is required.
2. The provisions of the authorities in the United States restrict the local banks in the amount of exposures of any type vis-à-vis related companies. The maximum rate of the exposure to a related company is 10% of the Bank's capital in the United States, and vis-à-vis the Group of which the Bank in the United States is part, the maximum rate is 20% of its capital.
3. The provisions of the authorities in the United Kingdom restrict the local banks in the level of exposures of any type vis-à-vis related companies. The maximum rate of exposure vis-à-vis the Group (except for Bank Leumi Le-Israel) is 25% of the capital of the Bank in the United Kingdom.

   A waiver has been newly approved by the regulator in the UK for increasing the level of exposure vis-à-vis Bank Leumi Le-Israel B.M., such that the maximum rate of exposure today is 100% of the Bank's capital in the United Kingdom.
4. The provisions of the authorities in Romania restrict the local banks' scope of exposure towards related companies. Leumi Romania's maximum rate of exposure towards the Group is 100% of the capital of the Bank in Romania.

## Description of Leumi Group's business

Bank Leumi Le-Israel B.M. (hereinafter: "Leumi Bank" or "the Bank"), whose head office is situated in Tel Aviv, Israel, is the parent company of the Leumi Group (hereinafter: "Leumi" or "the Group"), which includes the principal investee companies appearing in the Group Structure Chart in the Corporate Governance Report**.** Bank Leumi and its subsidiary companies constitute one of the largest banking groups in Israel.

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

As a leading banking group in Israel, and in order to achieve suitable profitability over time, Leumi constantly examines the trends and changes in the business environment in which it operates, and formulates strategy to deal with these changes.

**For further details regarding targets and strategy and regarding the Group's main activity lines, see the Board of Directors and Management Report.**

## Risk Management in Leumi - Principal Metrics

### Table 1 - Summary of regulatory ratios and key financial data

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | **2016** | **2016** |
| | NIS millions | | |
| Tier 1 shareholders' equity [(a)] | **33,527** | 31,187 | 32,586 |
| Overall capital[(a)] | **44,832** | 44,025 | 44,436 |
| Credit risk[(a)] | **271,671** | 273,129 | 266,534 |
| Market risk | **6,308** | 6,369 | 4,788 |
| Operational risk | **21,129** | 20,433 | 20,843 |
| Total weighted balances of risk assets | **299,108** | 299,931 | 292,165 |
| | % | | |
| Ratio of Tier 1 shareholders' equity to risk assets[(b)] | **11.21%** | 10.40% | 11.15% |
| Total overall capital to risk assets[(b)] | **14.99%** | 14.68% | 15.21% |
| Liquidity coverage ratio[(c)] | **127%** | 127% | 132% |
| Leverage ratio[(a)] | **6.93%** | 6.51% | 6.77% |
| Rate of balance of allowance for credit losses in respect of credit to the public out of balance of impaired credit to the public | **111.2%** | 114.2% | 110.2% |
| Ratio of problem debts to the whole credit portfolio | **2.7%** | 2.9% | 2.9% |
| Rate of balance of allowance for credit losses out of credit to the public, net | **1.4%** | 1.5% | 1.5% |
| Return on equity | **9.6%** | 10.1% | 9.3% |

(a) These data include adjustments in respect of the efficiency plan set according to a letter of the Supervisor of Banks dated 12 January 2016 on the subject of "Efficiency plan of the Banking System in Israel" (hereinafter – "adjustments in respect of the efficiency plan"), in accordance with aforesaid letter, the reliefs granted for purposes of the capital adequacy and leverage ratios in respect of the efficiency plans approved by the Board of Directors in June 2016 and in July 2017, are being gradually reduced until 30 June 2021 and 30 June 2022 respectively. For further details regarding the impact of the Transitional Provisions and the adjustments in respect of the streamlining plan, see Article D Note 9B – Capital Adequacy, Leverage and Liquidity in the Financial Statements and chapter "Relief in respect of Operational Efficiency Plans" in this Risk Report. An amount of NIS 34 million was reduced from the total weighted balance of risk assets due to adjustments in respect of the efficiency plans (December 31, 2016 – NIS 116 million).

(b) The minimum CET1 ratio and the minimum total capital ratio required as of 1 January 2015 to December 31, 2016 is 9% and 12.5%, respectively, and as of 1 January 2017 they are 10% and 13.5%, respectively. To these ratios, there will be added a capital requirement at a rate reflecting 1% of the balance of housing loans at the reporting date. This requirement was implemented gradually in equal quarterly amounts as of 1 April 2015 to 1 January 2017. In view of this, the minimum CET1 ratio required and the minimum total capital ratio required at the reporting date are 10.26% and 13.76%, respectively.

(c) The Bank's liquidity coverage ratio has been calculated based on the average of daily observations during the reported quarter.

## Capital

### Capital Structure

**Capital attributable to the shareholders of the Bank** as at June 30, 2017 amounted to NIS 32,521 million, compared with NIS 31,347 million at the end of 2016, an increase of 3.7%. The increase is mainly due to net profit for the period.

The ratio of capital to balance sheet at June 30, 2017 reached 7.4%, compared with 7.1% at December 31, 2016.

This capital constitutes the basis for calculating supervisory capital used for calculating the capital adequacy ratio of the Bank with the addition of equity instruments and regulatory adjustments as set out in Proper Conduct of Banking Business Directive No. 202 of the Supervisor of banks.

## Structure of supervisory capital

For purposes of capital adequacy measurement and management, the Bank applies the final directives for implementing Basel III in Israel as adopted as part of Proper Conduct of Banking Business Directives No. 201-211, and the directives of the Banking Supervision Department for the application thereof. These directives came into force on 1 January 2014, subject to the transitional provisions of Proper Conduct of Banking Business Directive No. 299 of the Supervisor of banks.

Measurement of the capital is based on the division of capital into Tier 1 capital (including Common Equity Tier 1 Capital and Additional Tier 1 capital) and Tier 2 capital. The sum of these tiers is called the "capital basis for capital adequacy purposes" or "supervisory capital" or "Total capital".

**Common Equity Tier 1 Capital** includes the capital attributable to the shareholders of the banking corporation in addition to part of minority interests (the non-controlling rights in the capital of consolidated subsidiaries) after deducting goodwill, other intangible assets, regulatory adjustments and other deductions. All as detailed in Proper Conduct of Banking Directive No.202 "Measurement and Capital Adequacy - Supervisory Capital", and subject to the transitional provisions of Proper Banking Directive No. 299 "Measurement and Capital Adequacy- Supervisory Capital – Transitional Provisions". In addition to these, adjustments to Common Equity Tier 1 Capital are included, which derive from the implementation of the efficiency plan and from the method of calculating the discount rate used for calculating the liability for employee benefits, as set forth below.

**Additional Tier 1 capital** comprises capital instruments complying with the criteria determined in Proper Conduct of Banking Business Directive No. 202. There are no capital instruments in this tier in the Leumi Group. In addition, if Tier 1 capital instruments are issued in the future, they will be required to meet all of the criteria detailed in Proper Conduct of Banking Directive No.202.

**Tier 2 capital** includes mainly capital instruments and the remaining collective allowance for credit losses before the effect of tax up to maximum of 1.25% of total credit risk assets.

With regard to capital instruments which were included in Tier 2 capital on 31 December 2013, transitional provisions and recognition ceiling were determined, so that the amount actually recognized for them is the lower of the amortized amount of the instruments themselves and the recognition ceiling based on the balance of the capital instruments included Tier 2 capital on 31 December 2013, which is amortized at the beginning of each year by 10% until 1 January 2022. In 2017 the ceiling of recognition is 50%.

From the beginning of 2014, capital instruments that will be issued for the purposes of their inclusion in capital are required to meet the criteria specified in Proper Conduct of Banking Business Directive No. 202. The main criteria for the instrument to be included are: (1) a mechanism for absorbing the losses of the principal by conversion to ordinary shares or the amortization of the instrument when the CET1 ratio of the banking corporation falls below 5%; (2) a section determining that at the point of non-viability (as defined in Appendix E to Proper Conduct of Banking Business Directive No. 202), the instrument will be converted immediately to ordinary shares or will be written off.

**A description of the main characteristics of regulatory capital instruments issued appears on the Bank's website at http://leumi.co.il/ in the tab About>Financial Information >Disclosure according to Pillar 3 of Basel and additional information on risks.**

### Restrictions on the capital structure

Proper Conduct of Banking Business Directive No. 202 establishes restrictions on the capital structure:

- Tier 2 capital may not exceed 100% of Tier 1 capital after the required deductions from this capital.
- Capital instruments eligible for inclusion in Tier 2 capital shall not exceed 50% of Tier 1 capital after the required deductions from this capital. This limit does not include capital instruments that were included prior to this directive in Upper Tier 2 capital, in the amount of the balance of those instruments as at 31 December 2013 and in accordance with the transitional provisions set forth in Proper Conduct of Banking Business Directive No. 299 (Regulatory Capital – the Transitional Provisions).

## Table 2 - The composition of capital for purposes of calculating the capital ratios (Pillar 3)

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | 2016 | 2016 |
| | NIS millions | | |
| **Capital components for purposes of calculating capital ratios** | | | |
| **1. Common Equity Tier 1 capital[(a)]** | | | |
| Equity attributed to shareholders of the Bank | **32,521** | 30,064 | 31,347 |
| Differences between equity attributed to shareholders of the Bank and Common Equity Tier 1 capital - minority rights | **217** | 232 | 245 |
| Differences between equity attributed to shareholders of the Bank and Common Equity Tier 1 capital- in respect of employee benefits | **451** | 1,046 | 868 |
| Adjustments in respect of the transition between the accounting yield curve and the 8 quarters' average yield curve[(b)] | **50** | 266 | 137 |
| Total Common Equity Tier 1 capital before regulatory adjustments and deductions | **33,239** | 31,608 | 32,597 |
| Regulatory adjustments and deductions | | | |
| Goodwill and intangible assets | **(254)** | (273) | (265) |
| Deferred taxes receivable | **(344)** | (505) | (120) |
| Investments in equity of financial corporations that are not consolidated in reports to the public | **-** | - | - |
| Regulatory adjustments and other deductions -Common Equity Tier 1 capital | **(23)** | (36) | (19) |
| **Total of regulatory adjustments and other deductions -Common Equity Tier 1 capital** | **(621)** | (814) | (404) |
| **Total of adjustments in respect of the efficiency plan[(a)]** | **909** | 393 | 393 |
| **Total Tier 1 shareholders' equity after regulatory adjustments and deductions** | **33,527** | 31,187 | 32,586 |
| **2. Tier 2 capital** | | | |
| Tier 2 capital: instruments before deductions | **8,228** | 9,671 | 8,662 |
| Tier 2 capital: provisions, before deductions | **3,077** | 3,167 | 3,188 |
| **Total of Tier 2 capital before deductions** | **11,305** | 12,838 | 11,850 |
| Deductions: | | | |
| Total of deductions- Tier 2 capital | **-** | - | - |
| **Total Tier 2 capital** | **11,305** | 12,838 | 11,850 |
| **Total capital** | **44,832** | 44,025 | 44,436 |

(a) These data include adjustments in respect of the efficiency plan set according to a letter of the Supervisor of Banks dated 12 January 2016 on the subject of "Efficiency Plan of the Banking System in Israel" (hereinafter – "adjustments in respect of the Efficiency Plan"), in accordance with aforesaid letter, the reliefs granted for purposes of the capital adequacy and leverage ratios in respect of the efficiency plans approved by the Board of Directors in June 2016 and in July 2017, are being gradually reduced until 30 June 2021 and 30 June 2022 respectively. For further details regarding the impact of the Transitional Provisions and the adjustments in respect of the streamlining plan, see Article D Note 9B – Capital Adequacy, Leverage and Liquidity in the Financial Statements and chapter "Relief in respect of Operational Efficiency Plans" in this Risk Report. An amount of NIS 34 million was reduced from the total weighted balance of risk assets due to adjustments in respect of the efficiency plans (December 31, 2016 – NIS 116 million).

(b) In accordance with individual approval from the Banking Supervision Department.

## Table 3 - Composition of regulatory capital (NIS mm) with references to the supervisory balance sheet (Pillar 3)

| | **30 June 2017** | | 30 June 2016 | | 31 December 2016 | | |
|---|---|---|---|---|---|---|---|
| | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Reference to the supervisory balance sheet |
| **Common Equity Tier 1 capital: instruments and retained earnings** | | | | | | | |
| Ordinary share capital issued by the banking corporation and premium on ordinary shares included in Common Equity Tier 1 capital | **8,839** | **-** | 8,831 | - | 8,831 | - | 1 |
| Retained earnings, including dividend proposed or declared after the balance sheet date | **26,166** | **-** | 23,413 | - | 24,792 | - | 2 |
| Accumulated other comprehensive income and retained earnings that were disclosed | **(2,034)** | **(450)** | (1,134) | (1,046) | (1,408) | (868) | 3 |
| Common Equity Tier 1 capital instruments issued by the banking corporation for inclusion in regulatory capital in the transitional period | **-** | **-** | - | - | - | - | - |
| Existing capital injections from the public sector that will be recognized up to 1 January 2018 | **-** | **-** | - | - | - | - | - |
| Ordinary shares issued by subsidiaries of the banking corporation (minority interests) that were consolidated and were held by a third party | **218** | **39** | 232 | 78 | 245 | 81 | 4 |
| Common Equity Tier 1 capital before regulatory adjustments and deductions | **33,189** | **-** | 31,342 | - | 32,460 | - | - |
| **Common Equity Tier 1 capital: regulatory adjustments and deductions** | | | | | | | |
| Stabilization adjustments of valuations | **-** | **-** | - | - | - | - | - |
| Goodwill | **254** | **-** | 273 | - | 264 | - | 6 |
| Other intangible assets excluding mortgage servicing rights, less deferred taxes payable | **-** | **-** | - | - | - | - | 7 |
| Deferred taxes receivable whose use is based on future profitability of the banking corporation | **2** | **-** | 1 | 1 | 1 | 1 | 8 |
| Total accumulated other comprehensive income in respect of cash flow hedges of items not shown in the balance sheet at fair value | **-** | **-** | - | - | - | - | - |
| Shortfall between provision and expected losses | **-** | **-** | - | - | - | - | - |
| Increase in shareholders' equity deriving from securitization transactions | **-** | **-** | - | - | - | - | - |
| Unrealized profits and losses resulting from changes in fair value of liabilities deriving from changes in the own credit risk of the banking corporation. In addition, with reference to liabilities in respect of derivative instruments, all derivative value adjustments (DVA) deriving from the own credit risk of the Bank are to be deducted | **23** | **6** | 36 | 24 | 19 | 13 | 9 |
| Excess of provision over reserve, less deferred taxes payable that will be removed if the asset becomes impaired of will be deleted pursuant to the Public Reporting Directives | **-** | **-** | - | - | - | - | - |

| | **30 June 2017** | | 30 June 2016 | | 31 December 2016 | | |
|---|---|---|---|---|---|---|---|
| | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Reference to the supervisory balance sheet |
| Own investment in ordinary shares, held directly or indirectly (including liability to purchase shares subject to contractual agreements). | **-** | **-** | - | - | - | - | - |
| Mutual cross holdings in ordinary shares of financial corporations | **-** | **-** | - | - | - | - | - |
| Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation does not exceed 10% of the ordinary share capital issued by the financial corporation (in an amount exceeding 10% of Common Equity Tier 1 capital) | **-** | **-** | - | - | - | - | - |
| Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation | **-** | **-** | - | - | - | - | - |
| Mortgage servicing rights whose total exceeds 10% of the Common Equity Tier 1 capital | **-** | **-** | - | - | - | - | - |
| Deferred taxes receivable created as a result of timing differences, whose total exceeds 10% of the Common Equity Tier 1 capital | **1,417** | **354** | 1,488 | 992 | 1,044 | 696 | 10 |
| Total mortgage servicing rights, deferred taxes receivable created a s a result of timing differences and investments exceeding 10% of the ordinary share capital issued by financial corporations, which exceed 15% of the Common Equity Tier 1 capital of the banking corporation | **-** | **-** | - | - | - | - | - |
| Of which: | **-** | **-** | - | - | - | - | - |
| In respect of investments exceeding 10% of the ordinary share capital issued by financial corporations | **-** | **-** | - | - | - | - | - |
| In respect of mortgage servicing rights | **-** | **-** | - | - | - | - | - |
| Of which: deferred taxes receivable created as a result of timing differences | **(2,035)** | **(264)** | (1,642) | (581) | (1,454) | (575) | - |
| Additional regulatory adjustments and deductions determined by the Supervisor of Banks | **-** | **-** | - | - | - | - | - |
| Of which: in respect of investments in capital of financial corporations | **-** | **-** | - | - | - | - | - |
| Of which: in respect of mortgage servicing rights | **(72)** | **-** | (377) | - | (199) | - | - |
| Of which: in respect of calculating capital base, based on eight-quarter average discount rate of liability. | **(909)** | **-** | (393) | - | (393) | - | - |
| Of which: additional regulatory adjustments to Common Equity Tier 1 capital | **(1,054)** | **(264)** | (873) | (581) | (862) | (575) | - |

| | 30 June 2017 | | 30 June 2016 | | 31 December 2016 | | |
|---|---|---|---|---|---|---|---|
| | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Reference to the supervisory balance sheet |
| Adjustments applicable to Common Equity Tier 1 capital as there is insufficient capital in Additional Tier 1 capital and Tier 2 capital to cover the deductions | **-** | - | - | - | - | - | - |
| Total of all regulatory adjustments and deductions to Common Equity Tier 1 capital | **(339)** | - | 155 | - | (126) | - | - |
| Common Equity Tier 1 capital | **33,527** | - | 31,187 | - | 32,586 | - | - |
| **Additional Tier 1 capital : instruments** | **-** | - | - | - | - | - | - |
| Additional Tier 1 share capital instruments issued by the banking corporation and premium on these instruments | **-** | - | - | - | - | - | - |
| Of which: classified as share capital pursuant to the Public Reporting Directives | **-** | - | - | - | - | - | - |
| Of which: classified as liability pursuant to the Public Reporting Directives | **-** | - | - | - | - | - | - |
| Additional Tier 1 capital : Instruments issued by the corporation that are eligible for inclusion in regulatory capital in the transitional period | **-** | - | - | - | - | - | - |
| Additional Tier 1 capital instruments issued by subsidiaries of the banking corporation and held by third party investors | **-** | - | - | - | - | - | - |
| Of which: additional Tier 1 capital instruments issued by subsidiaries of the banking corporation and held by third party investors, that are deducted gradually from | **-** | - | - | - | - | - | - |
| Additional Tier 1 capital before deductions | **-** | - | - | - | - | - | - |
| **Additional Tier 1 capital: deductions** | **-** | - | - | - | - | - | - |
| Own investment in capital instruments included in Tier 1 shareholders' equity, held directly or indirectly (including liability to purchase instruments subject to contractual agreements) | **-** | - | - | - | - | - | - |
| Mutual cross holdings in ordinary shares of financial corporations included in additional Tier 1 capital | **-** | - | - | - | - | - | - |
| Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation does not exceed 10% of the ordinary share capital issued by the financial corporation | **-** | - | - | - | - | - | - |

| | 30 June 2017 | | 30 June 2016 | | 31 December 2016 | | |
|---|---|---|---|---|---|---|---|
| | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Reference to the supervisory balance sheet |
| Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation exceeds 10% of the ordinary share capital issued by the financial corporation | **-** | **-** | - | - | - | - | - |
| Additional deductions determined by the Supervisor of Banks | **-** | **-** | - | - | - | - | - |
| Of which: in respect of investments in capital of financial corporations | **-** | **-** | - | - | - | - | - |
| Of which: additional deductions in Common Equity Tier 1 capital | **-** | **-** | - | - | - | - | - |
| Deductions in Additional Tier 1 capital that are subject to treatment required before adoption of Directive 202 pursuant to Basel III | **-** | **-** | - | - | - | - | - |
| Deductions applying to Additional Tier 1 capital since there is insufficient Tier 2 capital to cover the deductions | **-** | **-** | - | - | - | - | - |
| Total of all deductions in Additional Tier 1 capital | **-** | **-** | - | - | - | - | - |
| Additional Tier 1 capital | **-** | **-** | - | - | - | - | - |
| Common Equity Tier 1 capital | **33,527** | **-** | 31,187 | - | 32,586 | - | - |
| **Tier 2 capital: Instruments and allowances** | | | | | | | |
| Instruments issued by the banking corporation (that are not included in Common Equity Tier 1 capital) and premium on these instruments | **926** | **-** | 926 | - | 926 | - | א11 |
| Tier 2 capital instruments issued by the corporation that are eligible to be included in the regulatory capital in the transitional period | **7,272** | **-** | 8,726 | - | 7,715 | - | 11 |
| Tier 2 capital instruments issued by subsidiaries of the banking corporation to third party investors | **30** | **-** | 19 | - | 21 | - | 5 |
| Of which: Tier 2 capital instruments issued by subsidiaries of the banking corporation and held by third party investors, that are deducted gradually from Tier 2 capital | **30** | **-** | 19 | - | 21 | - | - |
| Collective allowances for credit losses by the relevant tax effect | **3,077** | **-** | 3,167 | - | 3,188 | - | 12 |
| Tier 2 capital before deductions | **11,305** | **-** | 12,838 | - | 11,850 | - | - |
| **Tier 2 capital: deductions** | | | | | | | |
| Own investment in Tier 2 capital instruments, held directly or indirectly (including liability to purchase instruments subject to contractual agreements). | **-** | **-** | - | - | - | - | - |
| Mutual cross holdings in Tier 2 capital of financial corporations | **-** | **-** | - | - | - | - | - |

