Report of the Board of Directors to Shareholders in General Meeting

General

The Bank's Board of Directors and Management are pleased to present herewith a report relating to the financial position of the Bank and the results of its operations for 2015, being part of the annual report of the Bank which includes additional reports, as follows:

- The audited annual financial statements of the Bank and its consolidated subsidiaries for the year 2016.
- Reports concerning corporate governance, audit and additional details regarding the Bank.
- Annexes to the annual report
- Disclosure requirements in accordance with Pillar III of the Basel rules, and additional information regarding risk*.
- Additional regulatory information*.

The data presented in this report are extracted from the Bank's consolidated financial statements and are presented in reported amounts (see Note 1A (2) to the financial statements).

* The data included in these reports is presented on the Internet website of the Bank, at the following address: https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

Part "A" – General review, goals and strategy

1. Description of the Bank and its principal areas of operation

A. Description of the Bank and its development

The Bank was founded on October 25, 1971, by the British Barclays Bank International Ltd. (hereinafter – "Barclays Bank") and by the Discount Bank Group, under the name of "Barclays-Discount Bank Ltd.".

The financial operations in Palestine of the banking groups which had founded the Bank began in 1918, upon the conquest of Palestine by the British forces, when the Anglo-Egyptian Bank, operating at that time in Egypt, opened three branches in Palestine: in Jerusalem, Jaffa and Haifa. At a later stage, in 1921, a fourth branch was opened in Nazareth. Barclays Bank D.C.O (a bank owned by the British Barclays Bank which had provided financial services to the administrative authorities throughout the British Empire) acquired in 1925 the shares of the Anglo-Egyptian Bank whereupon this bank became part of the Barclays Bank Group. In 1971, Barclays Bank D.C.O changed its name to Barclays Bank International.

Soon after its incorporation, the Bank acquired on December 7, 1971, all the assets and liabilities of the Barclays Bank branches in Israel (at that time Barclays Bank was operating some forty branches in Israel).

On February 28, 1993, following the acquisition in full by Israel Discount Bank Ltd. of the interests of Barclays Bank in the Bank – the Bank's name was changed to its present name. The Bank is defined as a "banking corporation" under the Banking Act (Licensing), 1981, and it holds a banking license according to the said Act.

The Bank is subject to a set of laws, orders and regulations under which it operates, including, inter alia, the Banking Ordinance, Bank of Israel Act, the Banking Act (Licensing), the Banking Act (Customer service), 1981, as well as directives, rules and guidelines issued from time to time by the

Supervisor of Banks (as regards developments in legislation pertaining to the banking sector – see Chapter 10 of the Corporate Governance Report).

The Bank is engaged in commercial financing activity, providing services to all segments of operation, including: corporate banking, middle-market banking, private banking and retail banking. The Bank markets the full range of financial banking products, including: loans and bank deposits, mortgages, rolling finance to construction companies, credit cards, derivative instruments, etc. In addition, the Bank operates a consulting setup that provides consulting services with respect to the capital market.

This comprehensive framework of operations enables the Bank to provide its customers with the full range of banking and financial solutions. The Bank provides professional service, at a high level and through diversified channels of communication, with respect to the entire standard banking products adapted to the specific requirements of the customer. In order to provide this array of services, the Bank has established a widespread nationwide network of 78 branches at the disposal of its customers.

The Bank is being rated by S&P-Ma'alot (hereinafter – "the rating company"). In view of the good capital adequacy ratios and the profitability of the Bank, the rating company decided on December 20, 2016, to update the rating of the Bank to "AA+" (with a stable horizon rating), comprising a one grade improvement over the rating given to the Bank last year ("AA").

2. Condensed financial information

A. Consolidated statement of profit and loss – multi-period information (in reported amounts) (in NIS millions)

	For the year ended December 31				
	2016	**2015**	**2014**	**2013**	**2012**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Interest income	**1,058**	974	1,011	1,128	1,224
Interest expense	**124**	102	211	406	495
Net interest income	**934**	872	800	722	729
Expense in respect of credit losses	**934**	67	15	75	35
Net interest income, after expense for credit losses	**898**	805	785	647	694
Non-interest income					
Non-interest financing income	**36**	37	42	81	7
Commissions	**304**	310	313	375	363
Other income (expense)	**9**	33	1	(1)	23
Total non-interest income	**349**	380	356	455	393
Operating and other expenses					
Payroll and related expenses	**581**	518	585	527	479
Maintenance and depreciation of buildings and equipment	**154**	152	150	154	154
Other expenses	**175**	171	167	161	164
Total operating and other expenses	**910**	841	902	842	797

Profit before taxes	**337**	344	239	260	290
Provision for taxes	**146**	136	94	85	101
Profit after taxes	**191**	208	145	175	189
Share of the Bank in profits of equity base companies, net	**2**	2	2	4	-
Net profit for the year	**193**	210	147	179	189
Profit per share (in NIS thousands)					
Shares of NIS 0.1 par value	**1.55**	1.69	1.18	1.44	1.52
Shares of NIS 0.01 par value	**0.15**	0.17	0.12	0.15	0.15

B. Consolidated balance sheet - multi-period information (in reported amounts) (in NIS millions)

	December 31				
	2016	**2015**	**2014**	**2013**	**2012**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**	**NIS millions**
Assets					
Cash and deposits with banks	**3,422**	5,502	4,994	3,757	3,672
Securities	**6,002**	3,432	3,831	6,154	5,486
Credit to the public	**22,349**	20,754	19,234	18,157	16,966
Provision for credit losses	**(348)**	(337)	(319)	(365)	(337)
Credit to the public, net	**22,001**	20,417	18,915	17,792	16,629
Investment in equity base companies	**9**	7	11	9	5
Building and equipment	**358**	346	397	406	430
Assets in respect of derivative instruments	**26**	31	30	24	27
Other assets	**346**	341	392	335	278
Total assets	**32,164**	30,076	28,570	28,477	26,527
Liabilities and shareholders' equity					
Deposits from the public	**27,199**	25,388	24,060	23,964	22,254
Deposits from banks	**259**	459	492	487	137
Deposits from the government	**149**	151	139	168	167
Bonds and subordinate debt notes	**926**	672	681	823	923
Liabilities in respect of derivative instruments	**79**	122	109	140	250
Other liabilities	**1,308**	1,181	1,173	1,038	914
Total liabilities	**29,920**	27,973	26,654	26,620	24,645
Shareholders equity	**2,244**	2,103	1,916	1,857	1,882
Total liabilities and shareholders' equity	**32,164**	30,076	28,570	28,477	26,527

C. Principle performance indices

	For the year ended December 31		
	2016	**2015**	**2014**
	%	**%**	**%**
Income statement financial ratios			
Return on equity	**8.9**	10.4	7.8
Return on assets	**0.6**	0.7	0.5
Credit loss expense to credit to the public	**0.2**	0.3	0.1
Accounting write-offs to average credit	**0.1**	0.2	0.3
Overall financial spread	**3.1**	3.2	2.9
Operating expenses to total income (efficiency ratio)	**70.9**	67.2	78.0
Comprehensive income to total assets	**4.0**	4.2	4.0
Total operating and other expenses to total assets	**2.8**	2.8	3.2

	December 31		
	2016	**2015**	**2014**
	%	**%**	**%**
Balance sheet financial ratios			
Credit to the public to total assets	**68.4**	67.9	66.2
Impaired debts to total credit to the public	**1.4**	1.6	1.8
Shareholders' equity to total assets	**7.0**	7.0	6.7
Deposits from the public to total assets	**84.6**	84.4	84.2
Securities to total assets	**18.7**	11.4	13.4
Deposits from the public to total credit to the public	**123.6**	124.3	127.2
Financial stability ratios			
Comprehensive capital adequacy ratio	**13.8**	14.0	14.5
Ratio of Tier I equity capital to risk assets	**10.9**	10.6	10.6
Liquidity coverage ratio	**143.8**	(1)121.2	-
Leverage ratio	**6.6**	6.6	-

1. Restated.

3. Description of principal risks

Following is summarized information regarding the principal risks arising from the current operations of the Bank:

- **Credit risk** – defined as a risk of loss arising from the failure of a borrower or counterparty to partly of fully honor his obligations.
- **Market risk** – defined as a risk of impairment of the income of the Bank or its profitability due to possible changes in the fair value of its assets and liabilities (both stated and off-balance sheet) arising from changes in market prices, such as: change in the rate of inflation, change in interest rates, change in exchange rates, changes in the capital market, etc. Market risk includes the following risk components:
  - **Linkage base risk** – defined as exposure to impairment of the fair value of the Bank, which may be caused by possible changes in inflation rate and in exchange rates of foreign currencies as against the shekel. The Bank's exposure in this respect derives from the

difference between the financial assets and the financial liabilities of the Bank in each of the linkage segments.

- **Interest risk –** defined as exposure to impairment of the profits of the Bank or of its capital in respect of a change in interest rates. In addition, the said changes in interest rates might affect also the economic value of the Bank, its assets, liabilities and the value of off-balance sheet instruments.
- **Share risk** – defined as exposure to impairment of the fair value of the Bank and its profitability due to a decline in the market price of shares (including non-financial investments) included in the securities portfolio of the Bank.
- **Option risk –** defined as exposure of the Bank to a possible loss stemming from changes in parameters affecting the fair value of options, including inherent options.

- **Liquidity risk –** defined as possible exposure to loss and to impairment of the stability of the Bank stemming from the inability of the Bank to provide for its liquidity requirements.
- **Operating risk –** defined as exposure of the Bank to loss which might occur as a result of improper internal procedures, persons and systems, or failure thereof, or due to external events.
- **Data protection and cyber risk –** defined as exposure of the Bank to impairment of its operations (leading even to a complete shut down), theft of financial assets, monetary losses and impaired reputation, stemming from cyber attacks on the computer systems of the Bank, or from the unauthorized gathering of information from these systems.
- **Legal risk –** defined as exposure of the Bank to loss, due, inter alia, to the lack of ability to legally enforce performance of an agreement, or due to legal proceedings being conducted against the Bank, as well as exposure to fines or sanctions imposed by regulatory authorities, and also to specific arrangements.
- **Compliance risk –** defined as exposure of the Bank to legal or regulatory sanctions, to financial loss of damage to reputation, which the Bank might sustain due to non-compliance with laws, regulations, regulatory directives, internal procedures and the ethical code applying to the Bank.
- **Reputation risk** – defined as possible exposure to impairment of profits of the Bank due to a negative image of the Bank that might develop among customers and other parties connected to the Bank.
- **Strategic risk –** defined as exposure of the Bank to possible impairment in equity, in financial results and in reputation, stemming from taking wrong decisions or from the incorrect implementation of business decisions, or from the absence of response to changes in competition and in business developments.