| | **30 June 2017** | | 30 June 2016 | | 31 December 2016 | | |
|---|---|---|---|---|---|---|---|
| | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Reference to the supervisory balance sheet |
| Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation does not exceed 10% of the ordinary share capital issued by the financial corporation | **-** | - | - | - | - | - | - |
| Investments in capital of financial corporations not consolidated in the reports to the public of the banking corporation, where the holding of the banking corporation exceeds 10% of the ordinary share capital issued by the financial corporation | **-** | - | - | - | - | - | - |
| Additional deductions determined by the Supervisor of Banks | **-** | - | - | - | - | - | - |
| Of which: in respect of investments in capital of financial corporations | **-** | - | - | - | - | - | - |
| Of which additional deductions in Tier 2 capital | **-** | - | - | - | - | - | - |
| **Regulatory adjustments in Common Equity Tier 1 capital subject to treatment required before adoption of Directive 202 pursuant to Basel III** | | | | | | | |
| Total regulatory adjustments to Tier 2 capital | **-** | - | - | - | - | - | - |
| Tier 2 capital | **11,305** | - | 12,838 | - | 11,850 | - | - |
| Total capital | **44,832** | - | 44,025 | - | 44,436 | - | - |
| Total risk assets weighted in accordance with the treatment required before adoption of Directive 202 pursuant to Basel III | **90** | - | 411 | - | 122 | - | - |
| Of which: other deferred tax assets | **90** | - | 411 | - | 122 | - | 13 |
| Total weighted risk assets | **299,108** | - | 299,931 | - | 292,165 | - | - |
| **Capital ratios and capital buffers** | | | | | | | |
| Common Equity Tier 1 capital (as percentage of weighted risk assets) | **11.21%** | - | 10.40% | - | 11.15% | - | - |
| Tier 1 capital (as percentage of weighted risk assets) | **11.21%** | - | 10.40% | - | 11.15% | - | - |
| Total capital (as percentage of weighted risk assets) | **14.99%** | - | 14.68% | - | 15.21% | - | - |
| Minimum Common Equity Tier 1 capital determined by the Supervisor of Banks | **10.26%** | - | 9.17% | - | 9.24% | - | - |
| Minimum Tier 1 capital determined by the Supervisor of Banks | **-** | - | - | - | - | - | - |
| Minimum total capital determined by the Supervisor of Banks | **13.76%** | - | 12.67% | - | 12.74% | - | - |

| | 30 June 2017 | | 30 June 2016 | | 31 December 2016 | | |
|---|---|---|---|---|---|---|---|
| | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Supervisory capital | Amounts not deducted from the capital that are subject to the treatment required before adoption of Directive 202 pursuant to Basel III | Reference to the supervisory balance sheet |
| **Amounts below the deduction threshold (before risk weighting)** | | | | | | | |
| Investments in capital of financial corporations (excluding banking corporations and their subsidiaries) not exceeding 10% of the ordinary share capital issued by the financial corporation and that are below the deduction threshold | **341** | - | 408 | - | 455 | - | 14 |
| Investments in capital of financial corporations (excluding banking corporations and their subsidiaries) exceeding 10% of the ordinary share capital issued by the financial corporation and that are below the deduction threshold | **252** | - | 240 | - | 249 | - | 15 |
| Mortgage servicing rights | **-** | - | - | - | - | - | - |
| Deferred taxes receivable created as a result of timing differences that are below the deduction threshold | **3,359** | - | 3,158 | - | 3,262 | - | 16 |
| **Ceiling for inclusion of allowances in Tier 2** | | | | | | | |
| Allowance eligible for inclusion in Tier 2 with reference to exposures under the Standardized Approach, before implementation of the ceiling | **3,077** | - | 3,167 | - | 3,188 | - | - |
| Ceiling for inclusion in Tier 2 under the Standardized Approach | **3,396** | - | 3,414 | - | 3,332 | - | - |
| Allowance eligible for inclusion in Tier 2 with reference to exposures under the Internal Ratings Approach, before implementation of the ceiling | **-** | - | - | - | - | - | - |
| Ceiling for inclusion in Tier 2 under the Internal Ratings Approach | **-** | - | - | - | - | - | - |
| **Capital instruments not eligible as regulatory capital subject to the transitional provisions** | | | | | | | |
| Amount of the present ceiling for instruments included in Common Equity Tier 1 capital subject to the transitional provisions | **-** | - | - | - | - | - | - |
| Amount deducted from Common Equity Tier 1 capital due to the ceiling | **-** | - | - | - | - | - | - |
| Amount of the present ceiling for instruments included in Additional Tier 1 capital subject to the transitional provisions | **-** | - | - | - | - | - | - |
| Amount deducted from Additional Tier 1 due to the ceiling | **-** | - | - | - | - | - | - |
| Amount of the present ceiling for instruments included in Tier 2 capital subject to the transitional provisions | **7,272** | - | 8,726 | - | 8,726 | - | - |
| Amount deducted from Tier 2 capital due to the ceiling | **34** | - | 659 | - | - | - | - |

**Table 4 - Composition of the supervisory balance sheet with references to components of supervisory capital (Pillar 3)**

| | 30 June | | 31 December | References to regulatory capital components |
|---|---|---|---|---|
| | 2017 | 2016 | 2016 | |
| | NIS millions | | | |
| **Assets** | | | | |
| Cash and deposits in banks | **69,352** | 57,881 | 74,757 | - |
| Securities[1] | **78,470** | 84,872 | 77,201 | - |
| [1]Of which: investments in capital of financial corporations that do not exceed 10% of the share capital of the financial corporation | **341** | 408 | 455 | 14 |
| [1]Of which: Other securities | **78,129** | 84,464 | 76,746 | - |
| Credit to the public | **267,786** | 269,602 | 265,450 | - |
| Allowance for credit losses[1] | **(3,302)** | (3,554) | (3,537) | - |
| [1]Of which: collective allowance for credit losses included in Tier 2 | **(2,712)** | (2,846) | (2,854) | 12 |
| [1]Of which: allowance for credit losses not included in regulatory capital | **(590)** | (708) | (683) | - |
| Credit to the public, net | **264,484** | 266,048 | 261,913 | - |
| Credit to governments | **619** | 480 | 642 | - |
| Investments in companies included on equity basis[1] | **883** | 923 | 901 | - |
| [1]Of which: investments in capital of financial corporations that exceed 10% of the share capital of the financial corporation | **252** | 240 | 249 | 15 |
| [1]Of which: goodwill | **238** | 255 | 246 | 6 |
| [1]Of which: intangible asset | **-** | - | - | 7 |
| Buildings and equipment | **2,954** | 3,042 | 3,147 | - |
| Other assets[1] | **7,797** | 8,662 | 8,087 | - |
| [1]Of which: deferred tax assets[2] | **5,062** | 5,586 | 4,960 | - |
| [2]Of which: deferred tax assets except for those attributed to timing differences | **2** | 1 | 1 | 8 |
| [2]Of which: deferred tax liability in respect of intangible assets | **-** | - | - | 7 |
| [2]Of which: deferred taxes attributed to timing differences, whose total exceeds 10% of the Tier 1 shareholders' equity | **1,415** | 1,487 | 1,044 | 10 |
| [2]Of which: deferred taxes attributed to timing differences, whose total does not exceed 10% of the Tier 1 shareholders' equity | **3,359** | 3,158 | 3,262 | 16 |
| [2]Of which: other deferred tax assets pursuant to the transitional provisions | **286** | 939 | 652 | 13 |
| [1]Of which: additional other assets | **2,735** | 3,076 | 3,127 | - |
| Intangible assets and goodwill | **16** | 17 | 17 | - |
| [1]Of which: goodwill | **16** | 17 | 17 | 6 |
| [1]Of which: intangible asset | **-** | - | - | 7 |
| Securities borrowed or purchased under repurchase agreements | **1,031** | **1,476** | 1,284 | - |
| Assets in respect of derivative instruments | **11,361** | **12,999** | 10,654 | - |
| Total assets | **436,967** | 436,400 | 438,603 | - |

| | 30 June | | 31 December | References to regulatory capital components |
|---|---|---|---|---|
| | **2017** | 2016 | 2016 | |
| | NIS millions | | | |
| **Liabilities and capital** | | | | |
| Deposits from the public | **342,766** | 339,998 | 346,854 | - |
| Deposits from banks | **4,330** | 4,165 | 3,394 | - |
| Deposit from governments | **625** | 686 | 900 | - |
| Debentures and subordinated notes[1] | **22,337** | 24,151 | 22,640 | - |
| [1]Of which subordinated notes not recognized as supervisory capital | **14,139** | 14,499 | 14,000 | - |
| [1]Of which subordinated notes recognized as supervisory capital[2] | **8,198** | 9,652 | 8,640 | - |
| [2]Of which: eligible as supervisory capital components | **926** | 926 | 926 | 11(a) |
| [2]Of which: ineligible as supervisory capital components and subject to transitional provisions | **7,272** | 8,726 | 7,714 | 11 |
| Other liabilities | **21,694** | 22,455 | 21,885 | - |
| [1]Of which: collective allowance for credit losses included in Tier 2 | **365** | 321 | 334 | 12 |
| Securities lent and sold under repurchase agreements | **244** | 789 | 539 | - |
| Liability in respect of derivative instruments[1] | **12,078** | 13,743 | 10,677 | - |
| [1]Of which; in respect of own credit risk | **29** | 60 | 32 | 9 |
| Total liabilities | **404,074** | 405,987 | 406,889 | - |
| Non-controlling interests[1] | **372** | 349 | 367 | - |
| [1]Of which: non-controlling interests that can be attributed to Tier 1 shareholders' equity | **217** | 232 | 245 | 4 |
| [1]Of which: non-controlling interests that can be attributed to Tier capital | **30** | 19 | 21 | 5 |
| Capital attributed to shareholders of the banking corporation[1] | **32,521** | 30,064 | 31,347 | - |
| [1]Of which: ordinary share capital | **7,110** | 7,109 | 7,109 | 1 |
| [1]Premium on ordinary shares | **1,729** | 1,722 | 1,722 | 1 |
| [1]Of which: retained earnings | **26,166** | 23,413 | 24,792 | 2 |
| [1]Of which: unrealized profits (losses) from adjustments of securities available for sale to fair value | **(89)** | 440 | (84) | 3 |
| [1]Of which: net losses from adjustments from translation of financial statements | **(179)** | (9) | (53) | 3 |
| [1]Of which: other reserves | **38** | 5 | 30 | 3 |
| [1]Of which: Profits (losses) from adjustments in respect of employee benefits included in regulatory capital | **(1,804)** | (1,570) | (1,301) | 3 |
| [1]Of which: Profits (losses) from adjustments in respect of employee benefits not included in regulatory capital | **(451)** | (1,046) | (868) | - |
| Total shareholders' equity | **32,893** | **30,413** | **31,714** | - |
| **Total liabilities and capital** | **436,967** | **436,400** | **438,603** | **-** |

## Table 5 - Report on the changes in the composition of regulatory capital (EDTF)

| | For the three months ended 30 June | | For the six months ended 30 June | | For the year ended 31 December |
|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | 2016 |
| | **NIS millions** | | | | |
| **Common Equity Tier 1 capital** | | | | | |
| Balance at the beginning of the period [(a)] | **32,965** | 29,719 | **32,586** | 29,001 | 29,001 |
| Issuance not for cash | **1** | 1 | **1** | 50 | 50 |
| Increase in premium | **7** | 6 | **7** | 593 | 593 |
| Net profit for the period | **752** | 970 | **1,374** | 1,429 | 2,791 |
| Surplus funds in respect of associate companies | **-** | - | **6** | 3 | 17 |
| Unrealized profits (losses) from adjustment of securities available for sale | **(16)** | 275 | **(5)** | 371 | (153) |
| Capital reserve for share-based payment transactions | **2** | (7) | **2** | (7) | (7) |
| Capital reserves in respect of employee benefits | **(334)** | (321) | **(502)** | (974) | (664) |
| Effect of the efficiency plan | **254** | 283 | **323** | 283 | 308 |
| The transitional effect of changing to the pension liability discount rate according to an eight-quarter moving average | **(27)** | 266 | **(84)** | 266 | 137 |
| Movement in translation difference fund in respect of subsidiaries | **(63)** | 40 | **(126)** | (16) | (73) |
| Minority interests | **4** | 8 | **(29)** | (30) | (17) |
| **Deductions** | | | | | |
| Goodwill and intangible assets | **5** | - | **10** | - | 9 |
| Deferred taxes in respect of future profitability | **-** | 1 | **(1)** | 1 | 1 |
| Change in deferred taxes as a result of discounting the pension liability according to an eight-quarter moving average rate | **(11)** | 111 | **(43)** | 111 | 63 |
| Change in deferred taxes as a result of the efficiencyplan | **174** | 111 | **192** | 111 | 84 |
| Deferred taxes in respect of timing differences | **(189)** | (253) | **(179)** | 25 | 458 |
| Accumulated profits/losses resulting from changes in own credit risk on financial liabilities at fair value | **3** | (23) | **(4)** | (30) | (13) |
| Net increase in Tier 1 shareholders' equity | **562** | 1,468 | **941** | 2,186 | 3,585 |
| Balance at the end of the period | **33,527** | 31,187 | **33,527** | 31,187 | 32,586 |
| **Tier 2 capital** | | | | | |
| Balance at the beginning of the period | 11,369 | 12,890 | **11,850** | 12,593 | 12,593 |
| Amortization of subordinated notes pursuant to the transitional provisions | **-** | - | **(443)** | (711) | (1,723) |
| Eligible subordinated notes | **-** | - | **-** | 926 | 926 |
| Minority interests | **1** | - | **9** | 7 | 9 |
| Expenses in respect of collective allowance | **(65)** | (53) | **(110)** | 23 | 45 |
| Net decrease in Tier 2 capital | **(64)** | (53) | **(545)** | 245 | (743) |
| Balance at the end of the period | **11,305** | 12,838 | **11,305** | 12,838 | 11,850 |
| Total overall capital at the end of the year | **44,832** | 44,025 | **44,832** | 44,025 | 44,436 |

See notes on next page.

(a) The changes in the regulatory capital in the three-month period ended 30 June, 2017 derive mainly from the net profit for the period in the amount of NIS 876 million, after offsetting a dividend for the period in the amount of NIS 124 million, an increase in the negative balance of the fund in respect of employee benefits in the amount of NIS 334 million, and an increase in capital in the amount of NIS 254 million as a result of the initial implementation of the relief in respect of the efficiency plan approved in July 2017, which was offset as a result of the reduction of 20% of the relief granted in connection with the efficiency plan approved in June 2016.

The changes in the regulatory capital in the three-month period ended 30 June, 2016 derive mainly from the net profit for the period of NIS 970 million, an increase in unrealized profits from adjustments of securities available for sale in the amount of NIS 275 million, an increase in the negative balance of the fund in respect of employee benefits In the amount of NIS 321 million, an increase in capital due to the effect of the relief (net of tax) in respect of the efficiency plan approved in June 2016 in the amount of NIS 283 million and an increase in capital as a result of the effect of the relief (net of tax) in respect of the change to discounting pension liability according to an average yield curve of eight quarters in the amount of NIS 266 million.

The changes in the regulatory capital in the six-month period ended 30 June, 2017 derive mainly from the net profit for the period in the amount of NIS 1,498 million, after offsetting a dividend for the period of NIS 124 million, an increase in the negative balance of the reserve in respect of employee benefits in the amount of NIS 502 million mainly as a result of the reduction of the transitional provisions in respect of deductions from capital of 20% and an increase in capital in the amount of NIS 323 million, mainly as a result of the initial implementation of the relief in respect of the efficiency plan approved in July 2017, which was offset as a result of a 20% reduction in the relief given for the efficiency plan approved in June 2016. In addition, there was a decrease of NIS 443 million in supervisory capital instruments in Tier 2, due to the effect of the decrease in the recognition ceiling from 60% to 50% for those instruments which are no longer eligible and subject to amortization in accordance with the transitional provisions.

The changes in the regulatory capital for the six-month period ended 30 June, 2016 derive mainly from the net profit for the period in the amount of NIS 1,429 million, the issue of shares to employees and officers and a premium thereon in the amount of NIS 643 million, an increase in unrealized profits from adjustments of securities available for sale in the amount of NIS 371 million, an increase in the balance of the negative reserve in respect of employee benefits in the amount of NIS 974 million, an increase in capital due to the effect of the relief (net of tax) in respect of the efficiency plan approved in June 2016, in the amount of NIS 283 million, and an increase in capital due to the effect of the relief (net of tax) in respect of the change to discounting the pension liability according to an average yield curve of eight quarters of NIS 266 million. In addition, there was a decrease in supervisory capital instruments in the amount of NIS 711 million, due to the effect of the decrease in the recognition ceiling from 70% to 60% in respect of these instruments which are no longer eligible and are subject to amortization in accordance with the transitional provisions and an increase in supervisory capital instruments from the issue of eligible subordinated notes in the amount of NIS 926 million.

The changes in regulatory capital in 2016 derive mainly from the net profit for the period in the amount of NIS 2,791 million, the issue of shares to employees and officers and a premium thereon in the amount of NIS 643 million, an increase in unrealized losses from adjustments of securities available for sale in the amount of NIS 153 million, An increase in negative capital reserves in respect of employee benefits in the amount of NIS 664 million, an increase in capital due to the effect of the relief (net of tax) in respect of the efficiency plan approved in June 2016 in the amount of NIS 308 million (pursuant to the letter of the Banking Supervision Department dated 12 January, 2016 on "Operational streamlining of the banking system in Israel", charged over five years from 30 June, 2016 onwards), a decrease in supervisory capital instruments in the amount of NIS 1,723 million due to the effect of the decrease in the recognition ceiling from 70% to 60% for these instruments which are no longer eligible and are subject to amortization in accordance with the transitional provisions and an increase in supervisory capital instruments resulting from the issuance of eligible subordinated notes in the amount of NIS 926 million.

**For details regarding steps taken for the purpose of strengthening the capital adequacy, see the 2016 Report on Risks.**

**Capital adequacy**

The Bank applies the measurement and capital adequacy instructions based on the Basel III provisions, as adopted by the Banking Supervision Department and as incorporated in Proper Conduct of Banking Business Directives 201-211, as well as within the framework of the provisions for the implementation thereof. The Basel provisions requires capital management within three pillars:

- Pillar 1 – includes the method of calculating the minimal regulatory capital in respect of credit risk, operational risk and market risk. When applying Pillar 1 requirements, the Bank applies the standard approach regarding all of the Bank's exposures and the current exposure approach regarding counterparty exposures.
- Pillar 2 – (ICAAP – Internal Capital Adequacy Assessment Process) outlines the internal procedures in the Bank which are used for evaluating the required capital in respect of all risks, including those which are not covered by Pillar 1, such as concentrations of credit, interest rate risk in the banking book and pension risk. In parallel, the Banking Supervision Department conducts a review process.
- Pillar 3 – Market discipline. This Pillar determines the scope of the information and the manner of its presentation as part of the report to the public regarding the risks to which the Bank is exposed. As part of this pillar, disclosures which are included in the Report on Risks are required.

The capital ratios are calculated as the ratio of capital to weighted risk assets. The CET1 ratio is calculated as the ratio of Common Equity Tier 1 capital to weighted risk assets, and the total capital ratio is calculated as the ratio of overall capital to weighted risk assets.

**Capital adequacy targets prescribed by the Bank of Israel:**

Pursuant to Proper Conduct of Banking Business Directive No. 201, "Measurement and Capital Adequacy – Introduction, Application and Calculation of Requirements", a large banking corporation, whose total balance sheet assets on a consolidated basis constitute at least 20% of the balance sheet assets in the banking system in Israel is required to comply with a minimum CET1 ratio of 10% and a minimum total capital ratio of 13.5%, as of 1 January 2017. This requirement applies to Leumi.

Furthermore, pursuant to the amended Proper Conduct of Banking Business Directive No. 329 - "Limits on the Granting of Housing Loans", a banking corporation is required to increase the Common Equity Tier 1 capital target and the total capital target by a rate expressing 1% of the balance of housing loans. This requirement was gradually applied over eight quarters until 1 January 2017, and its effect was 0.26% in the capital ratio. In light of this, the minimum capital requirements applicable to the Bank as at June 30, 2017 are 10.26% for the CET1 ratio, and 13.76% for the total capital ratio.

**Capital adequacy targets prescribed by the Bank:**

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

As part of the supervisory review process, the Supervisor of Banks instructed the determination of internal capital targets which will suit the Bank's risk profile. Further thereto, the Board of Directors of the Bank approved an increase in the Bank's internal Common Equity Tier 1 capital such that as of 31 December 2017, it will stand at 10.5%.

## Adjustments to CET1

### Measurement of liabilities in respect of employee benefits

The accounting standard for employee benefits which was first implemented in January 2015, is a factor that significantly impacts Leumi's Common Equity Tier 1 capital, particularly due to the fact that the measurement of the liability is in accordance with market interest rates, which are at historically low levels, and also due to the high volatility that this type of measuring creates in the Bank's regulatory capital.

In July 2016 the Bank received specific approval from the Bank of Israel regarding the method of calculation of the discount rate which will be used to calculate the liability for employee benefits for the measurement of regulatory capital. Pursuant to the approval, the discount rate is calculated based on the moving average of the market yields, for a period of eight quarters, ending on the reporting date. The change is effective for the financial statements for the period ended 30 June 2016 to the financial statements dated 31 December 2020 (inclusive). Changing the method is significantly moderating the volatility in the Bank's supervisory capital resulting from changes in the discount rate

**For further information regarding the discounting methodology, see the chapter on Accounting Policy and Estimates in Critical Subjects in the Report of the Board of Directors and Management.**

## Relief in respect of the operation efficiency plans

In January 2016, the Supervisor of Banks published a circular regarding "Operational efficiency plan of the Banking System in Israel". Pursuant to this circular, a banking corporation which meets the conditions defined will receive relief, according to which it can amortize the effect of the plan on the capital adequacy and leverage ratios over five years on a straight-line basis.