Detailed information regarding the different risks involved in the operations of the Bank and the manner of management thereof is included in the risk report published on the Internet website of the Bank, at the following address:
https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

4. Goals and business strategy

A. The strategic plan

The Board of Directors approved in 2015 the strategic plan for the operations of the Bank in the years 2016-2020.

The plan includes two principal lines of action:

- Expansion of the Bank's retail operations (households and small businesses), within the framework of which the Bank is to focus on specific segments of population, in respect of which the Bank has gathered long standing experience in providing banking services adapted to the unique needs.

- Increasing operational efficiency through the strict management of operating expenses and improving the composition of income.

B. The means to be used in the implementation of the plan

- Development of the retail operation
  - Implementing systemized and efficient standards of work at the branches, adapted to the needs of customers while improving their service experience.
  - Introducing financial instruments adapted to retail customers (in the housing and consumer credit fields).
  - Adjustment of the branch layout to the geographic distribution of retail customers.
  - Introduction of designated marketing plans.
  - Expansion of the Bank's activity in the community.
  - Introduction of advanced credit rating systems and decision support systems in respect of retail credit.
  - Technological improvements (in cooperation with the parent company) in the computer hardware and software fields, enabling the provision of information and performance of banking operations in an efficient and convenient manner through mobile devices (mobile computers and cellular telephones).
- Operating efficiency
  - Implementation of a plan for improving efficiency of work procedures at the branches and the Bank's head office.
  - Continuing the expansion of the "back office" unit operations, within the framework of which certain operating activities are moved from the branches to the "back office" unit, while increasing efficiency and reducing the staff required for such operations.
  - Increasing synergy with the parent company in the matter of purchases and information systems.

The Board of Directors approved in the second half of 2016, a strategic plan, prepared by Management with the assistance of outside consultants, for the intensification of operations in the retail segment, including the focusing on designated segments of population, in respect of which the Bank had accumulated for many years specialization in rendering banking services.
For additional information regarding the efficiency program approved by the Board of Directors on September 11, 2016 and its implications – see Chapter 21A below.

C. Opportunities and threats deriving from the implementation of the strategic plan

- Enlarging the customer base and the deconcentration of the Bank's credit portfolio.
- Improving the composition of income by enlarging the customer base and the retail activity
- Exposure to a certain increase in operating risk (in the short-term), in respect of the planned changes in work procedures at the branches and at the "back office" operating unit.
- Exposure to a decline in interest margins stemming from an increase in competition in the retail sector.
- Exposure to a decline in the income basis, stemming from changes in legislation intended to increase competition in the retail sector.

D. Implementation of principal projects

Execution of the strategic plan, as stated, involves structural changes and changes in work procedures, which are being implemented by the Bank within the framework of projects, including:

- **"Expanding the operations of the back office unit"** – within the framework of which certain operating activities are being diverted from the branches to back office operating centers, with a view of increasing the resources of branches available for customer service.
- **"Improving the computer infrastructure"** – including infrastructure relating to the development of activity in the retail segment, such as: expanding the channels used for rendering banking services, improving the technological infrastructure allowing the transaction of business without obtaining the physical signature of the customer, upgrading and increasing the number of automatic machines at the branches and development of advanced digital applications, enabling customers to obtain available information and conduct banking operations by use of mobile communication means.

In addition to the above, the parent company, in cooperation with the Bank, introduced in 2015, a technological project, within the framework of which a new credit management operational system is being integrated at both banks. The project is expected to be completed until the end of 2018.

In the course of 2016, the "branch method" system was completed at all the Bank branches, and the content of operations of the back office unit was expanded by diverting additional operations from the branches to this unit.

E. Organizational changes

(1) Reorganization of the corporate/commercial division

As a derivative of the implementation of the strategic plan of the Bank, which, inter alia, includes lines of operations relating to the development of the retail and commercial activity, Management of the Bank decided on November 29, 2016 on a reorganization of the corporate/commercial division, according to which, the corporate group of the division was merged into two commercial groups.
The change took place on January 1, 2017, following which; the name of the corporate/commercial division was changed to the commercial banking division.

(2) An organizational change in the retail division

In the last quarter of 2016, Management approved organizational changes in the retail division, including:

- An organizational change in the marketing group, stemming from the implementation of the strategic plan, by which functions have been appointed for the marketing of banking products and services modified to the special needs of designated populations.
- Expansion of the activity of the credit and control group, including the appointment of functions engaged in the management of operating risk and compliance risk.

5. Additional information

A. Changes in accounting policy

Following the experience gained by the Bank in the implementation of Bank of Israel directives in the matter of "measurement and disclosure of impaired debts, credit risk and provisions for credit losses" (hereinafter – "the Directive"), including examinations made by Management of the Bank with regards to the adjustment of the criterion for the determination of the maximum amount for debts measured on a collective basis, to the composition of the credit portfolio of the Bank and the nature of its operations – which did not indicate the existence of significant differences between the results produced by the two provision methods as prescribed by the Directive ("specific" and "collective"), in respect of credits in small and medium amounts – Management of the Bank decided to change, as from January 1, 2016, the accounting policy in this respect and increase the maximum amount for debts measured on a collective basis from NIS 50 thousand to NIS 0.5 million.
For further information in this respect as well as the financial implications resulting from this change in accounting policy, as stated – see Note 1I. (4) to the financial statements.

B. Changes in the public reporting instructions of the Supervisor of Banks

The financial results of the Bank by segments of operation for the year 2016 (including the relevant comparative data), are presented in the Directors' and Management's Report and in the financial statements in accordance with rules determined in the public reporting instructions in the matter of "regulatory segments of operation".
For additional details regarding the rules prescribed in this respect by Bank of Israel – see Note 1D. (3) and Note 27 to the financial statements.

C. Legal proceedings

Pending against the Bank are legal actions filed by customers of the Bank as well as by various third parties, who consider themselves injured by operations of the Bank in its ordinary course of business.

For additional details regarding material claims lodged against the Bank and their possible impact upon its business results – see Note 24B. (8) and (9) to the financial statements.

Part "B" – Business condition and development in business results

6. Economic developments and trends

A. Economic developments in 2016

The economic indicators point to a mixed trend in economic development in 2016.

Gross domestic product - According to preliminary estimates of the Central Bureau of Statistics, the gross domestic product increased by 3.8% in 2016, in continuation to a growth at the rate of 2.5% recorded last year. This item comprises a central indicator for the trend of economic activity in the domestic market.

The per capita gross domestic product (computed by adjusting the rate of growth for the rate of population increase) rose in 2016 according to these preliminary estimates, by a rate of 1.8%, in continuation of a growth of 0.5% recorded in this item in the previous year.

The Composite State of the Economy Index rose in December 2016 by a rate of 0.4% completing a cumulative increase at the rate of 4.0% in 2016, in continuation to an increase of 2.9% recorded in this item in the previous year.

The business product (other than in relation to public and community services and housing services) rose by 3.9% in 2016, in continuation to an increase of 2.3% recorded in this item last year. According to the trend data, the seasonality adjusted industrial output index recorded in the months of September to November 2016 an annualized increase of 1.1%, in continuation of an annualized decline of 2.9% recorded in this item the previous three months. The drop in the Index derives mostly from the decline in the product of the hi-tech industries.

Consumption - The turnover index for the retail trade, which serves as an indicator for the demand on the local market, declined in the months of September and October 2016 at annualized rate of 4.3%, in continuation to the decline in this Index at the rate of 0.8% recorded in the earlier two months.

Sales of the marketing chains (comprising about one third of the retail trade turnover) also dropped in September to November of 2016 by an annualized rate of 1.6%, in continuation to a decline of 0.8% in this Index recorded in the previous three months.

Foreign trade and the balance of payments

Israel's trade deficit increased in 2016 by a rate of 66.1% amounting to NIS 50.2 billion.

Imports of goods increased by 4.8% in 2015 and totalled approximately NIS 249.8 billion. This increase in imports is mainly attributable to the increase of 33.8% in the import of investment goods, comprising 17.9% of total imports, and amounting to NIS 44.8 billion, an increase of 2.6% in the import of raw and polished diamonds, comprising 10.0% of total import and amounting to NIS 25.0 billion, and to an increase of 11.0% in the import of consumer goods comprising approximately 20.5% of total imports and amounting to approximately NIS 51.2 billion. On the other hand, the import of raw materials, which comprised approximately 41.6% of total imports and totalled approximately NIS 104.8 billion decreased by 1.6%, and the import of energy products comprising 9.0% of total imports and amounting to NIS 22.4 billion, decreased by 22.2%.

Notwithstanding the above, the seasonally-adjusted trend data point to stability, at an annualized rate, in the import of goods (excluding diamonds, ships, aviation and energy products) in the last quarter of 2016, in contrast to an increase of 0.9% recorded in this item in the preceding quarter.

The export of goods in 2016 decreased by 4.1%, and totalled approximately NIS 199.6 billion. The decrease in the export of goods is mainly attributable to a decline of 4.9% in industrial exports, which comprised approximately 83.8% of total goods exported and totalled NIS 167.3 billion, to a decline of 4.5% in exports of agricultural, forestry and fisheries products comprising 2.2% of total exports and amounting in 2016 to NIS 4.4 billion, and a decline of 7.3% in the export of polished diamonds, which comprised 9.0% of total goods exported in 2016 and amounting to NIS 18.0 billion.

On the other hand, an increase of 21.1% was recorded in the exports of the wholesale diamond trade industry, amounting to 5.2% of total export of goods and amounting to NIS 10.4 billion.

Not withstanding the above, the seasonally-adjusted trend data point to an increase of 2.7% on an annualized basis, in the export of goods (excluding diamonds, ships and aviation products) in the fourth quarter of 2016, in continuation to the increase of 1.8% on an annualized basis, recorded in this item for the preceding quarter.

Tourism

In 2016, bed-nights occupancy at tourist hotels recorded an increase of 1.8% totalling approximately 22.1 million. The increase in this item is mostly attributable to an increase of 4.0% in bed-night occupancy by foreign tourists and to an increase of 1.0% in bed-nights occupancy by Israeli residents.

The seasonally-adjusted trend data also point to an increase of 36.0% in the number of tourist bed-nights occupancy in the last quarter of 2016. On the other hand, bed-nights occupancy by Israeli residents declined by 5.0%.

The State Budget

State revenues from taxes and fees increased by approximately 5.7% in 2016, and totalled approximately NIS 283.1 billion.

The increase in State revenues in 2016 is attributable to an increase of 6.4% in revenues from direct taxes totalling approximately NIS 143.6 billion, to an increase of 5.0% in revenues from indirect taxes, which totalled approximately NIS 132.5 billion and to an increase of 5.0% in State revenues from fees and levies totalling NIS 7.0 billion.

A preliminary assessment shows that the total deficit arising from State operations in 2016 amounts to approximately NIS 25.9 billion, comprising 2.2% of GDP. Most of this deficit (NIS 18.1 billion) was recorded in December 2016. Notwithstanding, this data is lower than the maximum deficit target determined by the Government for 2016 (NIS 35.0 billion).

An analysis of the budgetary deficit by Government operations shows that most of the deficit in the amount of NIS 19.5 billion, stems from domestic operations of the Government (excluding the granting of credit), the remaining balance, in the amount of NIS 3.5 billion, stemming from the Government's foreign operations

Employment

According to the trend data for the month of December 2016, the rate of unemployed amounted to 4.6% of the total work-force in the market, comprising a decrease of 0.6 percentage points as compared to the data recorded at the beginning of the year.

The rate of participation in the work-force in December 2016, amounted to 64.2%, similarly to the data recorded at the beginning of the year.

Inflation

The Consumer Price Index ("CPI") fell by 0.2% in 2016, in continuation to a decrease of 1.0% in 2016. The decrease in the CPI in 2016 constitutes a deviation from the 1%-3% target rate that had been determined by the Government. The CPI, after excluding the housing component fell by 0.7%, and the CPI after excluding fruit and vegetables fell by 0.1%.

It should be noted in this respect that the contribution of the CPI-linked segment to the Bank’s income from financing operations showed a decline also in 2016. This decline in income stems from the decrease in the component of income from CPI linkage increments (stemming from the said decline in the CPI, as stated) and from the shifting of excess resources to the non-linked shekel segment.

Monetary policy

In 2016 Bank of Israel continued the implementation of the monetary policy adopted by it in the years 2012-2015, and maintained the interest rate in the monetary tender at the historical low level of only 0.10%. Bank of Israel's policy is explained by the global macro-economic data and by the low interest rates prevailing in many countries around the world (reaching negative interest rates recorded in certain of those countries).

The inflationary expectations for the forthcoming year (stemming from the difference between the yield of linked bonds and the yield of non-linked shekel-denominated bonds over a time-span of one year) point at the end of 2016, to a rate of only 0.5%, comprising a rise of 0.4 percentage points in comparison with the rate recorded at the end of 2015 (0.1%). These expectations are below than the lower limit of the targeted range of the Government’s official inflation target of 1%-3%.

The exchange rate

A mixed trend prevailed in 2016 in the exchange rate of the Israeli shekel as against most of the leading foreign currencies: against the US dollar it strengthened by 1.5%, against the Pound Sterling by 8.3%, and against the Euro the shekel strengthened by a rate of 4.8%.

On the other hand, the shekel weakened against the Japanese Yen by 1.4%. The strengthening of the shekel as against most of the foreign currencies has reduced the foreign exchange difference income included in the item "Non-interest financing income" (see extended discussion in the Chapter 7 B below).

The capital market

In total, the year 2016 recorded a mixed trend on the local equities market and price increases on the bond market (both in government and in corporate bonds) in all linkage segments.

The factors, which had a positive impact of price levels in the equities market, included:
The positive trend in the equity market has been influenced by several factors, amongst which may be cited the following:

- The historical low level of 0.1% in the monetary tender interest rate determined by Bank of Israel;

- The rising prices on the overseas equities markets, particularly in the US, on background of signs of recovery of the US economy and the expectation for the raising of the interest rate by the federal bank;

- Gradual reduction in the rate of corporation tax initiated by the Government of Israel, down to a future rate of 23% (in 2018).

The effect of these factors was moderated by several negative economic developments, including:

- The strengthening of the shekel exchange rate as against the currencies basket.

- A decline in share prices of pharma corporations due to a reduction in prices of pharmaceutical drugs and a slowdown in the generic drug market.

The mixed trend in prices of equities in 2016 was accompanied by low trading turnovers on and off the Stock Exchange. In total for 2016, trading turnover recorded a decline at the rate of 12.4% to an amount of NIS 1,269 million. Concurrently, the volume of funds raised in the primary market declined in 2016 by 24.8% to an amount of NIS 29.3 billion, in contrast to NIS 38.9 billion raised in 2015.

In total for 2016, share indices recorded a mixed trend: the TA 25 Index fell by approximately 3.6%, and the TA 100 Index fell by approximately 2.3%. On the other hand, the "other shares" Index rose by approximately 24.9% and the TA 75 Index rose by approximately 17.5%.

Price increases were also recorded in 2016 in the government bonds market and in the corporate bonds market. In total for 2016, the prices of CPI-linked government bonds had risen by 0.9% and the prices of non-linked government bonds had risen by approximately 1.4%. As of the end of the year, the gross yield to maturity of CPI-linked government bonds ranged from (-0.2%) for short-term bonds to 1.1% for long-term bonds.

Concurrently, the rates for short-term government loans also increased in 2016 by approximately 0.3%. Following these price increases, the annual yield to maturity of these loans reached approximately 0.1% as of the end of the year.

The average daily trading volume of short-term government loans on the Stock Exchange and other trading floors declined in 2016 by 32.1% amounting to approximately NIS 345 million.

The total amount of funds raised by the Government through the medium of bonds (in gross terms) amounted to approximately NIS 47.5 billion, as compared to approximately NIS 38.7 billion in the previous year. Due to the decline in volume of the Government deficit, a net redemption of government bonds was recorded in 2016 in an amount of NIS 5.3 billion, in contrast to the net amount raised by the Government in the previous year of NIS 5.9 billion. Approximately 70.0% of the funds were raised through the medium of non-linked bonds, reflecting a decrease of 4 percentage points in comparison to the figure for previous year (74.0%).

In 2016, the component of the asset portfolio of the public invested in the mutual funds declined by approximately NIS 19.5 billion, in continuation of the decline of NIS 33.7 billion recorded in this investment channel in the previous year. The distribution of amounts withdrawn from mutual funds by channels of investment shows withdrawals of NIS 6.3 billion from funds specializing in "Shekel" investments, NIS 8.5 billion withdrawn from the "monetary" funds, NIS 6.0 billion withdrawn from funds specializing in bonds investments, and NIS 2.3 billion withdrawn from foreign funds. On the other hand, NIS 3.6 billion were invested in funds specializing in equities.

B. Developments in exposure to risk

Data protection and cybernetic event risks

This risk is defined as exposure of the Bank to injury to its operations (leading even to a complete shutdown), theft of financial assets, financial losses and loss of reputation, stemming from cybernetic attacks on the computer systems of the bank (sometimes with no knowledge of the users), or by means of the gathering of information from such systems, with the aim of disturbing the regular operation of the bank, even to its complete shutdown.

Exposure of banking corporations to cyber threats (in Israel and abroad) has constantly increased in recent years, expresses in an increase in the ingenuity of the attacks, the volume of the potential damage and in the difficulty to identify these attacks.

The main operating environment of a bank is its internal operating network (the central computer system), by which the Bank performs its business operations.

The network is operated and maintained by the parent company, and is detached from the rest of the work environment.

The Bank, in cooperation with the parent company, acts to reduce exposure to data protection risks and to cybernetic events, by an array of processes and means, including the integration of different defense systems and tools. For further information on this issue, see Chapter 16 below.

C. Changes in critical accounting assessments

(1) Provision for credit losses measured on a specific basis

In accordance with the public reporting instructions in the matter of "measurement and disclosure of impaired debts, credit risk and provision for credit losses" (hereinafter – "the instruction") published by Bank of Israel on February 18, 2010, banks were required to form an accounting policy that would, inter alia, include reference to each of the methods for assessment of the provision for credit losses, as follows:

- "provision for credit losses assessed on a specific basis" – applied in respect of troubled debts the contractual balance of which exceeds NIS 1 million, and in respect of identified troubled debtors (the provision for credit losses in their respect is measured on a collective basis);
- "provision for credit losses assessed on a collective basis" – applied in respect of homogenous groups of loans in relatively small amounts (such as: outstanding credit card charges, housing loans, consumer credit repayable by installments, etc.) provided their contractual balance does not exceed NIS 1 million.

The accounting policy that had been formed by the Bank in the past stated a maximum debt amount for "homogenous credit groups" (as defined in the instruction) of NIS 50 thousand. Namely, credit, the balance of which exceeded the said amount, was examined by the Bank on a specific basis.

These criteria served the Bank in the implementation of the accounting policy for the classification of troubled debts and the measurement of provisions for credit losses in the period from the effective date of the instruction (January 1, 2011) and until December 31, 2015.

Following the experience gained by the Bank in the application of the instruction and the tests made by the Bank during the past period, as regards the adjustment of the criterion for determining the maximum amount for debts measured on a collective basis to the composition of the Bank's credit portfolio and the nature of its operations, which indicated insignificant differences in results between the two methods of assessing provisions, as described above (in respect of credit in small and medium amounts), on the one hand, and in view of the considerable investment of resources required for the examination of credit on a specific basis (including the requirement for abiding by detailed and strict documentation rules in this method of examination) on the other hand, Management of the Bank has decided to change as from January 1, 2016, the accounting policy in respect of this issue, and to increase the criterion for the maximum amount for debts examined on a collective basis from NIS 50 thousand to NIS 0.5 million.