In June 2016, the Board of Directors of the Bank approved the efficiency plan, whose cost amounted to approximately NIS 438 million (after tax). In June 2017, 20% of the costs of the plan have been attributed to the regulatory capital.

In June 2017, the Banking Supervision Department published a circular regarding "Operational efficiency plan of the Banking System in Israel- Efficiency in the Real Estate sector", the circular extended the validity of the relief in respect of human resources until the end of June 2018. In July 2017, the Bank's Board of the Directors approved an additional efficiency plan, whose cost is estimated at NIS 394 million (after tax), and its effect on the on the capital ratio and leverage ratio will amortize over five years on a straight-line basis, every quarter.

## Additional regulatory changes

### Capital requirements for exposures to central counterparties

In October 2015, the Banking Supervision Department issued a circular entitled "Capital Requirements for Exposures to Central Counterparties" This circular sets out the new instructions that will apply to exposures to central counterparties incurred by trading OTC derivatives, by trading derivatives quoted on the exchange and by securities financing transactions.

In June 2017 the Banking Supervision Department approved the TASE Clearing House and MAOF Clearing House as qualified central counterparties (QCCP) for capital requirements' calculation purposes in respect of exposures to central counterparties (as mentioned in Annex C of Directive No. 203).

**For further information, see Note 9B of the financial statements.**

**Below is an analysis of the sensitivity to the main factors affecting Leumi Group's capital adequacy:**

- Changing the total of risk assets – Leumi's risk assets at the end of June 2017 amounted to approximately NIS 299.1 billion. Each 1% increase in risk assets (about NIS 3 billion) will reduce the CET1 ratio by 0.11%, and the total capital ratio by 0.15%.
- Accumulated profit or a change in the capital reserve – the Common Equity Tier 1 capital of Leumi at the end of June 2017 amounts to NIS 33.5 billion. Total capital amounts to about NIS 44.8 billion. Any accumulation of net profit and/or positive movement in the capital reserve in the amount of NIS 1 billion, will improve the CET1 ratio and the total capital ratio by 0.33%.
- Obligations regarding employee benefits – the actuarial liability for employees discounted according to an eight-quarter moving average of market interest rates affected by the Israeli government bonds curve and the US AA corporate bonds spread. An increase of 0.1% over the yield curve for discounting, assuming a parallel shift, means an increase of approximately 0.07% with respect to CET1 ratio and total capital ratio. Out of this, according to a moving average calculation for eight quarters, an increase of about 0.01% in the CET1 ratio and in the total capital ratio for the current quarter.

The aforesaid information regarding capital adequacy and its management relates to future operations of the Bank and constitutes "forward looking information". For the meaning of this term, see the section "Forward looking information".

## The Group's capital planning

The management of capital is a process which is meant to ensure that the Group complies with the minimum capital requirements (which are part of the risk appetite statement), while fulfilling the business strategy for future years.

Capital planning takes into account the growth in the activity of the various profit centers in the Group and other factors affecting the Bank's compliance with capital requirements, such as profits forecast, changes included in other comprehensive income, regulatory adjustments and the effect of transitional provisions, the rate of increase in the risk assets.

**For further information regarding the Group's capital planning, see the 2016 Report on Risks.**

## Dividend distribution policy

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

On 14 August 2017 the Board of Directors approved the distribution of a dividend in the amount of NIS 175 million, in accordance with the said policy.

## Details of dividend paid

| Announcement date | Payment date | Dividend per share | Dividend paid in cash |
|---|---|---|---|
| | | In agorot | In NIS million |
| 25 May 2017 | 22 June 2017 | 8.168 | 124 |

**For further details, see Note 9B in the financial statements.**

## Table 6- The ratio of capital adequacy to risk components

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | 2016 | 2016 |
| | NIS million | | |
| **Data** | | | |
| **Capital for purposes of calculating capital ratio** | | | |
| Tier 1 shareholders' equity, after regulatory adjustments and deductions [(a)] | **33,527** | 31,187 | 32,586 |
| Tier 2 capital, after deductions | **11,305** | 12,838 | 11,850 |
| Total capital [(a)] | **44,832** | 44,025 | 44,436 |
| **Weighted balances of risk assets** | | | |
| Credit risk [(a)] | **271,671** | 273,129 | 266,534 |
| Market risk | **6,308** | 6,369 | 4,788 |
| Operational risk | **21,129** | 20,433 | 20,843 |
| Total weighted balances of risk assets | **299,108** | 299,931 | 292,165 |
| **Ratio of capital to risk assets** | | | |
| Ratio of Tier 1 shareholders' equity to risk assets | **11.21%** | 10.40% | 11.15% |
| Ratio of total capital to risk assets | **14.99%** | 14.68% | 15.21% |
| Minimum Tier 1 shareholders' equity required by the Supervisor of Banks[(b)] | **10.26%** | 9.17% | 9.24% |
| Minimum overall capital ratio required by the Supervisor of Banks[(b)] | **13.76%** | 12.67% | 12.74% |
| **B. Major subsidiary companies:** | | | |
| **Leumi Card** | | | |
| Ratio of Tier 1 shareholders' equity to risk components | **16.00%** | 16.82% | 16.81% |
| Ratio of total capital to risk components | **17.00%** | 17.76% | 17.79% |
| **Bank Leumi USA: [(c)]** | | | |
| Ratio of Tier 1 shareholders' equity to risk components | **11.72%** | 12.79% | 12.21% |
| Ratio of total capital to risk components | **14.18%** | 15.47% | 14.75% |

(a) These data include adjustments in respect of the efficiency plan set according to a letter of the Supervisor of Banks dated 12 January 2016 on the subject of "Efficiency Plan of the Banking System in Israel" (hereinafter – "adjustments in respect of the Efficiency Plan"), in accordance with aforesaid letter, the reliefs given for purposes of the capital adequacy ratio and leverage ratio in respect of the efficiency plans approved by the Board of Directors in June 2016 and in July 2017, are being gradually reduced until 30 June 2021 and 30 June 2022 respectively. For further details regarding the impact of the Transitional Provisions and the adjustments in respect of the efficiency plan, see Paragraph D in Note 9B – Capital Adequacy, Leverage and Liquidity in the Financial Statements and the chapter "Relief in respect of Operational Efficiency Plans" in this Risk Report. An amount of NIS 34 million was reduced from the total weighted balance of risk assets due to adjustments in respect of the efficiency plans (December 31, 2016 – NIS 116 million).

(b) The minimum CET1 ratio and total capital ratio required as of 1 January 2015 to December 31, 2016 are 9% and 12.5%, respectively, and as of 1 January 2017 they are 10% and 13.5%, respectively. To these ratios, there will be added a capital requirement at a rate reflecting 1% of the balance of housing loans at the reporting date. This requirement was implemented gradually in equal quarterly amounts as of 1 April 2015 to 1 January 2017. In view of this, the minimum CET1 ratio required and the minimum total capital ratio required at the reporting date are 10.26% and 13.76% respectively.

(c) Capital requirements are in accordance with the local regulation that applies to Leumi USA.

## The effect of transitional provision on CET1

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | 2016 | 2016 |
| | **%** | | |
| **Capital ratio to risk components** | | | |
| CET1 ratio to risk components before the effect of transitional provisions and before adustments are made in respect of the efficiency plan | **10.70%** | 9.81% | 10.66% |
| The effect of transitional provisions [(a)] | **0.20%** | 0.46% | 0.35% |
| CET1 ratio to risk components before the adustments made in respect of the efficiency plan | **10.90%** | 10.27% | 11.01% |
| The effect of adustments made in respect of the efficiency plan[(b)] | **0.31%** | 0.13% | 0.14% |
| CET1 ratio to risk components | **11.21%** | 10.40% | 11.15% |

(a) According to the transitional provisions, the Bank calculates deductions from capital and other regulatory adjustments at a gradual rate, until full implementation, commencing 1 January 2018.

(b) These data include adjustments in respect of the efficiency plan set according to a letter of the Supervisor of Banks dated 12 January 2016 on the subject of "Efficiency Plan of the Banking System in Israel" (hereinafter – "adjustments in respect of the Efficiency Plan"), in accordance with aforesaid letter, the reliefs given for purposes of the capital adequacy ratio and leverage ratio in respect of the efficiency plans approved by the Board of Directors in June 2016 and in July 2017 reducing gradually until 30 June 2021 and 30 June 2022, respectively.

**Table 7 - Risk assets and capital requirements in respect of credit risk, market risk and operational risk (Pillar 3)**

Measuring the exposures to the different risks is based on the balances in the Bank's books, as prepared in accordance with the generally accepted accounting principles applicable to the Bank and in accordance with the specific calculation provisions set forth in Proper Conduct of Banking Business Directives 203-209. The measurement may vary according to changes in these rules and provisions and other changes, such as changes in the size and composition of the portfolio, changes in portfolio quality and economic data and changes in calculation methods. The risk exposures presented below are based on the rules defined for calculating the regulatory capital required in order to support these risks.

| | Basel III | | | | | |
|---|---|---|---|---|---|---|
| | 30 June | | | | 31 December | |
| | **2017** | | 2016 | | 2016 | |
| | Risk assets | Capital requirements (a)(b) | Risk assets | Capital requirements (a)(b) | Risk assets | Capital requirements (a)(b) |
| | NIS millions | | | | | |
| Sovereign debts | **1,242** | **171** | 985 | 125 | 1,038 | 133 |
| Debts of public sector entities | **3,426** | **471** | 2,968 | 376 | 3,381 | 432 |
| Debts of banking corporations | **3,766** | **518** | 3,165 | 401 | 3,208 | 410 |
| Debts of securities | **278** | **38** | 206 | 26 | 173 | 22 |
| Debts of corporations | **95,112** | **13,087** | 98,532 | 12,484 | 94,582 | 12,078 |
| Debts collateralised by commercial real estate | **52,097** | **7,169** | 52,884 | 6,700 | 50,228 | 6,414 |
| Retail exposures to individuals | **36,225** | **4,985** | 34,908 | 4,423 | 35,512 | 4,535 |
| Small business loans | **12,621** | **1,737** | 11,710 | 1,484 | 12,074 | 1,542 |
| Housing mortgages | **43,670** | **6,009** | 45,231 | 5,731 | 43,972 | 5,615 |
| Securitization | **418** | **58** | 498 | 63 | 490 | 63 |
| Other assets | **21,166** | **2,912** | 20,353 | 2,579 | 20,469 | 2,614 |
| CVA risk | **1,650** | **227** | 1,689 | 214 | 1,407 | 180 |
| Total in respect of credit risk | **271,671** | **37,382** | 273,129 | 34,606 | 266,534 | 34,038 |
| Risk assets and capital requirements in respect of market risk | **6,308** | **868** | 6,369 | 807 | 4,788 | 611 |
| Risk assets and capital requirements in respect of operational risk | **21,129** | **2,907** | 20,433 | 2,589 | 20,843 | 2,662 |
| Total risk assets and capital requirements(a) | **299,108** | **41,157** | 299,931 | 38,002 | 292,165 | 37,311 |

(a) Additional capital buffers are calculated as part of Pillar 2.

(b) Capital requirements were calculated in accordance with the total minimum capital ratio according to the Supervision of Banks Departments in a rate of 13.76% at June 30, 2017, 12.76% at 30 June 2016 and 12.74% at December 31, 2016.

**Table 8 - Components of risk-weighted assets by business activity (EDTF)**

Presented below are the exposures according to their allocation to business activity lines as reflected in the report on the Bank's operating segments.

| | **30 June 2017** | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Israel | | | | | | | | | | Consolidated |
| | House -holds | Private banking | Small businesses | Mid-sized businesses | Large businesses | Instituional segment | Financial management segment | Others | Total Israel | Total abroad | Total |
| | NIS milions | | | | | | | | | | |
| Credit risk | **79,345** | **326** | **53,554** | **32,543** | **49,202** | **1,359** | **11,956** | **15,824** | **244,109** | **27,562** | **271,671** |
| Market risk | - | - | - | - | - | - | **6,240** | - | **6,240** | **68** | **6,308** |
| Operational risk | **6,971** | **455** | **3,233** | **1,900** | **3,129** | **354** | **2,434** | **278** | **18,754** | **2,375** | **21,129** |
| **Total risk assets** | **86,316** | **781** | **56,787** | **34,443** | **52,331** | **1,713** | **20,630** | **16,102** | **269,103** | **30,005** | **299,108** |

| | 30 June 2016[(a)] | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Israel | | | | | | | | | | Consolidated |
| | House -holds | Private banking | Small businesses | Mid-sized businesses | Large businesses | Instituional segment | Financial management segment | Others | Total Israel | Total abroad | Total |
| | NIS milions | | | | | | | | | | |
| Credit risk | 79,243 | 311 | 47,939 | 32,902 | 55,809 | 1,712 | 10,150 | 16,542 | 244,608 | 28,521 | 273,129 |
| Market risk | - | - | - | - | - | - | 6,090 | - | 6,090 | 279 | 6,369 |
| Operational risk | 7,070 | 486 | 2,520 | 2,169 | 3,159 | 25 | 2,518 | 206 | 18,153 | 2,280 | 20,433 |
| **Total risk assets** | 86,313 | 797 | 50,459 | 35,071 | 58,968 | 1,737 | 18,758 | 16,748 | 268,851 | 31,080 | 299,931 |

| | 31 December 2016[(a)] | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Israel | | | | | | | | | | Consolidated |
| | House -holds | Private banking | Small businesses | Mid-sized businesses | Large businesses | Instituional segment | Financial management segment | Others | Total Israel | Total abroad | Total |
| | NIS milions | | | | | | | | | | |
| Credit risk | 78,935 | 290 | 48,859 | 32,348 | 50,584 | 972 | 8,821 | 16,681 | 237,490 | 29,044 | 266,534 |
| Market risk | - | - | - | - | - | - | 4,705 | - | 4,705 | 83 | 4,788 |
| Operational risk | 7,003 | 475 | 2,938 | 2,033 | 3,208 | 483 | 2,032 | 321 | 18,493 | 2,350 | 20,843 |
| **Total risk assets** | 85,938 | 765 | 51,797 | 34,381 | 53,792 | 1,455 | 15,558 | 17,002 | 260,688 | 31,477 | 292,165 |

(a) Reclassified

### Table 9 - Movements in risk-weighted assets (EDTF)

Presented below are the movements in the portfolio mix and changes in the portfolio quality that may affect the manner of measuring the exposures in order to quantify the related capital requirements.

### Changes in credit risk assets

| | For the three months ended 30 June | | For the six months ended 30 June | | For the year ended 31 December |
|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | 2016 |
| | NIS millions | | | | |
| Opening balance | **272,108** | 272,523 | **266,534** | 277,034 | 277,034 |
| Change in transactions | **1,770** | (4,792) | **5,234** | (3,976) | (6,550) |
| Insurance of guarantees under the Sale Law | **(339)** | (294) | **(168)** | (7,620) | (7,540) |
| Change in credit risk rating | **(278)** | (254) | **(234)** | (473) | (362) |
| Exchange rate differentials | **(1,195)** | 314 | **(3,431)** | (1,500) | (2,482) |
| Entry / exit from credit failure | **55** | 151 | **496** | (59) | (210) |
| Derivative transactions, net | **15** | (866) | **1,067** | (557) | (1,200) |
| Changes in CVA | **(409)** | 92 | **243** | 49 | (233) |
| Offesetting payroll tax in deferred taxes | **-** | 2,026 | **515** | 2,027 | 1,979 |
| Other | **(57)** | 4,229 | **1,413** | 8,204 | 6,098 |
| Closing balance | **271,671** | 273,129 | **271,671** | 273,129 | 266,534 |

### Changes in market risk assets

| | For the three months ended 30 June | | For the six months ended 30 June | | For the year ended 31 December |
|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | 2016 |
| | NIS millions | | | | |
| Opening balance | **6,141** | 5,793 | **4,788** | 5,167 | 5,167 |
| Interest risk - changes in open positions | **141** | 65 | **1,001** | 359 | (605) |
| Foreign currency risk - changes in open short positions in dollars | **(14)** | 182 | **(86)** | 454 | 97 |
| Shares risk - changes in futures contracts and options on stock indices | **98** | 401 | **411** | 207 | 101 |
| Options risk - changes in foreign currency option scenarios | **(58)** | (72) | **194** | 182 | 28 |
| Closing balance | **6,308** | 6,369 | **6,308** | 6,369 | 4,788 |

**Changes in operational risk assets**

| | For the three months ended 30 June | | For the six months ended 30 June | | For the year ended 31 December |
|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | 2016 |
| | NIS millions | | | | |
| Opening balance | **20,862** | 20,100 | **20,843** | 20,432 | 20,432 |
| Changes | **267** | 333 | **286** | 1 | 411 |
| Closing balance | **21,129** | 20,433 | **21,129** | 20,433 | 20,843 |

**Leverage ratio**

The "leverage ratio" is a complementary metric to the capital ratio and an additional restriction on the level of leverage in the banking sector.

The leverage ratio is defined as the measurement of capital divided by the measurement of exposure, expressed as a percentage. Capital for purposes of measuring the leverage ratio is the Tier 1 capital as defined in Proper Conduct of Banking Business Directive No. 202, taking into account the transitional arrangements that were set. The total exposure measurement of a banking corporation is the amount of balance-sheet exposures, exposures to derivatives and securities financing transactions, and off-balance sheet items.

The leverage ratio may be affected by the changes in the regulatory capital of the Bank. Amongst other things brought into account in calculating the leverage ratio is the effect of implementing the efficiency plan and the adjustments from implementation of the discount rate, calculated over a moving average of the market yields, for the period of eight quarters ended on the reporting date, in connection with certain actuarial liabilities as detailed above.

## Table 10 - Leverage ratio on consolidated basis and principal subsidiaries according to Basel (Pillar 3)

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | 2016 | 2016 |
| | NIS millons | | |
| **A. Consolidated data** | | | |
| Tier 1 shareholders' equity[(a)] | **33,527** | 31,187 | 32,586 |
| Total exposures[(a)] | **483,683** | 479,140 | 481,384 |
| **Leverage ratio** | | | |
| Leverage ratio | **6.93%** | 6.51% | 6.77% |
| Minimum leverage ratio required by the Supervisor of Banks | **6.00%** | 6.00% | 6.00% |
| **B. Significant subsidiary companies** | | | |
| **Leumi Card Ltd.** | | | |
| Leverage ratio | **11.19%** | 11.62% | 11.73% |
| Minimum leverage ratio required by the Supervisor of Banks | **5.00%** | 5.00% | 5.00% |
| **Bank Leumi USA** | | | |
| Leverage ratio | **9.64%** | 9.95% | 8.94% |

(a) These data include adjustments in respect of the efficiency plans set according to a letter of the Supervisor of Banks dated 12 January 2016 on the subject of "Efficiency Plan of the Banking System in Israel". In accordance with aforesaid letter, the reliefs given for purposes of the capital adequacy ratio and leverage ratio in respect of the efficiency plans approved by the Board of Directors in June 2016 and in July 2017 are reducing gradually until 30 June 2021 and 30 June 2022, respectively. The effect of the relief in respect of the efficiency plan on the leverage ratio was 0.18% at June 30, 2017 (0.08% at December 31, 2016 and 30 June 2016, respectively). For further details regarding the impact of the Transitional Provisions and the adjustments in respect of the efficiency plan, see Paragraph D in Note 9B – Capital Adequacy, Leverage and Liquidity in the Financial Statements and the chapter "Relief in respect of Operational Efficiency Plans" in this Risk Report.

## Table 11 - Comparison of the assets in the balance sheet with the measurement of exposure for the purpose of the leverage ratio (Pillar 3)

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | 2016 | 2016 |
| | NIS millons | | |
| Total assets in accordance with the consolidated financial statements | **436,967** | 436,400 | 438,603 |
| Adjustments in respect of: | | | |
| Investments in entities in banking, finance, insurance or commerce that were consolidated for accounting purposes, but for which consolidation is not applicable for supervisory purposes | **-** | - | - |
| Trust assets recognized in the balance sheet pursuant to the Public Reporting Directives, but were not included in the measurement of exposure of the leveraging ratio | **-** | - | - |
| Derivative financial instruments | **(2,260)** | (6,669) | (5,529) |
| Securities financing transactions | **-** | - | - |
| Off-balance sheet items | **46,608** | 47,269 | 45,776 |
| Others | **2,368** | 2,140 | 2,534 |
| Exposure for purposes of leveraging ratio | **483,683** | 479,140 | 481,384 |

(a) The data for June 30, 2017 includes the first effect of the directive's implementation regarding "Capital requirements in respect of exposures to central counterparties", implemented at 1 January 2017.

## Table 12 – Additional disclosure on the leverage ratio (Pillar 3)

| | **30 June** | | 31 December |
|---|---|---|---|
| | **2017** | **2016** | 2016 |
| | NIS millons | | |
| **Balance sheet exposures** | | | |
| Balance sheet assets (except for derivatives and securities financing transactions, but including collaterals) | **424,896** | 422,089 | 426,996 |
| Amounts in respect of assets deducted for purposes of determining Tier 1 shareholders' equity | **(344)** | (704) | (319) |
| **Total balance sheet exposures** | **424,553** | 421,385 | 426,677 |
| **Exposures in respect of derivatives** | | | |
| Replacement cost related to all the transactions in respect of derivatives (for example, after reduction of eligible variable cash-collateral | **2,583** | 2,138 | 1,084 |
| Amounts of additions in respect of potential future exposure related to all the transactions in respect of derivatives | **9,050** | 5,653 | 5,572 |
| Grossing up of collateral provided for derivatives, deducted from the balance sheet assets in accordance with the Public Reporting Directives | **-** | - | - |
| Deductions of assets of debtors in respect of variable cash-collateral given in transactions in derivatives | **(2,532)** | (1,461) | (1,532) |
| Business exposures exempt from central counterparty leg that were repaid by the customer | **-** | - | - |
| Effective notional amount of credit derivatives written | **-** | - | - |
| of credit derivatives written | **-** | - | - |
| **Total exposures in respect of derivatives** | **9,101** | 6,330 | 5,125 |
| **Exposures in respect of securities financing transactions** | | | |
| Gross assets in respect of securities financing transactions (without recognizing set-offs), after adjustments in respect of transactions dealt with as an accounting sale | **1,272** | 2,045 | 1,609 |
| Amounts of cash payable and receivable that were offset by gross assets in respect of securities financing transactions | **-** | - | - |
| Credit risk exposure of a central counterparty in respect of securities financing assets | **-** | - | - |
| Exposures in respect of transactions as an agent | **2,150** | 2,112 | 2,197 |
| **Total exposures in respect of securities financing transactions** | **3,421** | 4,156 | 3,806 |
| **Other off-balance sheet exposures** | | | |
| Total off-balance sheet exposure at gross notional value | **127,627** | 129,617 | 124,386 |
| Of which: Conversion coefficient 0% | **4,108** | 4,818 | 3,411 |
| Conversion coefficient 10% | **28,046** | 27,396 | 27,618 |
| Conversion coefficient 20% | **21,517** | 23,727 | 21,362 |
| Conversion coefficient 50% | **68,911** | 67,786 | 66,506 |
| Conversion coefficient 100% | **5,045** | 5,892 | 5,489 |
| (Adjustments in respect of conversion to equivalent credit amounts) | **(81,019)** | (82,348) | (78,610) |
| Total off-balance sheet after conversion to credit value | **46,608** | 47,269 | 45,776 |
| **Capital and total exposures** | | | |
| Tier 1 shareholders' equity [(a)] | **33,527** | 31,187 | 32,586 |
| Total exposures[(a)] | **483,683** | 479,140 | 481,384 |
| **Leverage ratio** | | | |
| Leverage ratio according to the Proper Conduct of Banking Business Directive No. 218 | **6.93%** | 6.51% | 6.77% |

(a) These data include adjustments in respect of the efficiency plans set according to a letter of the Supervisor of Banks dated 12 January 2016 on the subject of "Efficiency Plan of the Banking System in Israel". In accordance with aforesaid letter, the reliefs given for purposes of the capital adequacy ratio and leverage ratio in respect of the efficiency plans approved by the Board of Directors in June 2016 and in July 2017 are reducing gradually until 30 June 2021 and 30 June 2022, respectively. The effect of the relief in respect of the efficiency plan on the leverage ratio was 0.18% at June 30, 2017 (0.08% at December 31, 2016 and 30 June 2016, respectively). For further details regarding the impact of the Transitional Provisions and the adjustments in respect of the efficiency plan, see Paragraph D in Note 9B – Capital Adequacy, Leverage and Liquidity in the Financial Statements and the chapter "Relief in respect of Operational Efficiency Plans" in this Risk Report.

(b) The data for June 30, 2017 includes the first-time effect of the directive's implementation regarding "Capital requirements in respect of exposures to central counterparties", implemented at 1 January 2017.

**Risk exposure and its assessment**

Risk management and the achievement of an adequate return are at the basis of the Bank's business activity. The main risks the Bank manages are financials risks: Credit risk management is the core activity of the Bank, alongside liquidity risk management and market risk management. Alongside the business risk management, the Bank's activity generates additional risks, the management of which is a necessary condition for meeting the Group's current and long-term goals. Among these risks are included operational risks, including technological and cyber, legal, regulatory, reputation, compliance and conduct (fair business conduct with customers) and strategy risks.

The main objectives of Leumi's risk management are maintaining the stability of the Group and supporting the achievement of business goals. These objectives are achieved while adhering to the outlined risk appetite, the policy and the system of limitations derived from it, which create the boundaries for the business activity. This framework is managed under the appropriate control and reporting mechanisms.

The Bank conducts ongoing operation to upgrade the risk management infrastructure and analyzing the risk status, which enables informed decisions.

**The Risk Management Department and its areas of responsibility**

The Group is engaged in a wide range of activities involving the taking of financial risks, including credit risks. market and liquidity risks and other non-financial risks, such as operating risks, including
the Bank manages operational risks, including technological and cyber, legal, regulatory, reputation, compliance and conduct (dealing fairly with customers) risks.

The main areas of responsibility of the Risk Management Department fall within the definition of the provision of Proper Conduct of Banking Management Directive No. 310. Including, responsibility for the risk management at Bank and Group level, leading the preparation of Leumi's risk policy documents with regard to all of the main risks, assisting the Board of Directors in outlining the Bank's risk appetite statement, leading the process of assessing the adequacy of the Bank's capital (ICAAP).

The methods and procedures of risk management are examined and revised on an ongoing basis, taking into account the changes in the business environment, the requirements of the Bank of Israel and other relevant regulatory authorities in Israel and abroad.

The working framework used for estimating and managing risks as a basis for decision-making includes:

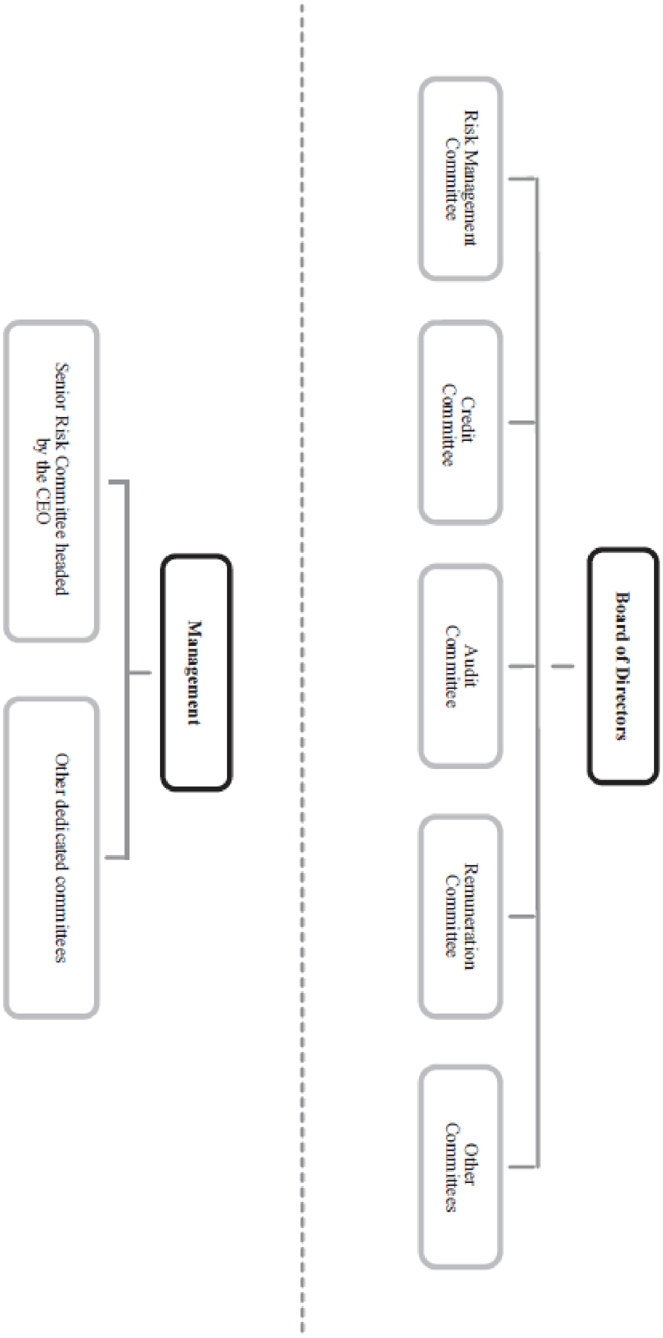
A. The risk appetite statement, which defines the boundaries for business activity, both on a routine basis, and under a stress scenario and which defines, inter alia, the establishment of risk policy documents and limits on the exposure for each type of risk.
B. Working processes are defined for analyzing and managing risk at the single transaction level and at the overall portfolio level.
C. Periodic reports for evaluating risk, taking account of changes in the environment in which the Bank operates, assessing the potential losses and implications for the Bank in various scenarios, the definition of general and for risk mitigation.

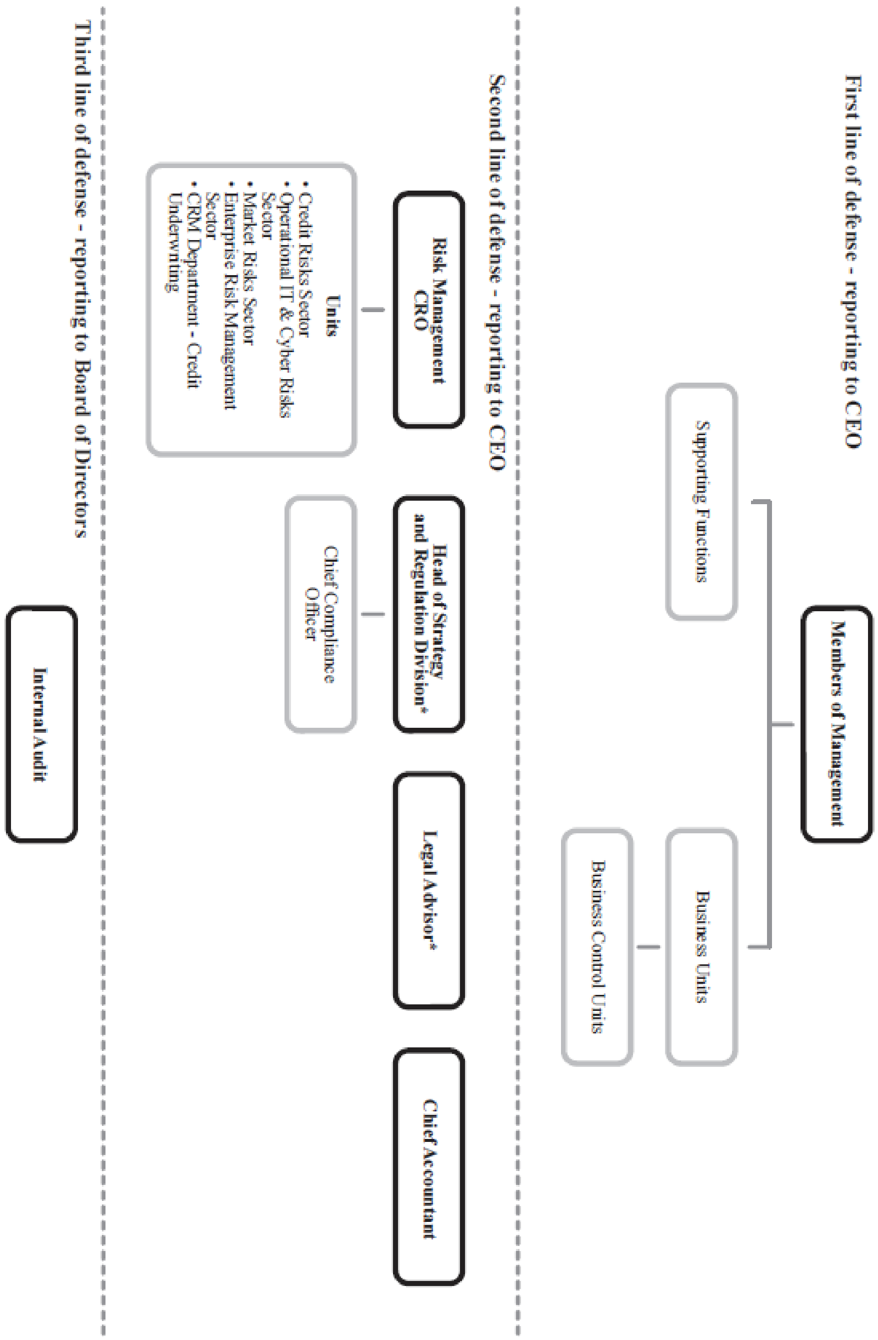
The assessment of risks at the overall level of the Group and the level of the activity and single transaction is based on multiple structured methodologies, some based on expert assessments, and some, on the basis of statistical models. The changes in the risk environment in Israel and around the world, as well as the changes in the perception of risk, require the Bank to revise its assessments and the methodologies it employs, while constantly being challenged by the internal, and sometimes external, factors.

Risk Management in Leumi is based on three "lines of defense".

It should be noted that the Compliance Department reports to the Legal Counsel Division. In light of the organizational changes and appointments made in the Bank during the reporting period, until the end of 2017 only, the Compliance Department continues to report to Mr. Hanan Friedman, who served as the Bank's Chief Legal Counsel and currently serves as Head of the Strategy and Regulation Division.

**For further details regarding the method by which the risks are managed, the organizational structure and the risk management culture within the group, see the 2016 Risk Report.**


Board of Directors
Risk Management Commitee
Credit Commitee
Audit Commitee
Remuneration Commitee
Other Commitees
Management
Senior Risk Commitee headed by the CEO
Other dedicated commitees




* In light of the organizational changes and appointments made in the Bank during the reporting period, until the end of 2017 only, the Compliance Department continues to report to Mr. Hanan Friedman, who served as the Bank's Chief Legal Counsel and currently serves as Head of the Strategy and Regulation Division

## Credit risks

Granting credit is the Bank's and the Group's principal activity in a number of business lines. Credit risk is the risk of a loss as a result of the possibility that a counterparty will not meet its obligations vis-à-vis the banking corporation, as agreed.
Activities which create credit risk include balance sheet credit risk and off-balance sheet credit risk, including:
Credit to the public, credit to banks, credit to governments, deposits in banks, investments in bonds, holdings in equity, transactions of derivatives, guarantees, unutilized commitments to provide credit and unutilized credit facilities.

The Bank implements an overall policy for managing credit risk, in accordance with the provisions of Proper Conduct of Banking Business Directive No. 311 and Proper Conduct of Banking Business Directive No. 314, including the responsibility of Management and the Board of Directors. In addition, the Bank takes care to manage risk in accordance with the additional instructions and requirements in the Directives of the Banking Supervision Department while implementing corporate governance that includes three lines of defense".

The credit management and credit risks policy document at the Group level constitutes the key expression of the Bank's credit risk strategy and outlines the framework and supra-principles for the policy documents of the Bank and of each of the subsidiaries in the Group, in Israel and abroad. In addition, this document includes the limitations in the area of credit which are defined and managed at Group level.

Since the beginning of the year, no material changes occurred in the organizational structure, the policy and the corporate governance of the credit risk management.

**For further details regarding credit risk management at the Bank, see the 2016 Report on Risks.**

**Credit concentration**

Concentration risk is defined as a single large exposure or group of correlated exposures with a potential for causing significant losses. Concentration risk management is conducted by determining restrictions and monitoring and controlling compliance therewith.
The relevant sources of concentration for the Bank's credit portfolio are groups of borrowers, single large borrowers, industry sectors, and collateral.

Since the beginning of the year, no material changes occurred in the restrictions of the credit concentration risk and the Bank meets all the regulatory and internal restrictions.

**The Supervisor's guidelines regarding analysis of credit risk of the vehicle sector**

On 9 July 2017, the Supervisor of Banks published guidelines in regards to analyzing the credit risk in the vehicle sector. As part of the guidelines, corporate banking and credit cards companies must perform risk analysis to the "vehicle trading" sector and for the public's credit for vehicle purchasing. The risk analysis will be performed using different scenarios that may influence the sector, and in respect to the analysis results, the banks and credit cards companies will have to review the need in updating the credit policy, risk appetite, the rules and limitations in financing the vehicle market and the need to tighten the checks in regards of existing significant borrowers and the public's credit for vehicle purchasing.

The Bank is studying the guidelines included in the aforementioned letter.
**Updates in the guidelines of the Supervisor of Banks on industry sector indebtedness**

On 10 July 2017, a circular updating the of the Proper Banking Conduct no. 315 regarding "Additional provision to doubtful debts" was publish. The directive was update in order to minimize the negative affect of the industry sector concentration on the quality of the credit portfolio, and as part of the regulations policy and simplifying the procedures. The update included, inter alia, reference to the following subjects:

- An industry sector indebtedness restriction was set, in which the indebtedness for a certain industry shall not exceed 20% of the total of the public's indebtedness to the banking corporation, or 22% in some cases. The set threshold will be a restriction on the sector's' indebtedness that must not be exceeded.
- The mechanism of additional provision and the general provision was cancelled.

In light of the aforementioned cancellation of the additional provision mechanism the Proper Banking Conduct No. 314 on "An adequate evaluation of the credit risks and an adequate measurement of indebtedness" was updated. Part of the update determined that when setting provisions for credit loss, the banking corporation must calculate, inter alia, credit that no updated financial statements exist in its regard.

These changes are to be implemented from 1 January 2018. The Bank reviewed the updates to the directive and per its estimation it's expected to comply with the limits in respect to the updated directive.

**The quality of the credit portfolio**

As part of managing credit risk, the Bank applies major importance to monitoring the quality of the credit portfolio, and to identifying and monitoring problematic and impaired debts. At the same time, the Bank conducts an overall due diligence of the provision for credit losses which is calculated in accordance with the Public Reporting Directives of the Banking Supervision Department and its guidelines.

**Updates to the directives of the Banking Supervision Department regarding the classification of problem debts according to the initial source of payment.**

On 20 February 2017, an update to the Q&A of the Banking Supervision Department was published on the subject of "Implementation of the directives for reporting to the public on impaired debts, credit risks and provision for credit loss." The update refers mainly to the classification of debt, definition of impaired debt and private provision for credit losses determination of the appropriate classification of debt, up to Failure or if Highly Probable based on the customer's ability to pay. Hence: expected strength of the initial repayment source despite the support of second and third repayment sources (such as collateral, guarantor's support, re-financing by third party).

These changes will come into effect as of 1 July 2017 and thereafter. The Bank estimates that the Directive is not expected to have a material effect.

## Table 14 - Exposure distribution by key industry sectors

| | 30 June 2017 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total credit risk(a) | Debts(b) | | | | | Credit losses(c) | | |
| | Total | Total | Non-problematic | Problematic, non-impaired(d) | Impaired (d) | In arrears | Expenses (income) for credit losses | Net accounting write-offs | Balance of allowance for credit losses |
| | NIS millions | | | | | | | | |
| **Activity of borrowers in Israel** | | | | | | | | | |
| **Public-commercial** | | | | | | | | | |
| Construction & real estate - construction(e) | **47,803** | **16,751** | **16,306** | **209** | **236** | **49** | **42** | **26** | **(344)** |
| Construction & real estate - real estate activity | **27,390** | **24,141** | **23,314** | **196** | **631** | **36** | **(54)** | **(27)** | **(413)** |
| Financial services | **20,765** | **10,767** | **10,442** | **4** | **321** | **12** | **(63)** | **(54)** | **(195)** |
| Other public-commercial | **92,543** | **70,509** | **67,555** | **1,457** | **1,497** | **212** | **135** | **213** | **(1,229)** |
| **Total commercial(f)** | **188,501** | **122,168** | **117,617** | **1,866** | **2,685** | **309** | **60** | **158** | **(2,181)** |
| Private individuals - housing loans | **79,715** | **77,996** | **77,296** | **700** | **-** | **1,195** | **(11)** | **3** | **(450)** |
| Private individuals - other | **68,825** | **38,774** | **38,193** | **461** | **120** | **281** | **72** | **123** | **(772)** |
| **Total public - activity in Israel** | **337,041** | **238,938** | **233,106** | **3,027** | **2,805** | **1,785** | **121** | **284** | **(3,403)** |
| **Banks in Israel** | **4,032** | **1,156** | **1,156** | **-** | **-** | **-** | **-** | **-** | **(1)** |
| **Government of Israel** | **45,204** | **154** | **154** | **-** | **-** | **-** | **-** | **-** | **-** |
| **Total activity in Israel** | **386,277** | **240,248** | **234,416** | **3,027** | **2,805** | **1,785** | **121** | **284** | **(3,404)** |
| **Total activity abroad** | **93,707** | **37,493** | **36,106** | **752** | **635** | **70** | **22** | **43** | **(422)** |
| **Total activity in Israel and abroad** | **479,984** | **277,741** | **270,522** | **3,779** | **3,440** | **1,855** | **143** | **327** | **(3,826)** |

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, bonds, securities borrowed or purchased under repurchase agreements, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments as calculated for borrower debt limitations in the sum of NIS 277,741, 75,292, 1,031, 11,366, 114,554 million, respectively.
(b) Credit risk to the public, credit to governments, deposits with banks and other debts, excluding bonds and securities borrowed or purchased under repurchase agreements.
(c) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other Liabilities").
(d) Impaired, substandard, or special mention balance sheet credit risk, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans for which there is no provision by extent of arrears that are in arrears of 90 days or more.
(e) Including housing loans, extended to certain purchasing groups in the process of construction.
(f) The balance of commercial debts includes the balance of housing loans, amounting to NIS 945 million, which were extended to purchasing groups in the process of construction.