The accounting assessments in the matter of provisions for credit losses (in respect of each of the provision methods determined by the instruction, as stated) are considered critical accounting assessments. The change in the distribution of credit balances in respect of which the relevant accounting assessments are being applied (the specific provision and the collective provision), derived from the change in accounting policy, as stated, did not result in a material change in expenses for credit losses.

(2) Provision for credit losses on a collective basis

The process of determining the provision for credit losses on a collective basis is based on rules determined by Bank of Israel, including guidelines as to the determination of the "provision range" component (as defined in Bank of Israel instructions).

In view of the experience gained in this matter, Bank of Israel published on December 11, 2016, a draft instruction, in which banking corporations were required to expand, as from the year 2016, the period for the write-off data used in determining the "provision range" from five to six years
(and to seven years as from January 1, 2071). The Bank has applied the new guidelines during the reported period. The said application of the guidelines did not have a material impact on the balance of the provision for credit losses on a collective basis.

The process of computing the provision for credit losses on a collective basis is based on significant assessments (such as: determination of the "decision coefficient" within the "provision range" for each of the credit groups), and on subjective estimates (such as: the correlation between the provisions for credit losses recorded in the past and the present loss inherent in the credit portfolio). Accordingly, the provision for credit losses on a collective basis is sensitive to possible changes in assessments or in the subjective estimates, as stated, in a way hat a possible deviation in these factors, may materially divert the amount of the provision for credit losses on a collective basis.

(3) Liability for the payment of severance compensation

The process for the determination of the provision for the payment of severance compensation to employees of the Bank is based on the accounting principles detailed in Note 1P to the financial statements.
Computation of the said provision is made on an actuarial basis, which relies on past experience, on statistical parameters and on forecasts as to the future, such as: expected mortality, rates of early retirement, probability of additional benefits payable to future retirees over and above the contractual liability, etc.

The Board of Directors approved on September 11, 2016, an efficiency program formed by Management of the Bank and which includes a plan for voluntary retirement of employees at beneficial terms. Following approval of the plan, the Bank has updated its liabilities for the payment of severance compensation as of December 31, 2016, by an amount of NIS 17 million.

Moreover, during the reported period, the Bank has updated its actuarial assumptions in respect of its liabilities for the payment of severance compensation, based on updated data for the years 2011-2016 and on forecasts of Management regarding the rates of employee retirement and the enlarged amounts of severance compensation, which the Bank may have to pay to the retiring employees. The updating of the above assumptions, as stated, increased the provisions of the Bank for the payment of severance compensation by an amount of NIS 37 million.

The said provision in respect of the Bank's liabilities for the payment of severance compensation, based on actuarial assessments and assumptions, as described above, is sensitive to possible changes in parameters or forecasts on which it is based, so that a possible deviation in these components, may materially divert the amount of the liability included in the financial statements.

7. Development in income, expenses and in other comprehensive income

A. Income and profitability

Profits before taxes amounted in 2016 to NIS 337 million, as compared to NIS 344 million in 2015, a decrease of 2.0%.

In 2016, the return of profit before taxes on net shareholders' equity was 15.6%, as compared to 17.0% in 2015.

The provision for taxes on the income amounted to NIS 146 million in 2016, as compared to NIS 136 million in the previous year. The tax provision was 43.3% of the gross income, as compared to 39.5% in 2015.

Net income amounted in 2016 to NIS 193 million, as compared to NIS 210 million in 2015, a decrease of 8.1%.

The return of net income on gross shareholders' equity in 2016 was 8.9%, as compared to 10.4% in 2015.

Details of the return of net profit on shareholders' equity during the last five years (in percentages):

	2016	2015	2014	2013	2012
			%		
Annual return	**8.9**	10.4	7.8	9.9	10.7

In 2016, **net earnings per share of NIS 0.1 par value** amounted to approximately NIS 1.55 thousand per share as compared to approximately NIS 1.69 thousand per share in the previous year. Net earnings per share of NIS 0.01 par value amounted in 2016 to approximately NIS 0.15 thousand, as compared with NIS 0.17 thousand in the previous year.

The business results of the Bank for the year 2016, as compared with the results for 2015, were mainly affected by the following factors:

- A rise of NIS 62 million in net interest income reflecting a growth of 7.1%.
- A decrease of NIS 1 million in non-interest financing income reflecting a decline of 2.7%.
- A decrease of NIS 31 million in credit loss expenses, reflecting a decline of 46.3%.
- A decrease of NIS 6 million in commission fee income, reflecting a decline of 1.9%
- A decrease of NIS 24 million in other income comprising mostly a decrease in capital gains from the sale of buildings.
- An increase in other operating expenses of NIS 69 million, reflecting a growth of 8.2%, stemming from the nonrecurring implications of the wage agreement signed in the corresponding period last year, and from the implications of the efficiency program applied in 2016.
- An increase in the effective tax rate from 39.5 in 2015 to 43.3% in 2016.

B. Income and expenses

In 2016, **net interest income** amounted to approximately NIS 934 million, as compared to approximately NIS 872 million in 2015, an increase of approximately 7.1%. The increase in net interest income is explained by the following:

- An increase of 9.7% in the average balance of income producing assets;
- A decrease of 0.10 percentage points in the interest spread, from 3.19% last year to a spread of 3.09% in 2016.

The Table below sets out the extent of financial operations at the Bank and interest spreads by linkage segments as well as the contribution to interest income of each of the segments in 2016, in comparison with 2015:

Linkage	2016 Volume of operations %	Interest spread %	Net interest income NIS millions	2015 Volume of operations %	Interest spread %	Net interest income* NIS millions
- Non-linked	**82**	**3.59**	**885**	81	3.61	812
- CPI linked	**12**	**0.46**	**17**	12	0.94	25
- Foreign currency	**6**	**1.90**	**32**	7	2.13	35
Total	**100**	**3.09**	**934**	100	3.19	872

Following is an analysis of the components of change in interest income:

The non-linked shekel segment

Total assets in this segment comprised approximately 82% of the total Bank's assets in 2016, as compared with 81% in the previous year. The segment's contribution to the Bank's interest income amounted to approximately NIS 885 million (prior to the application of the FAS-91 rules – NIS 736 million), as compared to approximately NIS 812 million in the previous year, comprising approximately 95% of total interest income of the Bank. The increase in interest income in this segment stems mostly from the rise in the volume of operations.

In 2016, the credit facilities extended to the general public as a proportion of the total income-producing assets in this segment (excluding derivative financial instruments) were at the rate of 78%, similarly to the ratio of the previous year.

In total for 2016, the volume of assets in this segment (excluding derivative financial instruments) increased by 10.2%, mostly due to a growth of 10.4% in credit to the public. The interest spread in this segment amounted in 2016 to 3.59% as compared with an interest spread of 3.61% in the previous year.
The decline recorded in the interest spread stems mostly from a decline in return on the securities portfolio of the Bank

The CPI-linked shekel segment

Total assets in this segment comprised on an average approximately 12% of the total assets of the Bank in 2016, similarly to the previous year. The segment's contribution to the Bank's interest income totaled NIS 17 million, as compared to NIS 25 million in the previous year, approximately 2.0% of total interest income of the Bank. The reduction in interest income in the interest spread – see extended discussion below.

The principal function of this segment is to coordinate the Bank's operations with respect to the raising of medium and long-term deposits from the general public (on the resources side), and the assets covering these liabilities (on the application side). In 2016, the extent of the credit facilities granted to the public, as a proportion of the total income-producing assets in this segment (excluding derivative financial instruments), amounted to approximately 54%, in contrast to 61% in the previous year.

As stated above, the segment interest spread in 2016 was a rate of 0.46%, as compared to a rate of 0.94% in the previous year. The decline in the interest spread is, explained both by the change in the mix of application of funds, as stated (a decline in the component of credit to the public and an increase in the component of investment in securities) and by the decline recorded in commission fees in respect of premature repayment of credit and in the return on the securities portfolio.

Foreign currency segment (including linkage to foreign currency)

Total assets in this segment comprised an average of approximately 6% of the Bank's total assets in 2016, as against 7% in the previous year. The segment's contribution to the Bank's interest income totaled NIS 32 million as compared to NIS 35 million in the previous year, approximately 3.0% of the Bank's total interest income.

The decrease in net interest income of this segment stems from a decrease of 0.23% in the interest spread, from 2.13% last year to a rate of 1.90% in 2016. The increase in the interest spread is explained, mainly, by the decrease in return on the securities portfolio.

In 2016, the inclusive **interest spread**, comprising the ratio of interest income (before expenses for credit losses) to the average balance of financial assets – amounted to 3.09% in comparison with 3.19% in the previous year.

For additional information regarding development and breakdown of interest income and interest spreads by banking products and by linkage segments – see the report on rates of interest income and expenses and analysis of changes therein (Appendix No.1 to the corporate governance report).

The Table below presents data regarding the development in interest income by regulatory segments of operation:

	Year ended December 31,		
	2016	**2015**	**Change**
	NIS (millions)	**NIS (millions)**	**%**
Households	**283**	246	15.0
Private banking	**3**	3	-
Small businesses	**512**	480	6.7
Medium businesses	**85**	81	4.9
Large businesses	**42**	41	2.4
Institutional bodies	**6**	4	50.0
Financial management	**3**	17	(82.4)
Total interest income	**934**	872	7.1

Non-interest financing income amounted in 2016 to approximately NIS 36 million, as compared with NIS 37 million in the previous year.

The decline in non-interest financing income stems mostly from a decrease of NIS 27 million, net, in gains on sale of securities.

The effect of this component was offset by the decrease recorded in expenses regarding adjustment to fair value of derivative financial instruments in the amount of NIS 24 million. The expense recognized in respect of this component derives from the mismatching of the accounting treatment principles applying to "base assets" relating to transactions in derivative instruments (measured by the "accrual" method), and the method for computing the value of the derivative instruments used to cover the base assets (measured by the "fair value" method). The differences in the accounting treatment, as stated above, comprise "timing differences" to be recognized in profit and loss of the Bank in future years.