**For more details regarding exposures to problem credit and changes in the allowance for credit losses, see the Report of the Board of Directors and Management and Notes 13 and 31 to the Financial Statements. For more details regarding credit exposures by industry sector, see the Report of the Board of Directors and Management. For more details regarding movement in the balance of impaired debts, see the Report of the Board of Directors.**

| | 30 June 2016 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total credit risk[(a)] | Debts[(b)] | | | | | Credit losses[(c)] | | |
| | Total | Total | Non-problematic | Problematic, non-impaired[(d)] | Impaired [(d)] | In arrears | Expenses (income) for credit losses | Net accounting write-offs | Balance of allowance for credit losses |
| | NIS millions | | | | | | | | |
| **Activity of borrowers in Israel** | | | | | | | | | |
| **Public-commercial** | | | | | | | | | |
| Construction & real estate - construction[(e)] | 47,749 | 16,363 | 15,945 | 261 | 157 | 46 | (58) | (17) | (303) |
| Construction & real estate - real estate activity | 28,237 | 25,502 | 24,284 | 592 | 626 | 29 | (201) | (39) | (467) |
| Financial services | 20,015 | 10,317 | 10,175 | 91 | 51 | 8 | (71) | (12) | (241) |
| Other public-commercial | 93,550 | 69,318 | 65,889 | 1,742 | 1,687 | 154 | (148) | (208) | (1,248) |
| **Total commercial[(f)]** | 189,551 | 121,500 | 116,293 | 2,686 | 2,521 | 237 | (478) | (276) | (2,259) |
| Private individuals - housing loans | 83,067 | 80,831 | 80,082 | 749 | - | 1,202 | 6 | 2 | (500) |
| Private individuals - other | 66,876 | 37,533 | 36,811 | 462 | 260 | 361 | 230 | 109 | (775) |
| **Total public - activity in Israel** | 339,494 | 239,864 | 233,186 | 3,897 | 2,781 | 1,800 | (242) | (165) | (3,534) |
| **Banks in Israel** | 5,771 | 3,103 | 3,103 | - | - | - | (1) | - | (2) |
| **Government of Israel** | 50,686 | 221 | 221 | - | - | - | - | - | - |
| **Total activity in Israel** | 395,951 | 243,188 | 236,510 | 3,897 | 2,781 | 1,800 | (243) | (165) | (3,536) |
| **Total activity abroad** | 99,650 | 40,056 | 38,872 | 455 | 729 | 106 | (34) | 28 | (475) |
| **Total activity in Israel and abroad** | 495,601 | 283,244 | 275,382 | 4,352 | 3,510 | 1,906 | (277) | (137) | (4,011) |

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, bonds, securities borrowed or purchased under repurchase agreements, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments as calculated for borrower debt limitations in the sum of NIS 283,244, 82,514, 1,476, 12,999, 115,368 million, respectively.
(b) Credit risk to the public, credit to governments, deposits with banks and other debts, excluding bonds and securities borrowed or purchased under repurchase agreements.
(c) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other Liabilities").
(d) Impaired, substandard, or special mention balance sheet credit risk, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans for which there is no provision by extent of arrears that are in arrears of 90 days or more.
(e) Including housing loans, extended to certain purchasing groups in the process of construction.

**For more details regarding exposures to problem credit and changes in the allowance for credit losses, see the Report of the Board of Directors and Management and Notes 13 and 31 to the Financial Statements. For more details regarding credit exposures by industry sector, see the Report of the Board of Directors and Management. For more details regarding movement in the balance of impaired debts, see the Report of the Board of Directors.**

| | 31 December 2016 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total credit risk[a] | Debts[b] | | | | | Credit losses[c] | | |
| | Total | Total | Non-problematic | Problematic, non-impaired[d] | Impaired[d] | In arrears | Expenses (income) for credit losses | Net accounting write-offs | Balance of allowance for credit losses |
| | NIS millions | | | | | | | | |
| **Activity of borrowers in Israel** | | | | | | | | | |
| **Public-commercial** | | | | | | | | | |
| Construction & real estate - construction[e] | 45,662 | 15,576 | 15,037 | 275 | 264 | 77 | (7) | 17 | (328) |
| Construction & real estate - real estate activity | 26,440 | 23,878 | 22,881 | 360 | 637 | 47 | (303) | (79) | (433) |
| Financial services | 19,520 | 10,854 | 10,390 | 5 | 459 | 4 | (82) | (23) | (222) |
| Other public-commercial | 90,189 | 68,414 | 65,119 | 1,745 | 1,550 | 209 | (151) | (282) | (1,309) |
| **Total commercial[f]** | 181,811 | 118,722 | 113,427 | 2,385 | 2,910 | 337 | (543) | (367) | (2,292) |
| Private individuals - housing loans | 80,570 | 78,645 | 77,926 | 719 | - | 1,249 | (10) | 25 | (462) |
| Private individuals - other | 67,691 | 38,141 | 37,502 | 531 | 108 | 374 | 458 | 291 | (820) |
| **Total public - activity in Israel** | 330,072 | 235,508 | 228,855 | 3,635 | 3,018 | 1,960 | (95) | (51) | (3,574) |
| **Banks in Israel** | 4,370 | 1,742 | 1,742 | - | - | - | (2) | - | (1) |
| **Government of Israel** | 41,992 | 206 | 206 | - | - | - | - | - | - |
| **Total activity in Israel** | 376,434 | 237,456 | 230,803 | 3,635 | 3,018 | 1,960 | (97) | (51) | (3,575) |
| **Total activity abroad** | 98,931 | 40,032 | 38,986 | 411 | 635 | 137 | (28) | 54 | (451) |
| **Total activity in Israel and abroad** | 475,365 | 277,488 | 269,789 | 4,046 | 3,653 | 2,097 | (125) | 3 | (4,026) |

(a) Balance sheet credit risk and off-balance sheet credit risk, including in respect of derivative instruments, including debts, bonds, securities borrowed or purchased under repurchase agreements, assets in respect of derivative instruments, and credit risk in off-balance sheet financial instruments as calculated for borrower debt limitations in the sum of NIS 277,488, 75,259, 1,248, 10,659, 110,675 million, respectively.
(b) Credit risk to the public, credit to governments, deposits with banks and other debts, excluding bonds and securities borrowed or purchased under repurchase agreements.
(c) Including in respect of off-balance sheet credit instruments (shown in the balance sheet under "Other Liabilities").
(d) Impaired, substandard, or special mention balance sheet credit risk, including in respect of housing loans for which there is a provision by extent of arrears, and housing loans for which there is no provision by extent of arrears that are in arrears of 90 days or more.
(e) Including housing loans which were extended to purchasing groups in the process of construction.
* Restated.

**For more details regarding exposures to problem credit and changes in the allowance for credit losses, see the Report of the Board of Directors and Management and Notes 13 and 31 to the Financial Statements. For more details regarding credit exposures by industry sector, see the Report of the Board of Directors and Management. For more details regarding movement in the balance of impaired debts, see the Report of the Board of Directors.**

### Activity and risk restrictions in the construction and real estate sector

Real estate is the industry sector in which the Bank is most exposed of all the industry sectors of the economy. As with other industry sectors, methodologies and parameters are defined as part of the credit policy for financing transactions in each of the sub-sectors of the real estate area.

**Table 15 - Development of obligations in the construction and real estate sector**

| | 30 June | | 31 December | | |
|---|---|---|---|---|---|
| | **2017** | 2016 | 2016 | Change | |
| | NIS millions | | | NIS millions | Percentages |
| Balance sheet credit risk | **51,468** | 51,563 | 49,368 | 2,100 | 4% |
| Guarantees to apartment purchasers [(a)] | **8,502** | 8,455 | 8,421 | 81 | 1% |
| Other off-balance sheet credit risk[(a)] | **29,801** | 28,489 | 28,035 | 1,766 | 6% |
| Total | **89,771** | 88,507 | 85,824 | 3,947 | 5% |

(a) Weighted to balance sheet equivalent.

## Risks in the Housing loans portfolio

Developments in the market in recent years (particularly in a low interest rate environment and a sharp increase in housing prices) resulted in a significant increase in the volume of housing loans in Israel.
The housing loans portfolio is monitored regularly, while analyzing the trends in the risk profile. This includes monitoring the breakdown of the credit portfolio according to index linkage, currency, interest rate as well as loan-to-value rates.

**Table 16 - Development of net balance of housing loans granted**

| | Credit portfolio balance | Growth rate |
|---|---|---|
| | NIS millions | % |
| 31 December 2015 | 80,616 | 9.1 |
| 31 December 2016 | 78,204 | (2.1) |
| **30 June 2017** | **77,559** | **(0.8)** |

As part of monitoring the risk in the housing loans portfolio, the characteristics of the new credit are monitored as well, including the distribution by loan-to-value rates (loan-to-value rate is the ratio of the amount of credit approved to a borrower, even before actually provided in full or in partial, to the value of the pledged asset, at the time of extending the credit).

**Table 17 - Development of new credit granted in Israel at a loan-to-value rate of over 60%**

Below is the development of the new credit extended by the Bank at a loan-to-value rate higher than 60% (the loan-to-value is the ratio of the amount of credit approved to a borrower, even before actually provided in full or in part, to the value of the pledged asset, at the time of extending the credit):

| | **2017** | | 2016 | 2015 |
|---|---|---|---|---|
| | **Q2** | **Q1** | Yearly average | Yearly average |
| Loan-to-value | **%[(a)]** | | | |
| Over 60 up to 70 including | **16.9** | **15.7** | 16.5 | 18.8 |
| Over 70 up to 80 including | **17.8** | **14.3** | 14.7 | 16.7 |
| Over 80 | **0.04** | **0.1** | 0.1 | 1.1 |

(a) Out of the new credit extended by the Bank.

In order to ensure effective risk management, the Bank operates under tight internal limits, especially regarding the following: loan-to-value rates, income-to-payment rates, and credit scorings in accordance with the Bank's internal statistical model.

**For further details regarding this segment, see the chapter on Credit Risks in the Report of the Board of Directors.**

## Credit to individuals (excluding housing loans)

Private credit, whose repayment capacity is based mainly on the household's earning capability, is characterized by a very wide diversification of borrowers in a variety of credit products (various types of loans, current accounts, credit cards) and to a smaller average loan size to a single customer.
Private customers' activity in the Bank is concentrated, almost entirely, in the Banking Division, into which the branches of the former Arab-Israel Bank were merged in the beginning of 2016.
In order to deal with the growth in private credit and with the wide span of controls required to manage it, as well as for the purpose of implementing proper corporate governance, several functions have been expanded and strengthened, in Banking Division which is the first line of defense, and in the Risk Management Division which is the second line of defense.

Private credit policy, formulated by the Risk Management Division in collaboration with the Banking Division, is an important pillar in outlining the risk appetite and in directing the ongoing management of this activity. Among the key principles of the private credit policy are: the estimated credit risk assessment of each borrower; maintaining a defined and structured system of credit granting authorizations, emphasis on fair conduct of business (integrity, transparency and keeping the best interest of the customer), matching the credit to the customers' needs and abilities, and increased awareness to compliance with regulation while providing credit.

**For further details regarding this segment, see the chapter on Credit Risks in the Report of the Board of Directors.**

**Groups of borrowers**

The Bank monitors the credit exposure of groups of borrowers, for the purposes of regular reporting to the Bank of Israel, examining compliance of the size of indebtedness with the regulatory limitations and for internal monitoring.

As of 1 January 2016, Proper Conduct of Banking Business Directive No. 313 on Single Borrower and Group of Borrowers Limitations came into force. The main update is the gradually minimizing (until 31 December 2018) of the definition of capital that the restriction is defined in regard to it, from total capital to CET1 only.
The Bank complies with all the requirements of the aforementioned update.

**Single Borrower and Group of Borrowers Limitations:**

1. As at June 30, 2017, the Group had no credit exposure to a group of borrowers whose indebtedness exceeded 15% of the Bank's capital (as defined in Proper Conduct of Banking Business Directive No. 313).

2. As at June 30, 2017, the Group had no credit exposure to large borrowers, groups of borrowers, and banking groups of borrowers whose indebtedness exceeds 10% of the Bank's capital. The aggregate regulatory limit in respect of these exposures is 120% of the Bank's capital.

**Exposure of the Bank to leveraged financing**

Proper Conduct of Banking Business Directive No. 311 provides that a bank's credit policy should relate inter alia to leveraged financing. The Bank operates according to unique principles in the credit policy for this segment, including from the perspective of financial parameters, lending authorities, etc.

On January 1 2016 the update of the Proper Conduct of Banking Business Directive No. 323 (Limitations on Financing Capital Transactions) and also the new Proper Conduct of Banking Business Directive No. 327 (Leveraged lending Management) came into force. The Bank complies with the requirements of these new directives.

Leveraged financing is defined and managed by the Bank in accordance with the updated instructions.

It should be noted that in general, the volume of leveraged credit at the Bank has been declining for some years.

**Table 18 – Aggregate credit balances for leveraged borrowers**

Below are the aggregated credit balances for leveraged borrowers, each having a credit balance in the amount of 0.5% of Tier 1 capital or more as at the reporting date, according to industry sectors of the economy:

| | 30 June | 31 December |
|---|---|---|
| | **2017** | 2016 |
| Sector of the economy | NIS millions | |
| Electricity | **835** | 601 |
| Mining & Quarrying | **381** | 377 |
| Commerce | **468** | 541 |
| Real estate | **167** | 434 |
| Financial Services | **496** | 596 |
| Transportation & Warehousing | **411** | 434 |
| Industry | **1,027** | 877 |
| Total | **3,785** | 3,860 |

## Geographic diversification

The geographic diversification in the portfolio is intended to reduce the risk of economic / political / security / deterioration in countries to which the borrower is exposed, and which could result in impairment to the borrower's financial situation and ability to meet its obligations.

As part of the data used to determine the internal credit risk rating of corporate borrowers, aspects relating to geographic exposure, and in particular the location of the sources of cash flow and / or physical assets which the borrower uses for his current activity are taken into account. This information enables the Bank to conduct monitoring from an overall perspective of the exposures of all borrowers to the various countries.

Currently, there is no significant concentration in the Bank's credit portfolio in the exposure of the corporate borrowers to any foreign country.

**For further information regarding credit exposures in foreign countries see the Risks Review chapter in the report of the Management and Board of Directors.**

## Table 19 – Total credit risk distribution by geographic area

| **30 June 2017** | | | | |
|---|---|---|---|---|
| | **Foreign countries** | | | |
| | Israel | United States | United Kingdom | Other |
| | **NIS million** | | | |
| Credit to the public | **242,256** | **16,710** | **4,841** | **676** |
| Bonds | **73,293** | **4,643** | **112** | **421** |
| Derivaties | **11,279** | **68** | **14** | **-** |
| Off-balance sheet exposure | **77,859** | **2,150** | **2,310** | **332** |
| Others | **93,105** | **6,753** | **1,613** | **206** |
| Total balance sheet and off-balance sheet exposures | **17,280** | **94** | **22** | **-** |

| 30 June 2016 | | | | |
|---|---|---|---|---|
| | Foreign countries | | | |
| | Israel | United States | United Kingdom | Other |
| | NIS million | | | |
| Credit to the public | 243,209 | 15,779 | 6,343 | 717 |
| Bonds | 79,214 | 5,021 | 223 | 414 |
| Derivaties | 12,810 | 44 | 146 | - |
| Off-balance sheet exposure | 64,502 | 4,589 | 2,363 | 1,027 |
| Others | 94,274 | 6,387 | 2,299 | 206 |
| Total balance sheet and off-balance sheet exposures | 18,632 | 61 | 156 | - |

| 31 December 2016 | | | | |
|---|---|---|---|---|
| | Foreign countries | | | |
| | Israel | United States | United Kingdom | Other |
| | NIS million | | | |
| Credit to the public | 238,346 | 17,329 | 5,566 | 672 |
| Bonds | 70,694 | 5,927 | 120 | 459 |
| Derivaties | 10,569 | 50 | 36 | 0 |
| Off-balance sheet exposure | 80,752 | 5,122 | 2,502 | 458 |
| Others | 90,935 | 7,156 | 1,674 | 184 |
| Total balance sheet and off-balance sheet exposures | 16,097 | 72 | 45 | 0 |

**Table 20 - Credit risk exposure by main types of credit exposure (Pillar 3)(a)**

| | 30 June | | | | 31 December | |
|---|---|---|---|---|---|---|
| | **2017** | | 2016 | | 2016 | |
| | Gross credit risk exposure(b) | Average gross credit risk exposure | Gross credit risk exposure(b) | Average gross credit risk exposure | Gross credit risk exposure(b) | Average gross credit risk exposure |
| | NIS millions | | | | | |
| **Type of credit exposure:** | | | | | | |
| Credit(c) | **331,946** | **333,638** | 324,351 | 322,360 | 336,655 | 325,367 |
| Bonds(d) | **66,565** | **67,343** | 72,946 | 65,496 | 67,611 | 66,379 |
| Others(e) | **17,510** | **16,966** | 16,136 | 16,714 | 16,653 | 16,767 |
| Guarantees and liabilities on account of customers | **127,784** | **126,288** | 129,750 | 129,852 | 124,542 | 128,233 |
| Derivatives(f) | **13,669** | **11,723** | 8,609 | 8,536 | 8,465 | 8,524 |
| **Total** | **557,474** | **555,958** | 551,792 | 542,958 | 553,926 | 545,270 |

(a) After deducting accounting write-offs, but before deducting allowances for credit losses on individual and collective basis.

(b) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities as credit) and after offsetting transactions in derivatives (netting).

(c) Including credit to the public, credit to the Government, and deposits in central banks, and after deducting liabilities in respect of transactions in derivative instruments subject to CSA agreements.

(d) Not including the bonds in the trading portfolio and not including equity investments in financial corporations.

(e) Including cash, investments in financial corporations not deducted from capital, advance payments to the tax authorities, shares and other assets without a counterparty such as buildings and equipment.

(f) Positive fair value of derivatives, including an add-on reflecting the amount of potential future exposure to credit in respect of the balance of nominal value of derivative instruments and after offsetting transactions in derivatives (netting). Also, as of 1 January 2017 changes have occurred in the method of calculation of exposures regarding key counterparties. The impact of implementation has caused an increase in derivative exposure in the amount of NIS 800 million.

**Table 21 - Credit risk exposure by counterparty and by main types of credit exposure (Pillar 3)[(a)]**

| | **30 June 2017** | | | | | |
|---|---|---|---|---|---|---|
| | Credit[(c)] | Bonds[(d)] | Others[(e)] | Guarantees and other liabilities | Transactions in derivative financial instruments[(f)] | Total[(b)] |
| | NIS millions | | | | | |
| Sovereign debts | **60,585** | **46,509** | **-** | **951** | **171** | **108,216** |
| Debts of public sector entities | **4,958** | **9,002** | **-** | **789** | **270** | **15,019** |
| Debts of banking corporations | **6,478** | **4,991** | **-** | **4,624** | **6,315** | **22,408** |
| Debts of securities companies | **-** | **779** | **-** | **-** | **763** | **1,542** |
| Debts of corporations | **86,182** | **2,530** | **-** | **43,923** | **6,107** | **138,742** |
| Debts collateralised by commercial real estate | **33,958** | **-** | **-** | **36,942** | **-** | **70,900** |
| Retail exposures to individuals | **44,937** | **-** | **-** | **30,774** | **38** | **75,749** |
| Small business loans | **17,062** | **-** | **-** | **4,956** | **5** | **22,023** |
| Housing mortgages | **77,786** | **-** | **-** | **4,825** | **-** | **82,611** |
| Securitization | **-** | **2,754** | **-** | **-** | **-** | **2,754** |
| Other assets | **-** | **-** | **17,510** | **-** | **-** | **17,510** |
| Total in respect of credit risk | **331,946** | **66,565** | **17,510** | **127,784** | **13,669** | **557,474** |

| | 30 June 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Credit[(c)] | Bonds[(d)] | Others[(e)] | Guarantees and other liabilities | Transactions in derivative financial instruments[(f)] | Total[(b)] |
| | NIS millions | | | | | |
| Sovereign debts | 49,042 | 52,574 | - | 887 | 31 | 102,534 |
| Debts of public sector entities | 3,829 | 9,521 | - | 972 | 107 | 14,429 |
| Debts of banking corporations | 6,618 | 4,825 | - | 4,507 | 2,406 | 18,356 |
| Debts of securities companies | 74 | 464 | - | - | 493 | 1,031 |
| Debts of corporations | 89,094 | 2,508 | - | 44,469 | 5,537 | 141,608 |
| Debts collateralised by commercial real estate | 34,875 | - | - | 38,028 | - | 72,903 |
| Retail exposures to individuals | 43,292 | - | - | 30,037 | 33 | 73,362 |
| Small business loans | 16,235 | - | - | 4,881 | 2 | 21,118 |
| Housing mortgages | 81,292 | - | - | 5,969 | - | 87,261 |
| Securitization | - | 3,054 | - | - | - | 3,054 |
| Other assets | - | - | 16,136 | - | - | 16,136 |
| Total in respect of credit risk | 324,351 | 72,946 | 16,136 | 129,750 | 8,609 | 551,792 |

| | 31 December 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Credit(c) | Bonds(d) | Others(e) | Guarantees and other liabilities | Transactions in derivative financial instruments(f) | Total(b) |
| | NIS millions | | | | | |
| Sovereign debts | 67,437 | 48,146 | - | 743 | 24 | 116,350 |
| Debts of public sector entities | 4,679 | 9,007 | - | 764 | 140 | 14,590 |
| Debts of banking corporations | 5,981 | 4,687 | - | 4,927 | 3,652 | 19,247 |
| Debts of securities companies | - | 462 | - | - | 659 | 1,121 |
| Debts of corporations | 86,160 | 2,274 | - | 43,343 | 3,961 | 135,738 |
| Debts collateralised by commercial real estate | 33,001 | - | - | 35,551 | - | 68,552 |
| Retail exposures to individuals | 44,455 | - | - | 30,074 | 28 | 74,557 |
| Small business loans | 16,473 | - | - | 4,857 | 1 | 21,331 |
| Housing mortgages | 78,469 | - | - | 4,283 | - | 82,752 |
| Securitization | - | 3,035 | - | - | - | 3,035 |
| Other assets | - | - | 16,653 | - | - | 16,653 |
| Total in respect of credit risk | 336,655 | 67,611 | 16,653 | 124,542 | 8,465 | 553,926 |

(a) After deducting accounting write-offs, but before deducting allowances for credit losses on individual and collective basis.

(b) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities as credit) and after offsetting transactions in derivatives (netting).