Following are data regarding the principal components of the item "non-interest financing income", in comparison with the previous year:

	Year ended December 31,		
	2016	**2015**	**Change**
	NIS (millions)		
Exchange differences:			
- Derivative instruments	**(12)**	(24)	12
- Other	**18**	31	(13)
Total exchange differences	**6**	7	(1)
Net income (expenses) from derivative instruments activity[(1) (2)]	**2**	(25)	27
Gains on sale of securities, net	**28**	[(3)]55	(27)
Total	**36**	37	(1)

(1) Not including exchange differences.
(2) Of which: income regarding adjustment to fair value of derivative instruments amounting in 2016 to NIS 14 million (2015 – expenses of NIS 3 million).
(3) Including a charge of NIS 9 million, which, in 2015, the Supreme Court ordered the Bank to refund to a debtor, being a proportion of the value of securities serving as collateral for his debt and which had been seized by the Bank in prior years.

Expenses in respect of credit losses, net, amounted in 2016, to NIS 36 million, as compared to NIS 67 million in the previous year. In 2016, the expense for credit losses comprised 3.9% of net interest income, as compared to 7.7% of such income in the previous year. The ratio of this expense in relation to the net credit facilities made available to the general public was approximately 0.16%, as compared to 0.33% in the previous year.

Following are data regarding the development of expenses for credit losses in 2016, in comparison with the previous year:

	Year ended December 31,	
	2016	**2015**
	NIS (millions)	
Expenses regarding credit losses:		
• On a specific basis	**(35)**	49
• On a collective basis*	**71**	18
Total	**36**	67

* Including accounting write-offs in the amount of NIS 83 million in respect of substandard debts, the provision for credit losses in respect thereof is assessed on a collective basis, after deduction of collections relating to debts that had been written off in the past in the amount of NIS 18 million (2015– NIS 10 million and NIS 16 million, respectively).

The decrease in expenses for credit losses in 2016 stems from the decrease in expenses measured on a specific basis (explained by an exceptional expense recorded last year in respect of a small number of borrowers whose financial condition had deteriorated) and from an increase in income from the collection of troubled debts that had been written-off in the past. The impact of these items was offset by an increase in the provision for credit losses on a collective basis component, due both to the growth in the volume of credit and to the change in the accounting policy of the Bank, initially applied in the reported period, within the framework of which new parameters had been set for the differentiation between credit the provision for credit losses in respect of which is computed on a specific basis, and the component of credit the provision for credit losses in respect of which is assessed on a collective basis. As a result of the said change in accounting policy, a change was recorded in the mix of expenses in respect of credit losses assessed with regards to each of the credit portfolio components, as stated (for additional information, see Note 1J (4) to the financial statements).

Following are details of developments in expenses (income) for credit losses by segments of operation:

	Year ended December 31,		
	2016	**2015**	**Change**
	NIS (millions)	**NIS (millions)**	**NIS (millions)**
Households	**11**	9	2
Small businesses	**17**	36	(19)
Medium Businesses	**10**	24	(14)
Large businesses	**(3)**	(2)	(1)
Financial management	**1**	-	1
Total expenses for credit losses	**36**	67	(31)

The decrease in expenses for credit losses in the small business segment and in the medium business segment is mainly explained by the following factors:

- The recording of exceptional provisions for credit losses in the previous year in respect of a small number of borrowers whose financial condition had deteriorated;
- A decline in the provisions for credit losses on a collective basis, stemming from the decline of NIS 63 million in the volume of troubled debts in 2016 (as compared to an increase of NIS 43 million recorded last year);
- An increase in income from the collection of troubled debts that had been written-off in the past;

The cumulative balance of the provision for credit losses measured on a collective basis amounted at December 31, 2016 to NIS 288 million, comprising 1.03% of the total credit to the public risk at that date (December 31, 2015 – NIS 282 million and 1.09%, respectively).

For additional details regarding the volume of troubled debts at the Bank as of December 31, 2016 and their classification, as well as regarding quality indices of the credit portfolio of the Bank – see Chapter 12B below.

Commission fees income in 2016 amounted to NIS 304 million, as compared with NIS 310 million in 2015, a decrease of approximately 1.9%. The decline in commission fees income stems mostly from a decline in the amount of NIS 6 million in income from ledger fees (explained mostly by the implementation of regulations taking effect in the third quarter of 2015, and which have reduced the Bank's commission income by this amount).

Following are data regarding commission fees income in 2016 as compared to the previous year:

		Year ended December 31,	
		2016	**2015**
		NIS (millions)	
Ledger fees		**148**	154
Credit cards		**33**	31
Securities transactions		**19**	21
Credit handling		**17**	17
Currency exchange		**30**	31
Financing commissions		**29**	26
Other commissions		**28**	30
Total commission fees		**304**	310

Other income amounted in the reported period to NIS 9 million as compared to NIS 33 million last year. The income stems mostly from gain on the sale of buildings used by the Bank in the past. For further details regarding these transactions – see Note 24B(12) to the financial statements.

In 2016, **operating and other expenses** totaled NIS 910 million as compared to NIS 841 million in the previous year, an increase of 8.2%.
The increase in operating costs stems mostly from an increase of 12.2% in payroll and related expenses, explained below:

- Nonrecurring payroll expenses of NIS 19 million recognized in 2016, stemming from the implementation of the efficiency program and from the amendment of the labor agreement in the matter of "jubilee awards" (see Chapter 21A and Chapter 8C (2) of the Corporate Governance Report).
- A one-off decrease of NIS 30 million in payroll expenses recognized in 2015, explained by the implications of the new wage agreement signed by the Bank last year.

The efficiency ratio of the Bank amounted in 2016 to 70.9% as compared to 67.2% last year. With the elimination of the nonrecurring payroll expenses (decrease in expenses), the efficiency ratio for 2016 would have amounted to 69.9% as compared with 71.5% last year.

The **provision for taxes on the pre-tax income** amounted to NIS 146 million in 2016, as compared to NIS 136 million in the previous year. In 2016, the ratio of the tax provision in relation to income from ordinary operations was approximately 43.3%, as compared to 39.5% in the previous year.

The increase in the ratio of tax provisions is explained mainly by the updating of the provisions for deferred taxes made in 2016, as follows:

- At the beginning of 2016, the Bank recognized as tax expense of NIS 8 million due to the reduction of 1.5% in corporation tax, which took effect on January 1, 2016).
- The Economic Efficiency Act (Legislation amendments to attain the budgetary goals for the 2017-2018 budget years), 2016, was published December 29, 2016, in which a gradual reduction in the corporation tax rate was proclaimed at the rate of 1% per year as from the year 2017 and until 2018 (down to a future rate of 23%).

  Following the expected reduction in the corporation tax rate, as stated, the Bank updated on December 31, 2016, the provisions for deferred taxes in accordance with the statutory tax rates that would prevail on dates of realization of the deferred taxes. The said updating of the deferred tax provisions increased the tax expense of the Bank in the fourth quarter of 2016 by an amount of NIS 10 million.

In total for 2016, the tax expense of the Bank increased by an amount of NIS 18 million, due to the said changes in tax rates.

The impact of such factors was offset by the reduction in the statutory tax rate in 2016 (from 37.18% to 35.9%) and by the recognition of tax expenses at beneficial rates applying to the gain on sale of building recognized in the reported period.

For additional information regarding developments in the quarterly income and expenses of the Bank – see Appendix 2 to the Corporate Governance Report.

C. Information regarding investments and expenses in respect of the information technology system

(a) General

The Bank's centralized computer systems are based on those of the Bank's parent company, which develops, operates and maintains the systems.

Computer and operational services made available to the Bank by the parent company are regulated by long-term agreements drawn up on the basis of economic criteria. The agreements in question set out the extent, qualitative nature and availability of the computer services provided to the Bank, and, in addition, guarantee the continuous supply of those services, both in relation to existing contractual arrangements and those arrangements that may apply during any transitional period in circumstances wherein either of the parties desires to terminate the existing arrangements. For information relating to the agreement signed between the Bank and the parent company regarding the cost of the said computer services, see Note 24B(10) to the financial statements.

The Bank's involvement in the central information systems, jointly used by the Bank and the parent company, addressed in 2016 several central issues, including: the introduction of software versions that improve and update the central computer system, improvements in online banking services for business customers and customers active on the capital market and systems improving credit control.

In addition to the said central information system, the Bank also operates localized computer systems which incorporate operational, information and management systems as, for example, a system for managing the foreign currency transactions dealing room, a system for managing and measuring market risks, a system for budget management, a system for measuring the operating results of individual operating segments, a system for measuring branch profitability and managing goal achievement, a system for human resource management, etc.

(b) Accounting policy

Payments made by the Bank in respect of the information technology systems are classified either to the statement of profit and loss or to fixed assets, as follows:

- Amounts charged to profit and loss: include payments to outside suppliers in respect of maintenance of the information systems, license fees for the use of software and hardware and current payments to the parent company under the long-term computer agreement signed by the parties (excluding the proportionate part of the "in-house software development costs" component charged by the parent company to fixed assets).
- Amounts charged to fixed assets include the purchase of hardware and software (both in respect of local computer systems and as part of joint purchases by the Bank and the parent company), and a proportionate part of the "in-house software development costs" component charged by the parent company to fixed assets.