(c) Including credit to the public, credit to the Government, and deposits in central banks, and after deducting liabilities in respect of transactions in derivative instruments subject to CSA agreements.

(d) Not including the bonds in the trading portfolio and not including equity investments in financial corporations.

(e) Including cash, investments in financial corporations not deducted from capital, advance payments to the tax authorities, shares and other assets without a counterparty such as buildings and equipment.

(f) Positive fair value of derivatives, including an add-on reflecting the amount of potential future exposure to credit in respect of the balance of nominal value of derivative instruments and after offsetting transactions in derivatives (netting).

## Table 22- Breakdown of the portfolio by term to maturity and by main types of credit exposure (Pillar 3) [(a)]

| | **30 June 2017** | | | | | |
|---|---|---|---|---|---|---|
| | Credit[(C)] | Bonds[(d)] | Others[(e)] | Guarantees and other liabilities | Transactions in derivative financial instruments[(f)] | Total[(b)] |
| | NIS millions | | | | | |
| Up to 1 year | **153,718** | **34,447** | **4,651** | **72,195** | **6,600** | **271,611** |
| From 1 to 5 years | **80,752** | **17,215** | **1,458** | **35,111** | **5,832** | **140,368** |
| Above 5 years | **97,090** | **14,903** | **4,018** | **20,478** | **4,096** | **140,585** |
| Non-monetary items | **386** | **-** | **7,383** | **-** | **8,046** | **15,815** |
| Benefits for offsetting | **-** | **-** | **-** | **-** | **(10,905)** | **(10,905)** |
| Total | **331,946** | **66,565** | **17,510** | **127,784** | **13,669** | **557,474** |

| | 30 June 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Credit[(c)] | Bonds[(d)] | Others[(e)] | Guarantees and other liabilities | Transactions in derivative financial instruments[(f)] | Total[(b)] |
| | NIS millions | | | | | |
| Up to 1 year | 142,845 | 31,493 | 3,737 | 75,619 | 5,161 | 258,855 |
| From 1 to 5 years | 81,415 | 16,010 | 1,270 | 32,642 | 6,609 | 137,946 |
| Above 5 years | 99,459 | 25,443 | 4,428 | 21,489 | 5,441 | 156,260 |
| Non-monetary items | 632 | - | 6,701 | - | 5,631 | 12,964 |
| Benefits for offsetting | - | - | - | - | (14,233) | (14,233) |
| Total | 324,351 | 72,946 | 16,136 | 129,750 | 8,609 | 551,792 |

| | 31 December 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Credit[(c)] | Bonds[(d)] | Others[(e)] | Guarantees and other liabilities | Transactions in derivative financial instruments[(f)] | Total[(b)] |
| | NIS millions | | | | | |
| Up to 1 year | 156,811 | 35,592 | 4,266 | 72,142 | 4,576 | 273,387 |
| From 1 to 5 years | 80,714 | 17,302 | 1,409 | 32,146 | 5,701 | 137,272 |
| Above 5 years | 98,666 | 14,717 | 4,141 | 20,254 | 4,306 | 142,084 |
| Non-monetary items | 464 | - | 6,837 | - | 5,619 | 12,920 |
| Benefits for offsetting | - | - | - | - | (11,737) | (11,737) |
| Total | 336,655 | 67,611 | 16,653 | 124,542 | 8,465 | 553,926 |

(a) After deducting accounting write-offs, but before deducting allowances for credit losses on individual and collective basis.

(b) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities as credit) and after offsetting transactions in derivatives (netting).

(c) Including credit to the public, credit to the Government, and deposits in central banks, and after deducting liabilities in respect of transactions in derivative instruments subject to CSA agreements.

(d) Not including the bonds in the trading portfolio and not including equity investments in financial corporations.

(e) Including cash, investments in financial corporations not deducted from capital, advance payments to the tax authorities, shares and other assets without a counterparty such as buildings and equipment.

(f) Positive fair value of derivatives, including an add-on reflecting the amount of potential future exposure to credit in respect of the balance of nominal value of derivative instruments and after offsetting transactions in derivatives (netting).

**Disclosure with regard to portfolios handled under to the Standardized Approach**

Weighting of credit exposures is based on the Standardized Approach. Under this Approach, risk weightings depend on the type of exposures and, in some of the cases, the credit ratings that refer to them (insofar as there is an eligible rating). In the event there are such exposure ratings, the Bank uses credit ratings of three external credit rating agencies:

- Standard & Poor's Ratings Services
- Moody's Investors Service
- Fitch Ratings

The risk weightings depend on the type of exposure and rating relates to it, if any, in the specified below:
The risk weightings for debts based on the rating of the country, including exposures to governments, banks, securities companies and public sector entities are determined according to Moody's long-term credit rating.
The risk weightings for debts of rated corporations are determined according to the long-term credit ratings of the three agencies, in the following way:
When the debt has one credit rating, this rating will be used to determine the debt's risk weight.
When there are two credit ratings given by two different agencies, which were mapped according to various risk weightings, the higher risk weighting is used.
When there are three ratings, the two best ratings will be considered and, out of these two, the risk weighting suitable for the lower rating is used.

## Credit risk under the Standardized Approach:

The tables below show details of credit exposure by risk weighting, distributing the exposure by counterparty, before and after credit risk provisions in respect of recognized collaterals.

## Table 23 - The amount of exposure after credit loss expenses and before mitigation of credit risk (Pillar 3)

| | 30 June 2017 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 0% | 20% | 35% | 40% | 50% | 75% | 100% | 150% | 225% | 250% | 350% | 650% | Deduction from equity | Gross credit exposure[(a)] |
| | NIS millions | | | | | | | | | | | | | |
| **Sovereign debts** | 103,089 | 3,871 | - | - | 221 | - | 1,035 | - | - | - | - | - | - | 108,216 |
| **Debts of public sector entities** | - | 8,798 | - | - | 6,210 | - | 11 | - | - | - | - | - | - | 15,019 |
| **Debts of banking corporations** | 3,272 | 14,760 | - | - | 3,813 | - | 551 | 12 | - | - | - | - | - | 22,408 |
| **Debts of securities companies** | - | 1,542 | - | - | - | - | - | - | - | - | - | - | - | 1,542 |
| **Debts of corporations** | - | 3,302 | - | - | 1,027 | - | 131,858 | 2,080 | - | - | - | - | - | 138,267 |
| **Debts collateralised by commercial real estate** | - | - | - | - | - | - | 70,370 | 518 | - | - | - | - | - | 70,888 |
| **Retail exposures to individuals** | - | - | - | - | - | 75,406 | 86 | 230 | - | - | - | - | - | 75,722 |
| **Small business loans** | - | - | - | - | - | 21,742 | 42 | 180 | - | - | - | - | - | 21,964 |
| **Housing mortgages** | - | - | 30,872 | - | 16,502 | 32,171 | 2,698 | 194 | - | - | - | - | - | 82,437 |
| **Securitization** | - | 2,658 | - | 35 | 61 | - | - | - | - | - | - | - | - | 2,754 |
| **Other assets** | 3,522 | - | - | - | - | - | 8,852 | 526 | - | 4,610 | - | - | - | 17,510 |
| **Total** | 109,883 | 34,931 | 30,872 | 35 | 27,834 | 129,319 | 215,503 | 3,740 | - | 4,610 | - | - | - | 556,727 |

(a) Before conversion to credit of off-balance sheet components (for example, weighting unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivative transactions (netting).

* As of 1 January 2017, changes have been made to the method by which exposures to central counterparties are calculated. In accordance with the updated guidelines in Proper Conduct of Banking Business Directive 203, exposure to the Stock Exchange was weighted at a risk weighting of 20%.

**For further information, see Note "Capital Adequacy" in the Financial Statement.**

| | 30 June 2016 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 0% | 20% | 35% | 40% | 50% | 75% | 100% | 150% | 225% | 250% | 350% | 650% | Deduction from equity | Gross credit exposure[(a)] |
| | NIS millions | | | | | | | | | | | | | |
| Sovereign debts | 97,880 | 3,527 | - | - | 666 | - | 461 | - | - | - | - | - | - | 102,534 |
| Debts of public sector entities | - | 9,317 | - | - | 5,110 | - | 1 | 1 | - | - | - | - | - | 14,429 |
| Debts of banking corporations | 2,692 | 13,238 | - | - | 1,710 | - | 689 | 27 | - | - | - | - | - | 18,356 |
| Debts of securities companies | - | 1,031 | - | - | - | - | - | - | - | - | - | - | - | 1,031 |
| Debts of corporations | - | 1,662 | - | - | 1,619 | - | 135,773 | 1,825 | - | - | - | - | - | 140,879 |
| Debts collateralised by commercial real estate | - | - | - | - | - | - | 72,704 | 189 | - | - | - | - | - | 72,893 |
| Retail exposures to individuals | - | - | - | - | - | 73,022 | 66 | 243 | - | - | - | - | - | 73,331 |
| Small business loans | - | - | - | - | - | 20,820 | 38 | 188 | - | - | - | - | - | 21,046 |
| Housing mortgages | - | - | 36,831 | - | 15,301 | 32,623 | 2,306 | 199 | - | - | - | - | - | 87,260 |
| Securitization | - | 2,937 | - | 117 | - | - | - | - | - | - | - | - | - | 3,054 |
| Other assets | 2,321 | 1 | - | - | - | - | 9,154 | 452 | - | 4,208 | - | - | - | 16,136 |
| Total | 102,893 | 31,713 | 36,831 | 117 | 24,406 | 126,465 | 221,192 | 3,124 | - | 4,208 | - | - | - | 550,949 |

(a) Before conversion to credit of off-balance sheet components (for example, weighting unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivative transactions (netting).

* As of 1 January 2017, changes have been made to the method by which exposures to central counterparties are calculated. In accordance with the updated guidelines in Proper Conduct of Banking Business Directive 203, exposure to the Stock Exchange was weighted at a risk weighting of 20%.

**For further information, see Note "Capital Adequacy" in the Financial Statement.**

| | 31 December 2016 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 0% | 20% | 35% | 40% | 50% | 75% | 100% | 150% | 225% | 250% | 350% | 650% | 1250% | Gross credit exposure[(a)] |
| | NIS millions | | | | | | | | | | | | | |
| Sovereign debts | 111,849 | 3,454 | - | - | 261 | - | 786 | - | - | - | - | - | - | 116,350 |
| Debts of public sector entities | - | 8,810 | - | - | 5,736 | - | 44 | - | - | - | - | - | - | 14,590 |
| Debts of banking corporations | 2,847 | 13,550 | - | - | 2,334 | - | 498 | 18 | - | - | - | - | - | 19,247 |
| Debts of securities companies | - | 1,121 | - | - | - | - | - | - | - | - | - | - | - | 1,121 |
| Debts of corporations | - | 1,781 | - | - | 1,276 | - | 130,537 | 1,578 | - | - | - | - | - | 135,172 |
| Debts collateralised by commercial real estate | - | - | - | - | - | - | 68,275 | 268 | - | - | - | - | - | 68,543 |
| Retail exposures to | - | - | - | - | - | 74,471 | 36 | 25 | - | - | - | - | - | 74,532 |
| Small business loans | - | - | - | - | - | 21,214 | 9 | 54 | - | - | - | - | - | 21,277 |
| Housing mortgages | - | - | 33,100 | - | 15,181 | 31,440 | 2,630 | 213 | - | - | - | - | - | 82,564 |
| Securitization | - | 2,931 | - | 78 | 26 | - | - | - | - | - | - | - | - | 3,035 |
| Other assets | 2,876 | - | - | - | - | - | 8,996 | 479 | - | 4,302 | - | - | - | 16,653 |
| Total | 117,572 | 31,647 | 33,100 | 78 | 24,814 | 127,125 | 211,811 | 2,635 | - | 4,302 | - | - | - | 553,084 |

(a) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivatives transactions (netting).

**Table 24 - The amount of exposure after expenses for credit losses and after mitigation of credit risk (Pillar 3)[(b)]**

| | 30 June 2017 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 0% | 20% | 35% | 40% | 50% | 75% | 100% | 150% | 225% | 250% | 350% | 650% | 1250% | Gross credit exposure[(a)] |
| | NIS millions | | | | | | | | | | | | | |
| Sovereign debts | 110,810 | 3,898 | - | - | 221 | - | 811 | - | - | - | - | - | - | 115,740 |
| Debts of public sector entities | 1,421 | 3,114 | - | - | 6,155 | - | 11 | - | - | - | - | - | - | 10,701 |
| Debts of banking corporations | 3,272 | 13,267 | - | - | 2,394 | - | 551 | 2 | - | - | - | - | - | 19,486 |
| Debts of securities companies | - | 1,391 | - | - | - | - | - | - | - | - | - | - | - | 1,391 |
| Debts of corporations | - | 21,657 | - | - | 4,944 | - | 98,755 | 2,074 | - | - | - | - | - | 127,430 |
| commercial real estate | - | - | - | - | - | - | 69,835 | 517 | - | - | - | - | - | 70,352 |
| individuals | - | - | - | - | - | 74,278 | 67 | 230 | - | - | - | - | - | 74,575 |
| Small business loans | - | - | - | - | - | 19,885 | 38 | 179 | - | - | - | - | - | 20,102 |
| Housing mortgages | - | - | 30,871 | - | 16,502 | 32,125 | 2,697 | 194 | - | - | - | - | - | 82,389 |
| Securitization | - | 1,857 | - | 35 | 61 | - | - | - | - | - | - | - | - | 1,953 |
| Other assets | 3,522 | - | - | - | - | - | 8,852 | 526 | - | 4,610 | - | - | - | 17,510 |
| **Total** | 119,025 | 45,184 | 30,871 | 35 | 30,277 | 126,288 | 181,617 | 3,722 | - | 4,610 | - | - | - | 541,629 |

(a) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivatives transactions (netting).
(b) Mitigation of credit risk reflects the classification of the final risk weighting from among the various rates.
* As of 1 January 2017, changes have been made to the method by which exposures to central counterparties are calculated. In accordance with the updated guidelines in Proper Conduct of Banking Business Directive 203, exposure to the Stock Exchange was weighted at a risk weighting of 20%.

**For further information, see Note "Capital Adequacy" in the Financial Statement.**

| | 30 June 2016 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 0% | 20% | 35% | 40% | 50% | 75% | 100% | 150% | 225% | 250% | 350% | 650% | 1250% | Gross credit exposure[(a)] |
| | NIS millions | | | | | | | | | | | | | |
| Sovereign debts | 105,487 | 3,528 | - | - | 666 | - | 110 | - | - | - | - | - | - | 109,791 |
| Debts of public sector entities | 1,021 | 3,892 | - | - | 5,038 | - | 1 | 1 | - | - | - | - | - | 9,953 |
| Debts of banking corporations | 2,692 | 11,649 | - | - | 1,888 | - | 689 | 3 | - | - | - | - | - | 16,921 |
| Debts of securities companies | - | 1,031 | - | - | - | - | - | - | - | - | - | - | - | 1,031 |
| Debts of corporations | - | 20,175 | - | - | 5,582 | - | 102,542 | 1,794 | - | - | - | - | - | 130,093 |
| commercial real estate | - | - | - | - | - | - | 71,973 | 188 | - | - | - | - | - | 72,161 |
| individuals | - | - | - | - | - | 71,601 | 127 | 243 | - | - | - | - | - | 71,971 |
| Small business loans | - | - | - | - | - | 18,599 | 36 | 183 | - | - | - | - | - | 18,818 |
| Housing mortgages | - | - | 36,506 | - | 15,625 | 32,583 | 2,306 | 199 | - | - | - | - | - | 87,219 |
| Securitization | - | 2,226 | - | 117 | - | - | - | - | - | - | - | - | - | 2,343 |
| Other assets | 2,321 | 1 | - | - | - | - | 9,154 | 452 | - | 4,208 | - | - | - | 16,136 |
| Total | 111,521 | 42,502 | 36,506 | 117 | 28,799 | 122,783 | 186,938 | 3,063 | - | 4,208 | - | - | - | 536,437 |

(a) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivatives transactions (netting).

(b) Mitigation of credit risk reflects the classification of the final risk weighting from among the various rates.

* As of 1 January 2017, changes have been made to the method by which exposures to central counterparties are calculated. In accordance with the updated guidelines in Proper Conduct of Banking Business Directive 203, exposure to the Stock Exchange was weighted at a risk weighting of 20%.

**For further information, see Note "Capital Adequacy" in the Financial Statement.**

| | 31 December 2016 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 0% | 20% | 35% | 40% | 50% | 75% | 100% | 150% | 225% | 250% | 350% | 650% | 1250% | Gross credit exposure[(a)] |
| | NIS millions | | | | | | | | | | | | | |
| Sovereign debts | 119,244 | 3,423 | - | - | 261 | - | 274 | - | - | - | - | - | - | 123,202 |
| Debts of public sector entities | 1,333 | 3,676 | - | - | 5,644 | - | 44 | - | - | - | - | - | - | 10,697 |
| Debts of banking corporations | 2,847 | 10,704 | - | - | 2,278 | - | 498 | 2 | - | - | - | - | - | 16,329 |
| Debts of securities companies | - | 863 | - | - | - | - | - | - | - | - | - | - | - | 863 |
| Debts of corporations | - | 20,135 | - | - | 5,207 | - | 98,838 | 1,571 | - | - | - | - | - | 125,751 |
| commercial real estate | - | - | - | - | - | - | 67,744 | 268 | - | - | - | - | - | 68,012 |
| individuals | - | - | - | - | - | 73,170 | 28 | 25 | - | - | - | - | - | 73,223 |
| Small business loans | - | - | - | - | - | 19,384 | 9 | 53 | - | - | - | - | - | 19,446 |
| Housing mortgages | - | - | 33,099 | - | 15,181 | 31,400 | 2,630 | 213 | - | - | - | - | - | 82,523 |
| Securitization | - | 2,203 | - | 78 | 26 | - | - | - | - | - | - | - | - | 2,307 |
| Other assets | 2,876 | - | - | - | - | - | 8,996 | 479 | - | 4,302 | - | - | - | 16,653 |
| Total | 126,300 | 41,004 | 33,099 | 78 | 28,597 | 123,954 | 179,061 | 2,611 | - | 4,302 | - | - | - | 539,006 |

(a) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivatives transactions (netting).

(b) Mitigation of credit risk reflects the classification of the final risk weighting from among the various rates.

### Table 25 - Mitigation of credit risk (Pillar 3)

In order to reduce the credit risk in the Standardized Approach, the Bank uses the comprehensive approach to handling collateral. During the reported period, there were no material changes in risk mitigation methods applied in the Bank.

For further details regarding the principal security instruments, as well as the use of offsetting arrangements and their eligibility conditions, see the Risk Report for 2016.

| | 30 June 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Gross credit exposure before allowance for credit losses[(a)] | Gross credit exposure after allowance for credit losses[(a)] | Total exposure covered by guarantees deducted | Total amounts added | Total exposure covered by eligible financial collateral[(b)] | Net credit exposure[(c)] |
| | NIS millions | | | | | |
| Sovereign debts | **108,216** | **108,216** | **(410)** | **7,934** | **-** | **115,740** |
| Debts of public sector entities | **15,019** | **15,019** | **(5,736)** | **1,421** | **(3)** | **10,701** |
| Debts of banking corporations | **22,408** | **22,408** | **(1,779)** | **390** | **(1,533)** | **19,486** |
| Debts of securities companies | **1,542** | **1,542** | **-** | **-** | **(151)** | **1,391** |
| Debts of corporations | **138,742** | **138,267** | **(23,530)** | **22,648** | **(9,955)** | **127,430** |
| Debts collateralised by commercial real estate | **70,900** | **70,888** | **(85)** | **-** | **(451)** | **70,352** |
| Retail exposures to individuals | **75,749** | **75,722** | **(2)** | **-** | **(1,145)** | **74,575** |
| Small business loans | **22,023** | **21,964** | **(30)** | **-** | **(1,832)** | **20,102** |
| Housing mortgages | **82,611** | **82,437** | **(20)** | **-** | **(28)** | **82,389** |
| Securitization | **2,754** | **2,754** | **(801)** | **-** | **-** | **1,953** |
| Other assets | **17,510** | **17,510** | **-** | **-** | **-** | **17,510** |
| Total | **557,474** | **556,727** | **(32,393)** | **32,393** | **(15,098)** | **541,629** |

| | 30 June 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Gross credit exposure before allowance for credit losses[(a)] | Gross credit exposure after allowance for credit losses[(a)] | Total exposure covered by guarantees deducted | Total amounts added | exposure covered by eligible financial collateral[(b)] | Net credit exposure[(c)] |
| | NIS millions | | | | | |
| Sovereign debts | 102,534 | 102,534 | (351) | 7,608 | - | 109,791 |
| Debts of public sector entities | 14,429 | 14,429 | (5,494) | 1,021 | (3) | 9,953 |
| Debts of banking corporations | 18,356 | 18,356 | (1,466) | 597 | (566) | 16,921 |
| Debts of securities companies | 1,031 | 1,031 | - | - | - | 1,031 |
| Debts of corporations | 141,608 | 140,879 | (23,563) | 22,706 | (9,929) | 130,093 |
| Debts collateralised by commercial real estate | 72,903 | 72,893 | (39) | - | (693) | 72,161 |
| individuals | 73,362 | 73,331 | (220) | - | (1,140) | 71,971 |
| Small business loans | 21,118 | 21,046 | (84) | - | (2,144) | 18,818 |
| Housing mortgages | 87,261 | 87,260 | (4) | - | (37) | 87,219 |
| Securitization | 3,054 | 3,054 | (711) | - | - | 2,343 |
| Other assets | 16,136 | 16,136 | - | - | - | 16,136 |
| Total | 551,792 | 550,949 | (31,932) | 31,932 | (14,512) | 536,437 |

| | 31 December 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Gross credit exposure before allowance for credit losses[(a)] | Gross credit exposure after allowance for credit losses[(a)] | Total exposure covered by guarantees deducted | Total amounts added | Total exposure covered by eligible financial collateral[(b)] | Net credit exposure[(c)] |
| | NIS millions | | | | | |
| Sovereign debts | 116,350 | 116,350 | (560) | 7,412 | - | 123,202 |
| Debts of public sector entities | 14,590 | 14,590 | (5,203) | 1,333 | (23) | 10,697 |
| Debts of banking corporations | 19,247 | 19,247 | (1,957) | 414 | (1,375) | 16,329 |
| Debts of securities companies | 1,121 | 1,121 | - | - | (258) | 863 |
| Debts of corporations | 135,738 | 135,172 | (23,084) | 22,457 | (8,794) | 125,751 |
| Debts collateralised by commercial real estate | 68,552 | 68,543 | (42) | - | (489) | 68,012 |
| individuals | 74,557 | 74,532 | (4) | - | (1,305) | 73,223 |
| Small business loans | 21,331 | 21,277 | (22) | - | (1,809) | 19,446 |
| Housing mortgages | 82,752 | 82,564 | (16) | - | (25) | 82,523 |
| Securitization | 3,035 | 3,035 | (728) | - | - | 2,307 |
| Other assets | 16,653 | 16,653 | - | - | - | 16,653 |
| Total | 553,926 | 553,084 | (31,616) | 31,616 | (14,078) | 539,006 |

(a) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivative transactions (netting).

(b) After taking safety factors into account.

(c) Before conversion to credit of off-balance sheet components (for example, weighting of unutilized facilities), before mitigation of credit risk as a result of taking certain actions (for example, by using guarantees) and after offsetting derivative transactions (netting).

**General disclosure regarding exposures related to counterparty risk**

Credit risk in derivatives is different from credit risk in loans due to the fact that changes in market prices can substantially increase the exposure to the counterparty.

In recent years, mechanisms for mitigating counterparty credit risks in trading, by accepting the effect of netting procedures in standard international legal agreements (such as ISDA), and also by a mechanism of depositing mutual collaterals between the counterparties to the transaction (CSA agreements), have been developed. Inter-banking trading activity is performed only with counterparties with whom the Bank has signed such agreements. In addition, there is a similar trend of contracting with high-activity in derivatives customers on a similar basis.

**Table 26 - Balances of credit risk of counterparties in derivatives (Pillar 3)**

| | **30 June** | | | | 31 December | |
|---|---|---|---|---|---|---|
| | **2017** | | 2016 | | 2016 | |
| | Balance of nominal value | Net credit exposures of derivatives | Balance of nominal value | Net credit exposures of derivatives | Balance of nominal value | Net credit exposures of derivatives |
| | NIS millions | | | | | |
| **Interest contracts** | **318,419** | **8,232** | 335,704 | 9,832 | 331,589 | 7,859 |
| Foreign currency contracts | **243,837** | **7,925** | 288,755 | 7,389 | 252,529 | 6,727 |
| Contracts for shares | **120,006** | **8,345** | 103,608 | 5,513 | 104,127 | 5,537 |
| Commoditries and other contracts | **496** | **72** | 682 | 108 | 610 | 79 |
| Credit derivative transactions(a) | **-** | **-** | - | - | - | - |
| Offsetting benefits | **-** | **(10,905)** | - | (14,233) | - | (11,737) |
| Eligible collateral | **-** | **(4,696)** | - | (3,380) | - | (3,682) |
| Total | **682,758** | **8,973** | 728,749 | 5,229 | 688,855 | 4,783 |

(a) As at the reporting date there are no credit risk exposures with regard to sold or purchased hedging.

## Securitization

The Bank has no asset securitization activity.

However, the Bank invests in asset-backed securities through its nostro activity.

Asset-backed securities are characterized by a wide diversification of borrowers and sometimes also in industry sectoral and inter-sectoral diversification. In addition, in some instruments there is an allocation to layers of different risk levels which enable the Bank to be flexible when adapting the investment to the risk appetite.

Investment in various types of asset-backed securities is examined in advance both in terms of expected return and from aspects of the inherent risks.

**Banking Portfolio**

**Table 27 - Banking portfolio - investment in asset-backed securities by type of exposure (Pillar 3)**

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | 2016 | 2016 |
| | Overall balance | | |
| | NIS millions | | NIS millions |
| **Mortgage-backed securities (MBS):** | | | |
| **Pass-through type securities by means of:** | | | |
| RMBS-type securities guaranteed by US | **194** | 389 | 273 |
| RMBS-type securities issued by FNMA and by | **1,416** | 2,099 | 1,986 |
| Other securities | **802** | 711 | 728 |
| Other mortgage-backed securities: | | | |
| RMBS-type securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities | **3,785** | 4,906 | 4,455 |
| Other mortgage-backed securities | **323** | 481 | 544 |
| **Total mortgage-backed securities (MBS)** | **6,520** | 8,586 | 7,986 |
| | | | |
| **Asset-backed securities (ABS)** | | | |
| Credit card receivables | **-** | 34 | - |
| Lines of credit for any purpose secured by dwelling | **-** | - | - |
| Credit for purchase of vehicle | **-** | - | - |
| Other credit to private persons | **-** | 4 | 338 |
| Credit not to private persons | **1** | 1 | 1 |
| CLO-type debentures | **1,584** | 1,823 | 1,424 |
| **Total asset-backed (ABS)** | **1,585** | 1,862 | 1,763 |
| **Total asset-backed securities** | **8,105** | 10,448 | 9,749 |

**Table 28 - Banking portfolio - investments in asset-backed securities by risk weighting(Pillar 3)(*)**

| | **30 June 2017** | | | |
|---|---|---|---|---|
| | Accumulated total exposure | | | |
| | Securitization exposures | Resecuritization exposures | Total | Capital requirements in respect of securitization exposures |
| | NIS millions | | | |
| 20% | **2,614** | **-** | **2,614** | **72** |
| 40% | **-** | **35** | **35** | **2** |
| 50% | **61** | **-** | **61** | **11** |
| 100% | **-** | **-** | **-** | **-** |
| 225% | **-** | **-** | **-** | **-** |
| 1250% | **-** | **-** | **-** | **-** |
| Total | **2,675** | **35** | **2,710** | **85** |

| | 30 June 2016 | | | |
|---|---|---|---|---|
| | Accumulated total exposure | | | |
| | Securitization exposures | Resecuritization exposures | Total | Capital requirements in respect of securitization exposures |
| | NIS millions | | | |
| 20% | 2,937 | - | 2,937 | 74 |
| 40% | - | 117 | 117 | 6 |
| 50% | - | - | - | - |
| 100% | - | - | - | - |
| 225% | - | - | - | - |
| 1250% | - | - | - | - |
| Total | 2,937 | 117 | 3,054 | 80 |

| | 31 December 2016 | | | |
|---|---|---|---|---|
| | Accumulated total exposure | | | |
| | Securitization exposures | Resecuritization exposures | Total | Capital requirements in respect of securitization exposures |
| | NIS millions | | | |
| 20% | 2,931 | - | 2,931 | 73 |
| 40% | - | 78 | 78 | 4 |
| 50% | 26 | - | 26 | 2 |
| 100% | - | - | - | - |
| 225% | - | - | - | - |
| 1250% | - | - | - | - |
| Total | 2,957 | 78 | 3,035 | 79 |

(*) Not including FNMA, FHLMC securities whose risk weighting is 20%. Not including GNMA securities whose risk weighting is 0%.

## Trading Portfolio

### Table 29 - Trading portfolio - investment in asset-backed securities by type of exposure (Pillar 3)[(a)]

| | **30 June** | | 31 December |
|---|---|---|---|
| | **2017** | **2016** | 2016 |
| | Overall balance of exposure | | |
| | NIS millions | | |
| **Mortgage-backed securities (MBS):** | | | |
| **Pass-through type securities by means of:** | | | |
| RMBS-type securities guaranteed by US Government GNMA | **-** | - | - |
| RMBS-type securities issued by FNMA and by FHLMC | **5** | 7 | 6 |
| Other securities | **-** | - | - |
| Other mortgage-backed securities: | **-** | - | - |
| RMBS-type securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities | **-** | 158 | - |
| Other mortgage-backed securities | **73** | 79 | 86 |
| **Total mortgage-backed securities (MBS)** | **78** | 244 | 92 |
| | | | |
| **Asset-backed securities (ABS)** | | | |
| Credit card receivables | **11** | 12 | 12 |
| Lines of credit for any purpose secured by dwelling | **-** | - | - |
| Credit for purchase of vehicle | **59** | 69 | 51 |
| Other credit to private persons | **10** | 13 | 12 |
| Credit not to private persons | **-** | - | - |
| Others | **117** | 123 | 113 |
| **Total asset-backed (ABS)** | **197** | 217 | 188 |
| **Total asset-backed securities** | **275** | 461 | 280 |

(a) As at December 31, 2016, there are no re-securitization positions in the trading portfolio.

**Table 30 - Trading portfolio - investments in asset-backed securities by risk weighting (Pillar 3)***

| | **30 June** | | | | 31 December | |
|---|---|---|---|---|---|---|
| | **2017** | | 2016 | | 2016 | |
| | Accumulated total exposure | Capital requirements in respect of securitization exposures | Accumulated total exposure | Capital requirements in respect of securitization exposures | Accumulated total exposure | Capital requirements in respect of securitization exposures |
| | NIS millions | | | | | |
| 20% | **132** | **4** | 150 | 4 | 150 | 4 |
| 50% | **134** | **9** | 141 | 9 | 121 | 8 |
| 100% | **1** | **-** | 1 | - | 1 | - |
| 350% | **3** | **1** | 2 | 1 | 3 | 1 |
| 1250% | **-** | **-** | 2 | 2 | - | - |
| Total | **270** | **14** | 296 | 16 | 274 | 13 |

* Not including FNMA, FHLMC securities whose risk weighting is 20%. Not including GNMA securities whose risk weighting is 0%.

**Portfolio held to maturity**

**Table 31 – Portfolio held to maturity – Investment in asset-backed securities by type of exposure (Pillar 3)***

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | 2016 | 2016 |
| | Overall balance of exposure | | |
| | NIS millions | | |
| RMBS-type securities issued by FNMA, FHLMC, or GNMA, or guaranteed by these entities | **245** | - | - |
| Other mortgage-backed securities | **173** | - | - |
| **Total mortgage-backed securities (MBS)** | **418** | - | - |
| | | | |
| **Total asset-backed (ABS)** | **-** | - | - |
| **Total asset-backed securities** | **418** | - | - |

* As of 1 January 2017, the Bank was permitted to renew classification of bonds to the held to maturity portfolio. As a result, the Bank reclassified bonds booked in the available for sale portfolio to the held to maturity portfolio of a subsidiary abroad in the amount of NIS 957 million, of which NIS 466 are assets backed securities.

In accordance with the directives of the Bank of Israel, the transfer of bonds from the available for sale portfolio to sale to the held to maturity portfolio, unrealized profit or loss from adjustment to fair value of the date of transfer remain presented in the shareholder's equity, but as of that day and forward are amortized to profit and loss over the rest of the duration of the bond. The amount of loss in the capital reserve as of the transfer date is NIS 35 million.

**Table 32- Portfolio held to maturity – Investment in asset-backed securities by risk weighting (Pillar 3)***

| | 30 June 2017 | | | |
|---|---|---|---|---|
| | Accumulated total exposure | | | |
| | Securitization exposures | Resecuritization exposures | Total | Capital requirements in respect of securitization exposures |
| | NIS millions | | | |
| 20% | **173** | **-** | **173** | **5** |
| 40% | **-** | **-** | **-** | **-** |
| 50% | **-** | **-** | **-** | **-** |
| 100% | **-** | **-** | **-** | **-** |
| 225% | **-** | **-** | **-** | **-** |
| 1250% | **-** | **-** | **-** | **-** |
| Total | **173** | **-** | **173** | **5** |

* Not including FNMA, FHLMC securities whose risk weighting is 20%. Not including GNMA securities whose risk weighting is 0%.

## Market Risk

Market risk is defined as the risk of loss in balance sheet and off-balance sheet positions as a result of a change in the fair-value of a financial instrument due to change in market conditions (change in price levels in various markets, volatility in interest rates, exchange rates, inflation, share prices and other economic indices). The exposure to market risks is reflected in the financial results, in the fair value of assets and liabilities, in shareholders' equity and in cash flows.

The Bank implements the directives of the Banking Supervision Department regarding market risks and the Group's liquidity, including Proper Conduct of Banking Directive No. 333 "Managing Interest Risk", No. 339 "Managing Market Risks", No. 342 "Managing Liquidity Risks", and No. 221 " Liquidity Coverage Ratio". As part of the implementation of these provisions, fundamental principles of risks management and control have been established, including the responsibility of the management and the Board of Directors, defining means of monitoring and tools for measuring the risks, while applying a corporate governance structure which includes three "lines of defense".

## Market Risk Management Policy

Market risk management policy is manifests in the Group's market risk strategy, alongside the present procedures for identifying, measuring, monitoring, developing and controlling market risks. The policy is meant, on the one hand, to support the achievement of business targets while assessing the risks and opportunities that can emanate from exposure to risks compared with the expected profit and, on the other hand, to decrease the risk level emanating from the Bank's ongoing activity, including maintaining a high level of liquidity.

The policy constitutes an important tool for defining the Bank's risk appetite in the nostro portfolio, the trading rooms and the market exposure in the entire Leumi Group. The policy defines the corporate governance, the division of organizational responsibility and the escalation mechanisms.

The exposures to market risks are routinely managed at Group level. The overseas subsidiaries determine market risk management policies which comply with the Group policies and its approved risk frameworks. Information on the actual exposure status according to the established frameworks is received from the subsidiaries and taken into account in the overall management of the Group's exposures.

Market risk management is performed in two risk focal points – the banking portfolio and the trading portfolio. The definition of the trading portfolio is derived from the Basel directives and includes the Bank's tradable securities portfolio and derivative transactions in tradable activity. The definition of the banking portfolio includes the transactions which are not included in the trade portfolio.

The Bank applies the US accounting principles for employee benefits, as set by the Bank of Israel. Managing the market risk in respect of the obligation to employees is partially performed as part of the banking portfolio and partially performed independently and separately against the "pension plan assets" portfolio, which is designed to yield a long term return, for serving the liability. The actuarial commitment to employees having a long term average duration is substantially influenced by changes in the discount rate. The discount rate, which is used for calculating the actuarial liabilities for employee benefits, is calculated based on the Government of Israel's bond yield curve plus the AA corporate bond credit risk spread in the US with a duration that matches the liabilities. The effect of the changes in the discount rate on the Bank's capital is significant.

**No major changes occurred since the beginning of the year in the organizational structure, in the policy and in the corporate governance structure of the market risk management**.

**Table 33 – Capital requirement in respect of market risks (Pillar 3)**

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | 2016 | 2016 |
| | NIS millions | | |
| **Capital requirements[(a)] in respect of:** | | | |
| Interest rate risk | **655** | 595 | 478 |
| Share price risk | **103** | 60 | 44 |
| Exchange rate risk | **63** | 114 | 70 |
| Options | **47** | 38 | 19 |
| Total capital requirements in respect of market risks | **868** | 807 | 611 |

(a) At 13.76%, 12.64%, and 12.74% in accordance with the required minimum capital ratio as of June 30, 2017, 30 June 2016 and December 2016 respectively.

### Market risks to which the Bank is exposed

### Basis Risk / Exchange Rate Risk

Basis risk is the risk deriving from the exposure of the value of assets and liabilities to change in inflation and in the exchange rate. The exposure to basis risk is measured as a percentage of the exposed capital at the Group level. The exposed capital includes shareholders' equity and certain reserves, after deducting fixed assets and investments in associate companies.

## Table 34- Actual economic exposure at Group level

**The data are presented in terms of percentage of the exposed capital**

| | Actual Status | | |
|---|---|---|---|
| | 30 June | | 31 December |
| | **2017** | 2016 | 2016 |
| | % | | |
| Unlinked | **(9.9)** | (20.9) | (19.0) |
| CPI linked* | **8.9** | 19.1 | 17.7 |
| Foreign Currency | **1.0** | 1.8 | 1.3 |

* The exposure does not take into account the effect of the index-floors certain assets and liabilities.

Since the beginning of the year, the Group complied with all the exposure limits set by the Board of Directors.

### Investment in shares and funds

The Bank set an investment policy in the Group, including setting limitations on the scope of the overall portfolio and on the investment in a single company, on the diversification of investments and on different risk levels between the types of investments.

The investment in equity is carried out through investments in indices or in negotiable investment instruments.

Also, the Bank manages investments in non-financial companies through its subsidiary "Leumi Partners".

## Table 35- The investment balance sheet in the banking portfolio (Pillar 3)

| | 30 June | | 31 December |
|---|---|---|---|
| | **2017** | 2016 | 2016 |
| | NIS millions | | |
| Unquoted shares in the available portfolio | **906** | 919 | 981 |
| Quoted shares and funds in the available portfolio | **1,765** | 1,043 | 961 |
| **Total** | **2,671** | 1,962 | 1,942 |

## Interest rate risk

Interest rate risk is the risk of loss as a result of changes in risk-free interest rates in various currencies, due to the gaps between the timing of interest rate repricing of the assets and liabilities in each of the index sectors, whichever is earlier.

The interest rate exposure policy is to limit the volatility in net asset value[1] and in net interest income for the upcoming year.

The interest rate risk is measured and managed based on different behavioral assumptions as to the maturity of the assets and liabilities. Based on past experience, the Bank considers part of the current accounts balance to be long term liabilities. In addition, there are assumptions regarding early repayment of mortgages. These estimates are highly important for managing interest risks, inter alia, due to a substantial increase in balances of current accounts and mortgages in recent years.

Measuring exposure to interest rate changes is simulated both for an increase and a decrease in interest rate in each currency or index-linked sector. This measurement is designed to examine the sensitivity of the current asset and liability structure to interest rate changes, which is kept constant in the simulation.

### Table 36 - Summary of exposure to unexpected changes in interest rates at the Group level (before tax and in NIS million)*

### The potential change in the net asset value as result of a scenario:

| | The potential change in the net asset value as result of a scenario | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **30 June 2017** | | | 30 June 2016 | | | 31 December 2016 | | |
| Scenario | Increase of 1% | Decrease of 1% | Change of 0.1% | Increase of 1% | Decrease of 1% | Change of 0.1% | Increase of 1% | Decrease of 1% | Change of 0.1% |
| **In Israeli currency:** | | | | | | | | | |
| Banking portfolio | **(362)** | **145** | **(26)** | (828) | 1,052 | (92) | (12) | (227) | 10 |
| Trading portfolio | **(48)** | **54** | **(5)** | (120) | 107 | (13) | 37 | (45) | 4 |
| **In foreign currency:** | | | | | | | | | |
| Banking portfolio | **(4)** | **(78)** | **5** | 18 | (107) | (1) | (42) | (143) | - |
| Trading portfolio | **(25)** | **(38)** | **1** | 25 | (43) | 1 | 52 | (49) | 5 |

| | Potential erosion in net interest income as a result of an increase of 1%** | | | | | |
|---|---|---|---|---|---|---|
| | **30 June 2017** | | 30 June 2016 | | 31 December 2016 | |
| | Israeli currency | Foreign currency | Israeli currency | Foreign currency | Israeli currency | Foreign currency |
| **Total** | **332** | **289** | 284 | 196 | 523 | 215 |

* The calculation of the exposure to a 1% decrease in interest rate is based on simulating a reduction of the interest rates on loans and deposits. Since the interest rate on most deposits today is less than 1%, and since there is a low probability that the interest rates on deposits will decline below 0%, the above calculation should be considered as a benchmark according to accepted standards.

** In an interest rate decrease scenario a loss of this amount is expected.

[1] The net asset value is defined as the difference between the present value of assets and liabilities. In calculating the present value, the cash flows are discounted using the risk-free yield curve or Libor for the foreign currency cash flows.

**Table 37 – Capital exposures to an instantaneous increase/decrease in interest (before tax and in NIS millions)**

| | Exposure in Israeli currency | | | Exposure in foreign currency | | |
|---|---|---|---|---|---|---|
| | **30 June 2017** | | | | | |
| | Increase of 1% | Decrease of 1% | Increase of 0.1% | Decrease of 1% | Increase of 1% | Increase of 0.1% |
| Exposure of capital to an immediate increase/decrease in interest* | **1,294** | **(1,685)** | **145** | **(405)** | **282** | **(35)** |
| | 30 June 2016 | | | | | |
| | Increase of 1% | Decrease of 1% | Increase of 0.1% | Decrease of 1% | Increase of 1% | Increase of 0.1% |
| Exposure of capital to an immediate increase/decrease in interest* | 434 | (707) | 54 | (377) | 288 | (43) |
| | 31 December 2016 | | | | | |
| | Increase of 1% | Decrease of 1% | Increase of 0.1% | Decrease of 1% | Increase of 1% | Increase of 0.1% |
| Exposure of capital to an immediate increase/decrease in interest* | 1,537 | (1,978) | 176 | (435) | 268 | (40) |

* This measurement includes the effect of instantaneous changes in interest rates on the market value of the trading portfolio and the actuarial liability for employees. This measurement does not include the impact on the pension plan asset portfolio, which is estimated as at June 30, 2017 as a reduction of about NIS 149 million (at June 30, 2016 approximately NIS 120 million, at December 31, 2016 approximately NIS 117 million) in a scenario of 1% increase in interest rates. Furthermore, this measurement does not include the impact of the transitional provisions of the employee benefits accounting standard, according to which the capital adequacy ratio is calculated.

Since the beginning of the year, the Group complied with all the interest exposure limits set by the Board of Directors.