(1) Quantitative aspects

- **Information technology maintenance costs not capitalized to assets:**

	Year ended December 31, 2016			
	Software	**Hardware**	**Other**	**Total**
	NIS millions			
Payroll and related expenses	-	-	-	-
Depreciation	**25**	**6**	**-**	**31**
License fees	**3**	**-**	**-**	**3**
Payments to parent company	**-**	**-**	**45**	**45**
Other	**3**	**3**	**6**	**12**
Total	**31**	**9**	**51**	**91**

	Year ended December 31, 2015			
	Software	**Hardware**	**Other**	**Total**
	NIS millions			
Payroll and related expenses	-	-	-	-
Depreciation	25	5	-	30
License fees	2	2	-	4
Payments to parent company	-	-	48	48
Other	2	2	6	10
Total	29	9	54	92

- **Assets relating to the information technology systems**

	December 31, 2016			
	Software		Hardware	
	Purchases	Capitalized costs	Computer systems	Total
	NIS millions			
Cost				
Balance at beginning of year	**211**	**218**	**81**	**510**
Additions	**6**	**20**	**10**	**36**
Disposals	**-**	**-**	**-**	**-**
Balance at end of year	**217**	**238**	**91**	**546**
Accumulated depreciation				
Balance at beginning of year	**182**	**173**	**69**	**424**
Depreciation for the year	**5**	**20**	**6**	**31**
Disposals	**-**	**-**	**-**	**-**
Balance at end of year	**187**	**193**	**75**	**455**
Depreciated cost	**30**	**45**	**16**	**91**

	December 31, 2015			
	Software		Hardware	
	Purchases	Capitalized costs	Computer systems	Total
	NIS millions			
Cost				
Balance at beginning of year	208	203	74	485
Additions	3	15	7	25
Disposals	-	-	-	-
Balance at end of year	211	2018	81	510
Accumulated depreciation				
Balance at beginning of year	177	153	64	394
Depreciation for the year	5	20	5	30
Disposals	-	-	-	-
Balance at end of year	182	173	69	424
Depreciated cost	29	45	12	86

D. Developments in other comprehensive income

Developments in other comprehensive income are as follows (in NIS millions):

	Year ended December 31,		
	2016	2015	Change
Adjustments regarding available-for-sale securities			
- Unrealized net gains (losses) from adjustments to fair value	**(9)**	12	(21)
- Gains reclassified to profit and loss	**(28)**	(61)	33
Total adjustments regarding available-for-sale securities	**(37)**	(49)	12
Employee rights			
- Actuarial income (loss) for the period	**(65)**	2	(67)
- Loss reclassified to profit and loss	**25**	11	14
Total adjustments regarding employee rights	**(40)**	13	(53)
Total before taxes in income	**(77)**	(36)	(41)
Tax effect	**25**	13	12
Total changes in other comprehensive income	**(52)**	(23)	(29)

The increase in the other comprehensive loss in 2016, as compared to the previous year amounted to NIS 29 million and is explained mainly by the increase of NIS 67 million in actuarial losses in respect of employee rights.

The increase in actuarial losses in respect of employee rights is explained as follows:

- An increase of NIS 17 million in liabilities for the payment of severance compensation, stemming from the efficiency program implemented by the Bank in 2016 (see Chapter 21A below);
- An increase of NIS 37 million in liabilities for the payment of severance compensation stemming from the revision in actuarial assumptions, both in respect of the updating of data relating to the retirement of employees and the payments made in their respect in the past, and in respect of the updating of Management's forecasts as to employee retirement payments that the Bank will have to make in the future.
- An increase of NIS 9 million in liabilities for the payment of severance compensation stemming from a decline of 0.15 percentage points in the discounting rate.

8. Structure of assets and liabilities, capital and capital adequacy and the changes therein

A. History of assets and liabilities

A summary of the history of principal items in the balance sheet is set out below:

	December 31		Rate of
	2016	2015	change
	NIS (millions)		%
Total assets	**32,164**	30,076	6.9
Cash and bank deposits	**3,422**	5,502	(37.8)
Securities	**6,002**	3,432	74.9
Credit to general public, net	**22,001**	20,417	7.8
Deposits from general public	**27,199**	25,388	7.1
Bonds	**257**	-	-
Subordinate debt notes	**669**	672	(0.4)
Shareholders' equity	**2,244**	2,103	6.7

Cash and bank deposits

	December 31		Rate of
	2016	2015	change
	NIS (millions)		%
Shekel (non-linked)	**2,720**	5,015	(45.8)
Shekel (CPI-linked)	**327**	100	227.0
Foreign currency	**375**	387	(3.1)
Total	**3,422**	5,502	(37.8)

The balances in the non-linked segment are mainly comprised of deposits with Bank of Israel for the purposes of compliance with liquidity directives, and deposits of surplus funds obtained from Bank of Israel tenders.

In the CPI-linked segment, the balance is partly made of long-term deposits with banking corporations as cover for the subordinate debt notes issued by the Bank.
In the foreign currency segment, the balance is mainly comprised of deposits with Bank of Israel and with commercial banks overseas.
The decline in cash balances and deposits with banks in the non-linked shekel segment stems from the diversion of funds from this item to credit applications and to investment in securities producing higher returns. The increase in cash balances and deposits with banks in the CPI-linked shekel segment is mostly explained by an increase in the volume of securities on loan to banks.

Securities

	December 31		Rate of
	2016	2015	change
	NIS (millions)		%
Bonds held to maturity	**306**	310	(1.3)
Securities available-for-sale	**5,684**	3,110	82.8
Securities held for trading purposes	**12**	12	-
Total	**6,002**	3,432	74.9

The portfolio of **bonds held to maturity** is presented at written-down cost.

The portfolio of **available-for-sale securities** is stated at fair value.

As of December 31, 2016, the fair value of the available-for-sale portfolio exceeded its written-down cost by NIS 6 million, net (in contrast to NIS 43 million at December 31, 2015). This sum, after adjustment for the tax effect, increased the Bank’s shareholders’ equity as of the reporting date by approximately NIS 4 million. This portfolio, which contains most of the securities owned by the Bank, includes investments of the Bank serving as cover for deposits by the public and the active capital.

Securities of the Bank on loan to customers and to banking corporations are reflected in the financial statements under credit granted to the general public and under cash and deposits with banks, as the case may be, and their balance at December 31, 2016 amounted to NIS 21 million and NIS 248 million, respectively (December 31, 2015 – NIS 22 million and NIS 5 million, respectively).

The increase in the balance of the available-for-sale securities portfolio is explained, inter alia, by the shifting of applications to this item from deposits with Bank of Israel.

Securities held for trading purposes portfolio - most of the operations within this framework are focused on trading in government bonds while exploiting differing price levels in the market-place. In 2016, the average value of the portfolio was approximately NIS 21 million (2015 – NIS 27 million), which constitutes approximately 2.8% of the portfolio size authorized by the Board of Directors.

Following are details regarding investment in bonds classified to the available-for-sale portfolio, by economic sectors and by credit rating, as well as details regarding accumulated gains (losses) in their respect:

		Year ended December 31, 2016			
		Adjusted cost	**Fair value**	**Accumulated gains**	**Unrealized losses**
	Bond rating[2]	**NIS millions**			
A. Corporate bonds					
(1) Marketable bonds					
Electricity and water	AAA	**110**	**110**	**-**	**-**
Total marketable bonds		**110**	**110**	**-**	**-**
(2)Non-marketable bonds					
Electricity and water	AA to AAA	**73**	**75**	**2**	**-**
Transportation and storage	-	**7**	**13**	**6**	**-**
Communication and computer services	AA	**3**	**3**	**-**	**-**
Hotel and tourism	A+	**4**	**4**	**-**	**-**
Total non-marketable bonds		**87**	**95**	**8**	**-**
Total corporate bonds		**197**	**205**	**8**	**-**
B. Government bonds[1]		**5,470**	**5,466**	**7**	**11**
Total available-for-sale Bonds		**5,667**	**5,671**	**15**	**11**

		Year ended December 31, 2015			
		Adjusted cost	**Fair value**	**Accumulated gains**	**Unrealized losses**
	Bond rating[2]	**NIS millions**			
A. Corporate bonds					
(1) Marketable bonds					
Financial and business services	AAA to AA+	177	174	-	3
Commerce	AA-	13	13	-	-
Communication and computer services	BB-	13	14	1	-
Electricity and water	AAA to BBB-	123	123	-	-
Industrial	AA- to A+	14	14	-	-
Other	AAA to BBB+	51	52	1	-
Total marketable bonds		391	390	2	3
(2)Non-marketable bonds					
Electricity and water	AA to AAA	74	77	3	-
Hotel and tourism	A	4	4	-	-
Communication and computer services	AA	5	5	-	-
Industrial	-	22	23	1	-
Other	-	7	12	5	-
Total non-marketable bonds		112	121	9	-
Total corporate bonds		503	511	11	3
B. Government bonds[1]		2,554	2,587	34	1
Total available-for-sale bonds		3,057	3,098	45	4

(1) The balance mainly includes Israeli government bonds.
(2) The bonds have mainly been rated by Israeli rating companies.

According to Bank of Israel instructions and to accepted accounting principles, unrealized losses are to be reflected in a "capital reserve" so long as they are of a "temporary" nature. Losses of a nature other than "temporary" must be charged to the statement of profit and loss.

Management's decision as to the nature of unrealized accumulated losses on bonds is based upon the following tests:

- The rating of the bonds, including changes occurring therein;
- The rate of impairment in value of the bonds in comparison to their cost (taking also into consideration developments occurring after balance sheet date);
- Extent of the period in which the value of the bonds was lower than their cost;
- The return to maturity of the bonds in relation to the period to maturity and accepted returns in the market;
- Volatility in the fair value of the bonds;
- The economic condition of the issuer of the bonds and his ability to honor his obligations;
- The intention and ability of the Bank to hold the bonds until maturity;
- Classification (or non-classification) of the bonds as a "troubled debt";
- Default events in payment concerning the bonds.

The said bonds had been purchased by the Bank with the aim of holding them until maturity or until such time as the rise in their fair value will enable the Bank to sell them at a profit. The Bank has the intention and ability to hold on to the said bonds during the period required to attain the said aims.

In view of the positive trend existing in the bond market in 2016 (reflected in the reduction in the rates of return to maturity inherent in the bond portfolio), the available-for-sale bond portfolio at December 31, 2016, contains unrealized losses in the amount of NIS 11 million (December 31, 2015 - NIS 4 million) comprising only 0.2% of the outstanding balance of the portfolio. Accordingly, Management is of the opinion that these losses (stemming mostly from investments in government bonds) mainly reflect general changes in interest trends in the bond market, and therefore it considers that these losses are of a "temporary" nature.

The classification of losses inherent in the available-for-sale bond portfolio (at a rate exceeding 20% of the adjusted cost of these bonds) is examined by the Bank on a quarterly basis. In this respect, the business condition of the relevant issuers is being reviewed (based on public information) including their ability to honor their liabilities.

Based on these reviews, the Bank did not recognize in profit and loss for the year 2016 any loss in respect of this item (2015 - identical).

For additional details regarding the distribution of unrealized losses accumulated on the available-for-sale bond portfolio by "period of accumulated losses" – see Note 12 to the financial statements.

Credit to the general public

	December 31, 2016	**December 31, 2015**	**Rate of change**
	NIS millions		**%**
Non- linked Shekel	**19,534**	17,694	10.4
CPI-linked Shekel	**1,736**	1,832	(5.2)
Foreign currency or linked thereto	**731**	891	(18.0)
Total	**22,001**	20,417	7.8

Total borrowings by the general public increased in 2016 by 7.8%, in comparison to an increase of 7.9% in the previous year. Most of the increase was recorded in the non-linked shekel borrowing and is explained by the expansion in the activity of the retail segment in 2016, which agrees with the goals of the Bank in this sector.

The Table below analyses the total risk of credit to the public[(1)] by industry segment:

	31.12.2016			31.12.2015		
	Total credit risk[(1)]	Troubled debts	Provision for credit loss	Total credit risk[(1)]	Troubled debts	Provision for credit loss
	NIS millions			NIS millions		
Private individuals[(2)]	**8,880**	**116**	**76**	8,005	127	71
Construction and real estate[(3) (5)]	**6,273**	**141**	**59**	5,571	186	54
Commerce	**4,769**	**131**	**98**	4,512	145	102
Industry	**2,526**	**64**	**43**	2,539	70	44
Other commercial services[(4)]	**1,522**	**57**	**28**	1,418	42	22
Transportation and storage	**1,190**	**30**	**33**	986	42	32
Public and community services	**1,058**	**13**	**5**	983	6	4
Other (less than 5%)	**1,389**	**41**	**34**	1,357	48	37
	27,607	**593**	**376**	25,371	666	366

(1) Credit risk includes off-balance sheet credit risk.

(2) The growth in credit to the private individuals segment in the amount of NIS 875 million stems from the implementation of the strategic plan of the Bank, under which the Bank focuses on the development of credit activity in the retail sector, including the private individuals segment.

(3) The growth in the real estate and construction segment in the amount of NIS 702 million stems from credit granted to housing construction projects, conducted under the "closed rolling finance' method.

(4) The growth in the other commercial services segment in the amount of NIS 257 million stems mainly from credit granted in small amounts to companies in the retail sector.

(5) The reduction in the volume of troubled debts in the construction and real estate segment in the amount of NIS 45 million stems mostly from a small number of business customers classified last year as "troubled" due to the deterioration in their financial condition. The outstanding credit balance of these borrowers was reduced in 2016.

The table below presents summarized data regarding development of the troubled debts [1] at the Bank:

	DECEMBER 31 2016	DECEMBER 31 2015	Change
	NIS millions	NIS millions	%
Impaired debts	337	347	(2.9)
Substandard credit risk	60	60	-
Credit risk under special supervision[2]	196	259	(24.3)
Total	593	666	(11.0)

(1) The data relates to the stated balance of troubled debts in respect of credit risk to the public.
(2) The reduction in volume of credit risk under special supervision in 2016 stems from the improvement in the financial condition of borrowers that had been classified to this group in the past.

Additional information as to credit risk is included in Chapter 12 below and in the risk report published on the Internet website of the Bank at the following address: https//www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

Deposits from general public

	December 31 2016			2015			
	On demand	Fixed Term	Total	On demand	Fixed Term	Total	Rate of change
	NIS (millions)						%
Shekel (non-linked)	**6,480**	**15,621**	**22,101**	5,518	14,282	19,800	11.6
Shekel (CPI-linked)	**-**	**2,500**	**2,500**	-	2,854	2,854	(12.4)
Shekel (linked to foreign currency)	**-**	**34**	**34**	-	35	35	(2.9)
Foreign currency	**1,424**	**1,140**	**2,564**	1,546	1,153	2,699	(5.0)
Total	**7,904**	**19,295**	**27,199**	7,064	18,324	25,338	7.1

Deposits from the general public within the non-linked segment increased by 11.6%, from NIS 19,800 million at the end of 2015 to NIS 22,101 million at the end of 2016. The increase in the volume of deposits is attributable to the growth in the retail banking activity which is mainly conducted in this linkage segment.

CPI-linked deposits from the general public, the greater part of which is the source for the granting of credit facilities (mainly in the fields of mortgage loans and for the commercial banking division), decreased during 2016 by 12.4%. The reduction in the volume of deposits in this segment is explained, among other things, by the low inflationary environment prevailing in 2015 and 2016, which caused changes in the savings preferences of the public and the diversion of financial assets to the non-linked segment.

Foreign currency deposits from the public declined in 2016 at the rate of 5.0%, amounting to NIS 2,564 million. This reduction in deposits in this segment stems, inter alia, from the weakness recorded in the exchange rates of most foreign currencies against the shekel in 2016.

The Table shows the composition and developments in securities held by the general public:

	December 31 2016	2015	Rate of change
	NIS (millions)		%
Mutual funds	**3,617**	3,765	(3.9)
Bonds	**4,023**	4,087	(1.6)
Shares	**2,517**	2,456	2.5
Total	**10,157**	10,308	(1.5)

Bonds

	December 31 2016	2015	change
	NIS millions		NIS millions
Non-linked bonds	**257**	-	257

On March 31, 2016, the Bank (through a designated investee company – Mercantile Issuance Ltd.) issued marketable bonds in an amount of NIS 253 million. The bonds are non-linked; carry interest of 2.07% (0.79 percentage points higher than the return on similar government bonds traded on the date of issue) and are redeemable at the end of six years from date of issue. It is noted in this respect that on December 21, 2016, the Bank published (through Mercantile Issuance Ltd.) a shelf Prospectus allowing the company to issue additional bonds or debt notes. The amount of such issue, its date and class of securities to be issued has not yet been determined.

Subordinate debt notes

	December 31 2016	2015	Rate of change
	NIS millions		%
Shekel (CPI-linked)	**669**	672	(0.4)

The subordinate debt notes of the Bank are being rated by Ma’alot (hereinafter – “the rating company”). In view of the good capital adequacy ratios and profitability of the Bank, the rating company decided on December 12, 2016, to update the rating of the debt notes of the Bank to "AA" (with a stable rating horizon), being a one grade improvement over the rating awarded to the Bank last year ("AA-"). This rating is one grade lower than the grade awarded to the remaining liabilities of the Bank ("AA+"). The difference in the rating stems from the rating methodology of the international rating company S&P (the parent company of S&P Ma'alot) according to which the rating of subordinate debt notes would be downgraded by one grade below that granted to the issuing bank.
According to the methodology of the international rating company, as stated, the Bank (for the purpose of determining its credit rating by the rating company) was defined as a "core company" of the Discount Bank Group. This decision creates a distinctive linkage between the rating of the parent company and the rating awarded to the Bank.

As of December 31, 2016, the subordinate debt notes of the Bank comprise only 17% of the Tier I capital of the Bank, as defined in directives of Bank of Israel. This rate is lower than the maximum rate permitted by the said directives (50%).

For additional details regarding the rules for the recognition of subordinate debt notes as "Tier II capital", as determined by the Basel Rules , including in the transitional period for the implementation of these rules – see Section "B" below.

Fair value of derivative instruments

	Other assets		Other liabilities	
	December 31		December 31	
	2016	2015	2016	2015
	NIS millions	NIS millions	NIS millions	NIS millions
Interest contracts:				
- Shekel/CPI	**4**	-	**-**	16
- Others	**-**	-	**9**	26
Foreign currency contracts	**21**	27	**67**	73
Contrast in respect of shares	**4**	8	**4**	8
Total Fair value of derivative instruments	**29**	35	**80**	123
Of that:				
- included in the "credit to the public" item	**(1)**	(2)	**-**	-
- included in "other assets" or in "other liabilities"	**(2)**	(2)	**(1)**	(1)
Total, included in the "derivatives" item	**26**	31	**79**	122

The fair value of the net liabilities of the Bank in respect of derivative instrument transactions as of December 31, 2016, amounted to NIS 51 million, comprising a decrease of 42% in comparison with the net liabilities as of December 31, 2015.

The reduction in the net fair value of derivative instruments stems from changes in market variables used for the computation of the fair value of such instruments, such as: linkage differences, exchange differences and interest rates prevailing in the market.

Other assets

	December 31		Rate of change
	2016	2015	
	NIS millions		%
Current taxes – excess advance payments	**28**	22	27.2
Deferred tax assets	**272**	265	2.6
Other assets	**46**	54	(14.8)
Total	**346**	341	1.5

The increase in the balance of deferred tax assets in the amount of NIS 7 million is explained, inter alia, by the increase in provisions for liabilities in respect of employee rights, offset by a reduction of NIS 18 million in the balance of deferred taxes, resulting from the change in tax rates introduced by legislation amendments published in 2016.

Other liabilities

	December 31		Rate of
	2016	**2015**	**change**
	NIS millions		**%**
Liabilities in respect of employee rights:			
- Liability in respect of "jubilee" awards	**-**	78	-
- Excess provision for severance pay, net	**383**	304	26.0
- Post retirement benefits	**47**	44	6.8
- Liability in respect of vacation pay	**28**	27	3.7
- Liability for unutilized sick pay	**7**	7	-
- Provisions for payroll and related benefits	**95**	53	79.2
Total liabilities for employee rights	**560**	513	9.2
Creditors in respect of credit card transactions	**550**	511	7.6
Provision for credit losses in respect of off-balance sheet items	**28**	29	(3.4)
Other	**170**	128	32.8
Total	**1,308**	1,181	10.8

The increase recorded in 2016 in the liabilities for employee rights stems, mostly, from an increase in actuarial losses recorded in 2016 (for additional information on this subject – see Chapter 7D above).