**The sensitivity of the fair value of assets and liabilities to interest rates**

Below is the fair value of financial instruments before the effects of changes in interest rates and the effect of potential changes in interest rates on the fair value of financial instruments in the Bank and its consolidated companies, excluding non-monetary items, in accordance with accounting principles.

**Table 38 – Fair value of financial instruments before the effect of changes in interest rates**

| | **30 June 2017** | | | | | |
|---|---|---|---|---|---|---|
| | Israeli currency | | Foreign currency including assets and liabilities linked to foreign currency | | | Total |
| | Unlinked | CPI-linked | Dollar | Euro | Others | |
| | NIS millions | | | | | |
| Financial assets | **284,124** | **47,568** | **58,274** | **10,759** | **9,529** | **410,254** |
| Amounts receivable in respect of derivative and off-balance sheet financial instruments | **261,183** | **6,996** | **187,253** | **62,772** | **26,185** | **544,389** |
| Financial liabilities [(a)] | **237,207** | **54,442** | **85,093** | **12,813** | **6,922** | **396,477** |
| Amounts payable in respect of derivative and off-balance sheet financial instruments | **280,958** | **11,036** | **162,663** | **61,110** | **29,621** | **545,388** |
| Net fair value of financial instruments | **27,142** | **(10,914)** | **(2,229)** | **(392)** | **(829)** | **12,778** |

| | 30 June 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Israeli currency | | Foreign currency including assets and liabilities linked to foreign currency | | | Total |
| | Unlinked | CPI-linked | Dollar | Euro | Others | |
| | NIS millions | | | | | |
| Financial assets | 268,086 | 53,102 | 71,064 | 7,244 | 9,863 | 409,359 |
| Amounts receivable in respect of derivative and off-balance sheet financial instruments | 267,056 | 7,461 | 218,270 | 52,116 | 43,143 | 588,046 |
| Financial liabilities [(a)] | 223,985 | 60,170 | 89,699 | 13,119 | 8,637 | 395,610 |
| Amounts payable in respect of derivative and off-balance sheet financial instruments | 288,517 | 8,867 | 199,973 | 46,772 | 44,879 | 589,008 |
| Net fair value of financial instruments | 22,640 | (8,474) | (338) | (531) | (510) | 12,787 |

| | 31 December 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Israeli currency | | Foreign currency including assets and liabilities linked to foreign currency | | | Total |
| | Unlinked | CPI-linked | Dollar | Euro | Others | |
| | NIS millions | | | | | |
| Financial assets | 278,940 | 48,232 | 69,263 | 8,061 | 8,561 | 413,057 |
| Amounts receivable in respect of derivative and off-balance sheet financial instruments | 252,169 | 6,790 | 214,767 | 55,373 | 28,222 | 557,321 |
| Financial liabilities [(a)] | 231,563 | 55,451 | 91,577 | 15,107 | 7,038 | 400,736 |
| Amounts payable in respect of derivative and off-balance sheet financial instruments | 276,575 | 8,526 | 193,704 | 48,587 | 30,473 | 557,865 |
| Net fair value of financial instruments | 22,971 | (8,955) | (1,251) | (260) | (728) | 11,777 |

(a) Including the fair value of the actuarial liabilities to employees and excluding the fair value of the pension plan assets.

**Table 39 – The effect of potential changes in interest rates on net fair value* of financial instruments**

| | 30 June 2017 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Net fair value of financial instruments after effect of changes in interest rates(a) | | | | | | Change in fair value | |
| | Israeli currency | | Foreign currency including financial instruments linked to foreign currency | | | | | |
| | Unlinked | CPI-linked | Dollar(b) | Euro | Others | Total | Total | Total |
| | NIS millions | | | | | | NIS millions | In % |
| Corresponding immediate increase of 1% | **26,253** | **(9,393)** | **(2,773)** | **(424)** | **(835)** | **12,828** | **50** | **0.39** |
| Corresponding immediate increase of 0.1% | **27,056** | **(10,743)** | **(2,277)** | **(393)** | **(830)** | **12,813** | **35** | **0.27** |
| Corresponding immediate decrease of 1% | **27,967** | **(12,915)** | **(1,793)** | **(385)** | **(823)** | **12,051** | **(727)** | **(5.69)** |

| | 30 June 2016 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Net fair value of financial instruments after effect of changes in interest rates(a) | | | | | | Change in fair value | |
| | Israeli currency | | Foreign currency including financial instruments linked to foreign currency | | | | | |
| | Unlinked | CPI-linked | Dollar(b) | Euro | Others | Total | Total | Total |
| | NIS millions | | | | | | NIS millions | In % |
| Corresponding immediate increase of 1% | 21,263 | (6,789) | (785) | (547) | (505) | 12,637 | (150) | (1.17) |
| Corresponding immediate increase of 0.1% | 22,491 | (8,288) | (388) | (533) | (511) | 12,771 | (16) | (0.13) |
| Corresponding immediate decrease of 1% | 24,238 | (10,558) | 16 | (514) | (514) | 12,668 | (119) | (0.93) |

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

(a) This measurement includes exposure to instantaneous changes in interest rates on the market value of the trading portfolios and on the actuarial liability to employees. This measurement does not include the impact on the pensions plan asset portfolio, which is estimated as at June 30, 2017 as a reduction of about NIS 149 million (at June 30, 2016 – NIS 120 million and at December 31, 2016 at NIS 117 million) in a scenario of 1% increase in interest rates. Furthermore, this measurement does not include the impact of the transitional provisions of the employee benefits accounting standard, according to which the capital adequacy ratio is calculated.

(b) Of which effect of complex financial assets: instantaneous increase of 1% - NIS (260) million (June 30, 2016 - NIS (169) million and at December 31, 2016 - NIS (345) million; instantaneous parallel decrease of 1% - NIS 182 million (at June 30, 2016 - NIS 56 million at December 31, 2016 - NIS 171 million);
instantaneous parallel increase of 2% - NIS (545) million; instantaneous parallel decrease of 2% - NIS 286 million (at December 31, 2016 - NIS (701) million and NIS 401 million, respectively).

* Not including estimated value of income in respect of early repayment commission.

**Liquidity risk**

Liquidity risk is the risk due to uncertainty regarding the possibility of raising sources and/or selling assets, unexpectedly and during a short time period, without incurring substantial loss. Liquidity risk management policy is an integral part of Leumi Group's strategic business management and is adapted to the requirements of the Proper Conduct of Banking Business Directive No. 342 regarding "Liquidity Risk Management" and the requirements of the Proper Conduct of Banking Business Directive no. 221 regarding "Liquidity coverage ratio" which adopts the recommendations of the Basel III committee for the calculation of a minimum liquidity ratio while making adjustments to the Israeli economy.

The management of foreign currency liquidity is also affected by the NIS-foreign currency derivatives activity, which may create volatility in the liquidity ratios in different currencies and therefore is closely monitored and managed.

For further information regarding liquidity risk management, see Risk Report for 2016.

As of 1 January 2017 onwards, the minimum requirement for the liquidity coverage ratio was set at 100%.

## Table 40 – Liquidity coverage ratio (Pillar 3)

| | **For the three months ended 30 June** | | | | For the three months ended 31 December | |
|---|---|---|---|---|---|---|
| | **2017** | | 2016 | | 2016 | |
| | Total unweighted value (average)(a) | Total weighted value (average)(b) | Total unweighted value (average)(a) | Total weighted value (average)(b) | Total unweighted value (average)(a) | Total weighted value (average)(b) |
| | NIS millions | | | | | |
| Total high-quality liquid assets | **-** | **113,066** | - | 103,306 | - | 109,432 |
| **Cash outflows** | | | | | | |
| Retail deposits from individuals and small businesses of which: | **174,582** | **11,931** | 171,557 | 11,322 | 175,501 | 11,670 |
| Stable deposits | **45,384** | **2,269** | 45,886 | 2,294 | 46,805 | 2,340 |
| Less stable deposits | **66,976** | **7,795** | 61,374 | 7,099 | 62,805 | 7,353 |
| Deposits for a period in excess of 30 days (Section 84) | **62,222** | **1,867** | 64,297 | 1,929 | 65,891 | 1,977 |
| Unsecured wholesale financing, of which: | **135,093** | **87,881** | 126,013 | 80,863 | 129,542 | 82,065 |
| of cooperative banking corporations | **-** | **-** | - | - | - | - |
| Non-operational deposts (all the counterparties) | **134,884** | **87,672** | 125,716 | 80,566 | 129,108 | 81,631 |
| Unsecured debts | **209** | **209** | 297 | 297 | 434 | 434 |
| Secured wholesale financing | **-** | **-** | - | - | - | - |
| Additional liquidity requirements, of which: | **82,696** | **21,331** | 83,119 | 19,526 | 82,043 | 20,017 |
| Cash outflows in respect of derivatives and other collateral requirements | **16,023** | **16,023** | 14,074 | 14,074 | 14,694 | 14,694 |
| Cash flows in respect of loss of financing of debt products | **-** | **-** | - | - | - | - |
| Credit and liquidity facility lines | **66,673** | **5,308** | 69,045 | 5,452 | 67,349 | 5,323 |
| Other contractual financing obligations | **5,447** | **5,447** | 7,115 | 7,115 | 6,317 | 6,317 |
| Other contingent financing obligations | **42,030** | **1,376** | 42,945 | 1,465 | 43,060 | 1,474 |
| **Total cash outflows** | **-** | **127,966** | - | 120,291 | - | 121,543 |
| **Cash inflows** | | | | | | |
| Secured loans (for example resale transactions) | **1,007** | **-** | 1,570 | - | 1,358 | - |
| Cash inflows from exposures repaid in order | **38,250** | **25,159** | 40,627 | 26,732 | 40,960 | 26,853 |
| Other cash inflows | **19,224** | **13,408** | 18,863 | 12,044 | 17,532 | 11,992 |
| **Total cash inflows** | **58,481** | **38,567** | 61,060 | 38,776 | 59,850 | 38,845 |
| **Total adjusted value(c)** | **-** | **-** | - | - | - | - |
| **Total high-qualit liquid assets** | **-** | **113,066** | - | 103,306 | - | 109,432 |
| **Total net cash outflows** | **-** | **89,399** | - | 81,515 | - | 82,698 |
| **Liquidity coverage ratio** | **-** | **127%** | - | 127% | - | 132% |

(a) Non-weighted values will be calculated as unpaid balances to be repaid or repayable by the holder within 30 days (for cash inflows and outflows).
(b) Weighted values will be calculated after the application of conservative hair-cuts or rates of inflow and outflow (for cash inflows and outflows).
(c) Adjusted values will be calculated after the application of (1) conservative hair-cuts or rates of inflow and outflow and (2) any relevant limits (i.e. limits on high-quality liquid assets in Level 2 B and in Level 2 and a limit on cash inflows).
(d) Values are calculated based on a weighted average of 74 observations during the first quarter (78 observations in the second quarter of 2016 and 70 observations in the fourth quarter of 2016).

**Table 41 – The composition of high-quality liquid assets according to average balances in the quarter in NIS millions**

| | For the three months ended 30 June 2017 | | | For the three months ended 30 June 2016 | | | For the three months 31 December 2016 | | |
|---|---|---|---|---|---|---|---|---|---|
| | **In Israeli currency** | **In foreign currency** | **In Israeli and foreign currency** | In Israeli currency | In foreign currency | In Israeli and foreign currency | In Israeli currency | In foreign currency | In Israeli and foreign currency |
| | **Total weighted value** | | | Total weighted value | | | Total weighted value | | |
| Total Level 1 assets | **87,843** | **22,116** | **109,959** | 76,449 | 23,612 | 100,061 | 81,645 | 25,330 | 106,975 |
| Total Level 2a assets | **-** | **2,851** | **2,851** | - | 3,032 | 3,032 | - | 2,224 | 2,224 |
| Total Level 2b assets | **104** | **152** | **256** | 99 | 114 | 213 | 93 | 140 | 233 |
| Total high-quality liquid assets | **87,947** | **25,119** | **113,066** | 76,548 | 26,758 | 103,306 | 81,738 | 27,694 | 109,432 |

## Funding Risk

Funding risk is the risk of an insufficiently stable funding structure in the long run, in a manner that does not serve the planned investments.

The Bank has been managing an extensive and diversified structure of stable funding sources of different maturities for years. The Bank's primary funding source is deposits of retail customers. In addition, the Bank funds its activity with deposits of commercial and business customers and by issuing debentures. Funding source management is regularly conducted for NIS and foreign currency separately. The funds are invested in loans, in liquid assets, mainly in low risk bonds, and in short term swap transactions. The Bank has a broad range of foreign currency funding sources from domestic retail, business and financial customers, and from foreign resident customers.

The concentration of funding sources is managed and monitored by risk indicators and models. The Bank monitors the composition and concentration of funding sources in several categories: customer size and type, single depositor, maturity, typical behavior over time. The ongoing managing of the composition of funding sources includes outlining a policy for the diversification of funding sources and refinancing. The concentration of funding sources is controlled and managed as part of the liquidity risk management at the Bank. Ongoing daily measurement of liquidity ratios, minimal coverage ratio and monitoring of warning signs enable dynamic management, control and supervision of the liquidity status and development of trends.

**Table 42 – Assets pledged according to balance sheet items (EDTF)**

| | **30 June 2017** | | | |
|---|---|---|---|---|
| | Pledged assets related to | | | |
| | Securing deposits | Clearinghouse activities and the CCP Risk Fund | CSA agreements | Activity in derivative instruments |
| | NIS millions | | | |
| Cash and deposits in banks | **-** | **-** | **643** | **954** |
| Securities | **1,864** | **1,009** | **-** | **1,182** |
| **Credit to the public** | **-** | **76** | **2,039** | **-** |

| | 30 June 2016 | | | |
|---|---|---|---|---|
| | Pledged assets related to | | | |
| | Securing deposits | Clearinghouse activities and the CCP Risk Fund | CSA agreements | Activity in derivative instruments |
| | NIS millions | | | |
| Cash and deposits in banks | - | - | 1,436 | 728 |
| Securities | 2,025 | 1,117 | - | 1,268 |
| Credit to the public | - | 102 | 305 | - |

| | 31 December 2016 | | | |
|---|---|---|---|---|
| | Pledged assets related to | | | |
| | Securing deposits | Clearinghouse activities and the CCP Risk Fund | CSA agreements | Activity in derivative instruments |
| | NIS millions | | | |
| Cash and deposits in banks | - | - | 484 | 121 |
| Securities | 2,698 | 911 | - | 1,267 |
| Credit to the public | - | 69 | 1,190 | - |

## Operational risks

Operational risk is defined as the risk of loss resulting from inadequacy or from failure of internal processes, people and systems, or as a result of external events.

Leumi Group operates in a wide range of financial activities and is therefore exposed to operational risks including, *inter-alia*, information and cyber security, information technology risks, embezzlement and fraud risks and business continuity risks.

Operational risks management in Leumi Group is carried out using three lines of defense, and is based on a proactive process of identifying, evaluating, measuring, monitoring, controlling, mitigating and reporting of material risks, carried out in all the Bank's Divisions.

### Policy and framework of operational risk management

The Group's operational risks management policy is approved annually by the Board of Directors. The Group's policy includes, inter alia, the following principles: risk management tailored to the different business lines, integrative approach, focusing on the risks with the potential for significant ramifications, risk management of substantial products and projects.

No significant changes occurred since the beginning of the year in the organizational structure, policy and corporate governance of operational risks management. For further details, see the Report on Risks for 2016.

## Major risk areas in the operational risks

### Technology risk

Bank Leumi is a leading bank in technological innovation for the purpose of creating advanced services for its customers. In order to enable the aforementioned services, the Bank requires suitable advanced technological infrastructures, which create business opportunities but also increase the exposure to technological risks in the business and operational processes.

The technological risk has many aspects: risks related to project management and managing a complex IT environment, risks related to the ability to manage extensive amounts of information in an effective manner while maintaining quality, risks related to the increasing exposure to cyber-crimes and risks related to the ability to maintain durable and business continuity, etc.

The IT environment is complex, rapidly changing, and the dependence on it continues to increase. Therefore, it is highly important that the technological infrastructure is stable, durable and strong.

Leumi is meticulous in maintaining the quality and proper function of the information systems, including the required processes and invests many resources in technological infrastructure.

### Information security and cyber risks

Developments in cyberspace have led to an increase in the volume and intensity of the threats, the capabilities of attackers and the complexity of the attacks and, accordingly, to a significant increase in the exposure to cyber risk. These risks may expose the Bank to damage to business activity and reputation.

The strategy and policy of cyber security and defense are updated in accordance with the constant changes in the business and financial environment and the scope of threats. The concept of cyber protection indicates the differential focus on protection resources, according to the level of the inherent risk and considering the technological, business, human and physical aspects.

The protection of sensitive information is executed on several levels: In databases, information systems, and providing access to systems and regularly managing them, by physical measures of security and raising awareness among all employees.

Since the beginning of the year, no events or embezzlements occurred in cyber which affected the books of the Bank.

## Regulation and compliance risks

(c) **Compliance, prohibition of money laundering and terror financing**

For the sake of effective management, a Compliance and Enforcement Department is operating at Leumi, headed by the Chief Compliance Officer responsible, among other things, for complying with the obligations according to the legislative provisions regarding the prohibition of money laundering and terror financing**.**

The Chief Compliance Officer is in charge of both enforcements in the area of securities laws and serves as the Responsible Officer in the FATCA area, as detailed below.

The Compliance Department activity is conducted by a professional team with profound knowledge and understanding in regulation, based on work processes, control and automated systems. The Department is in constant contact with the subsidiaries in Israel and abroad for purpose of monitoring the implementation of the compliance policy of the Group.

In accordance with developing global trends, the Bank handles a variety of topics related to compliance, prohibition of money laundering and terror financing and aspects of taxing and reporting to the tax authorities which are relevant to the customer.

(d) **Enforcement**

In January 2011, the Efficiency of Enforcement Procedures in the Securities Authority Law (Legislative Amendments), 2011, was passed in the Knesset. As part of this legislation, it will be possible to impose various sanctions on a corporation, including office holders and employees.

Pursuant to the law, the Securities Authority published a document of criteria for acknowledging an internal enforcement program The Chief Compliance Officer of the Group acts as the officer in charge of enforcement. The Board of Directors approved the internal enforcement plan, after the it had been validated by an outside specialist and after the main enforcement procedures were reviewed by said specialist.

(e) **Foreign Account Tax Compliance Act – FATCA**

In March 2010, the Internal Revenue Code in the United States (the U.S. Income Tax Law) was amended, so as to bring into effect a reporting regime, which aims to compel foreign financial institutions (FFI) to transfer information regarding accounts owned by U.S. customers.

The Bank operates in various levels in order to verify compliance of Leumi Group and its individual employees, to the provisions of the law among them: Appointing a Compliance Officer to this topic, adopting the appropriate policy and work procedures, developing automated tools to support the work processes, formulating training and implementation mechanisms, inspecting, controlling and operating mechanisms necessary for complying with the directives and instructing the subsidiaries in the Group regarding the appropriate preparedness.

(f) **OECD- Common Reporting Standard (CRS) Standards for Automatic Exchange of Financial Account Information**

In 2013 the OECD publish unified standard for the implementation of Automatic Exchange of Financial Account Information between countries (hereinafter: "The Standard"). The standard composed in the spirit of the American FATCA and was meant to increase the transparency and control of Tax reports of countries' residents holding financial accounts outside their country of residence. The Amendment to Income Tax Ordinance Law (No. 227) was published on July 2016 regarding the implementation of the FATCA and the Standard. Regulations for the implementation of the standard have not yet been published.

Leumi is preparing to implement the standard. And for the date of this writing is about to enter into effect in Israel on October 2017. Leumi offices in England and Romania started the implementation on 1 January 2016 according to the local regulatory they are subjected to.

## Legal risks

For further information regarding the manner of Legal Risk management, see the 2016 Risk Report.

There is a general exposure that cannot be estimated or quantified which is derived, inter alia, from the complexity of services provided by the Bank and the consolidated companies to their customers. The complexity of these services holds, inter alia, a potential for claims, interpretational and otherwise, relating to a long list of commercial and regulatory conditions. It is impossible to predict all sorts of claims that will be raised in this area and the exposure derived from these and other claims with regard to the Bank's and consolidated companies' services, that are raised, inter-alia, by the discussion mechanism stipulated in the Class Action Law.

Also, there is exposure due to regulatory changes and directives of the Supervisor of Banks. Relations with customers are, in some cases, relations which last many years, throughout which changes may occur in policy, regulation and law trends, including court ruling. The Bank and the consolidated companies operate via complex automated systems which, in light of said changes, must be regularly adjusted. All of these create increased operational and legal exposure.

Furthermore, there is a general exposure derived from complaints against the Bank and consolidated companies, which are submitted from time to time to the Supervisor of Banks which, under certain circumstances, may lead to taking legal proceedings against the Bank. Presently, it is not possible to estimate whether there is exposure regarding those complaints and it is impossible to estimate whether a broad ruling will be given by the Supervisor of Banks regarding complaints, as mentioned above and/or if class actions or other actions will be filed as a result of such processes, and therefore it is not possible to estimate the potential exposure to complaints, as mentioned above. Therefore, no provision for said exposure was included.

**Emerging Risks**

Emerging risks are risks that their characterizations and level of severity changes in accordance with to changes in the last years in the competitive environment, customer environment, regulatory environment and technology environment. Among these risks are the cyber risk, technology risk and conduct risk.

Likewise, the Bank's activity environment is profoundly affected in the last few years by risks related to regulation and legislation, to a volatile macro-economic environment, to changes applicable to the business model, including the transition to "New Banking", which is based on the digital world and on social and consumer trends.

Since the beginning of the year there have been no significant changes in the risk and threat map in the business environment in which the Bank operates in Israel and worldwide.

**For further information, see the Risk Report for 2016.**