Off-balance sheet items

The following Table analyses the principal developments in off-balance sheet items:

	December 31		Rate of
	2016	**2015**	**change**
	NIS millions		**%**
Documentary credit	**77**	68	13.2
Guarantees securing credit	**311**	299	4.0
Guarantees for purchasers of housing units(1)	**1,241**	984	26.1
Miscellaneous guarantees and liabilities(2)	**832**	677	22.9

(1) The increase in the item "guarantees for purchasers of housing units" stems from the growth in credit granted to building projects in the financing of housing construction field.

(2) The increase in "Miscellaneous guarantees and liabilities" stems from the growth in financing of construction transactions

B. Capital and capital adequacy

(1) General

The capital adequacy ratio is defined as the ratio of the capital resources of the Bank (Tier I and Tier II capital) to the risk assets of the Bank as defined in Proper Management of Banking Business Directives Nos. 201-211, published by Bank of Israel in 2013 (hereinafter - "the Basel Rules").

The Basel Rules specify different definitions regarding the capital resources and risk assets, including:

- Tier I capital is defined as the accounting equity capital net of regulatory adjustments (as defined by the Basel Rules), including:
    - Deduction of deferred tax assets the realization of which is based on the future profitability of the banking corporation.
    - "Excess taxes" – defined as the balance of the deferred tax assets, created by timing differences, exceeding 10% of the Tier I capital (subject to transitional provisions – see expanded discussion below).

- Tier II capital is defined as a combination of the following components:
    - Certain regulatory instruments issued for a period of at least five years and which include a "loss absorption" mechanism, enabling the automatic conversion of these instruments into shares, under certain circumstances defined in the Basel Rules (subject to transitional provisions – see expanded discussion below).
    - Collective basis provisions for credit losses, which do not exceed 1.25% of the risk assets averaged in respect of credit loss.

With the view of enabling banking corporations to gradually adopt the rules published in 2013, transitional provisions have been defined in the Basel Rules, as follows:

- The requirement to deduct "excess deferred taxes" shall take effect gradually in the years 2014-2017 (hereunder – "the transitional period") and would be fully implemented as from January 1, 2018. The gradual adoption includes the deduction of a certain part of the "excess deferred taxes" (as defined in the Directive), and recognition of the remaining part as a "risk asset".
- Whereas the debt notes issued by the banking corporations prior to December 31, 2013, do not agree with the criteria for recognition as a Tier II capital component (as they do not include a loss absorption mechanism), the transitional provisions include a mechanism for the gradual adoption of the criteria for recognition as regulatory capital of these debt notes, implemented in the years 2014-2021 (hereinafter – "the transitional period"), according to which, the debt notes would be recognized in part as Tier II capital during the transitional period, at gradually reduced rates, until their elimination in full at the end of the transitional period.
- The reduction in shareholders' equity of the banking corporations in respect of the adoption of the new measurement rules regarding employee rights as from January 1, 2015 (see Note 1D(7) to the financial statements) has been deferred and shall be deducted from equity in equal parts over the period from January 1, 2014 to January 1, 2018.

Determination of minimum requirements:

Within the framework of the guidelines contained in the Basel Rules, banks are required to maintain minimum capital ratios, as follows:

- Tier I equity capital ratio - shall not fall below 9% (for additional details regarding the broadening of this limitation – see below).
- Comprehensive capital adequacy ratio - shall not fall below 12.5% (for additional details regarding the broadening of this limitation – see below).

Increasing the capital requirements:

Following developments in recent years in the housing market in Israel (reflected in significant increases in housing prices and in the volume of housing loans), which increased the risk inherent in the loan portfolios of the banking corporations, Bank of Israel published on

September 28, 2014, an amendment to Proper Management of Banking business Directive No. 329, which prescribed for each banking corporation an additional minimum capital requirement, at a rate comprising 1% of the volume of the housing loan portfolio of each banking corporation. The new capital requirement took effect on January 1, 2015, and is being implemented gradually during eight consecutive quarters as from April 1, 2015 and until January 1, 2017.

The minimum equity capital requirement of the Bank stems from the said guidelines and amounted as of December 31, 2016, to a rate of 9.16% (the minimum comprehensive capital requirement amounted to 12.66%). A calculation made by the Bank, based on the housing loan portfolio data as of December 31, 2016, shows that the said guidelines are expected to increase the minimum capital requirements of the Bank as at January 1, 2017, by approximately 0.02 additional percent, to a rate of 9.18% (for the minimum equity capital requirement) and to 12.68% (for the minimum comprehensive capital requirement.

(2) Capital (in NIS millions)

	Year ended December 31,		
	2016	**2015**	**Change**
Capital and capital reserves	**203**	203	-
Other cumulative comprehensive Loss	**(97)**	(45)	(52)
Retained earnings	**2,138**	1,945	193
Total	**2,244**	2,103	141

The shareholders equity of the Bank as of December 31, 2016, amounted to NIS 2,244 million, an increase of 6.7% in comparison with the balance as of December 31, 2015. The increase in shareholders' equity stems from the current earnings of the bank in the reported year, which was offset by a reduction of NIS 52 million in the other comprehensive profit component (mostly due to an increase of NIS 29 million in the "actuarial differences in respect of employee benefits" component, stemming from the liability of payment of severance compensation) (see Chapter 21A below).

The ratio of shareholders' equity to total assets as of December 31, 2016, amounted to 7.0% (December 31, 2015 – identical).

(3) Capital adequacy

The data presented hereunder reflects developments in the components of the capital adequacy ration of the Bank:

	31.12.2016	31.12.2015
	NIS millions	NIS millions
Capital components used in computing the capital adequacy ratio:		
Equity capital	**2,244**	2,103
Differences between equity capital and Tier I capital and regulatory adjustments	**48**	25
Tier I capital, net of deductions	**2,292**	2,128
Tier II capital, net of deductions	**627**	680
Total comprehensive capital	**2,919**	2,808

Average balances of risk assets:		
Credit risk	**19,164**	18,110
Market risk	**22**	31
Operating risk	**1,930**	1,871
Total average balances of risk assets	**21,116**	20,012

	31.12.2016	31.12.2015
	%	%
Ratio of capital to risk assets:		
Ratio of Tier I equity capital to risk assets	**10.85**	10.63
Ratio of comprehensive capital to risk assets	**13.82**	14.03
Ratio of Tier I equity capital required by the Supervisor of Banks	**(1)9.16**	(1)9.06
Minimum comprehensive capital ratio required by the Supervisor of Banks	**(1)12.66**	(1)12.56

(1) The minimum equity capital requirement determined for the Bank according to instructions of Bank of Israel, amounts to 9.0% (for the Tier I equity capital ratio and 12.50% for the comprehensive capital adequacy ratio). However, according to the amendment to Proper Conduct of Banking Business Directive No. 329, the minimum capital requirement for the Bank was raised as from April 1, 2015, by 0.02% - 0.03% per quarter. In view of the above, the minimum comprehensive equity capital ratio of the Bank as of December 31, 2016 (based on the housing loan portfolio data as of December 31, 2016) amounts to 9.16% (for the minimum Tier I equity capital ratio and 12.66% for the comprehensive capital adequacy ratio) (December 31, 2015: 9.06% and 12.56%, respectively). In accordance with the said guidelines, this rate is expected to continue rising up to a maximum addition of 0.18% on January 1, 2017.

(4) The purchase of indemnification for the "sale guarantees" portfolio

In the course of April 2016, the Bank entered into an agreement (hereinafter – "the indemnification agreement") with reinsurers of a high international rating, for the indemnification by them of future credit losses, which the Bank may sustain in respect of the honoring of guarantees specified in the indemnification agreement.

The agreement applied to guarantees (including commitments for the issue of guarantees) issued by the Bank within the framework of the financing of housing construction projects in terms of the Apartment Sale Act and to other guarantees related to such projects. The agreement was in effect in the period from May 1, 2016 until December 31, 2016. The volume of guarantees (including commitments for the issue of guarantees) to which the agreement applied, amounted at December 31, 2016 to NIS 1.5 billion.

In accordance with the approval received from Bank of Israel, the said indemnification agreement reduced the risk assets of the Bank as of December 31, 2016, by an amount of NIS 0.6 billion, comprising a rise of 0.30 percentage points in the Tier I equity capital ratio of the Bank.

On January 18, 2017, the Bank signed a further agreement extending the validity of the previous agreement until December 31, 2017.

For further information regarding the implications of the indemnification agreement, as stated, on the measurement of the Bank's exposure to "segment concentration" risk, as defined by Bank of Israel, see Note 1D(5)(b) to the financial statements.

(5) Goals

The Bank's policy with respect to its capital adequacy goals stems from the risk appetite of the Bank, as approved by the Board of Directors. Within the framework of this policy, the Board of Directors instructed the Bank to maintain a capital adequacy level that is higher than the minimum level required by Bank of Israel, and higher than the level required by the results of the ICAAP survey. The capital adequacy rates of the Bank as of December 31, 2016, exceed those prescribed by the Board of Directors.

As stated in item (1) above, the debt notes issued by the Bank in the past (included as a regulatory capital component in Tier II capital) are being amortized gradually until the year 2021. Not withstanding the above, and in accordance with the work plan of the Bank for 2017, the Bank would not be required to raise further regulatory capital in order to comply with the inclusive capital goals for the year 2017.

(6) Leverage ratio

On April 28, 2015, Bank of Israel published a new Proper Conduct of Banking business Directive (No. 218) in the matter of leverage ratio, with the aim of restricting the leverage accumulation in the banking sector, by way of measuring a transparent "leverage ratio" that is not risk based and which may be easily and quickly calculated. In accordance with the guidelines contained in the Directive, the "leverage ratio" is defined as the ratio between the "measurement of capital" and the "measurement of exposure", as follows:

- **"Measurement of capital"** – is defined as Tier I equity capital including implications stemming from the application of the transitional provisions.
- **"Measurement of exposure"** – is defined as a combination of the following exposures: "balance sheet exposure" (assets stated in the balance sheet), "derivatives exposure", exposure to financing of securities transactions and exposure to off-balance sheet items.

In accordance with the said guidelines, banking corporations are required to maintain as from January 1, 2018 at the latest, a leverage ratio of not less than 5%. Following are data regarding the components of the leverage ratio at the Bank:

Components of the calculation (in NIS millions)	**December 31, 2016**	**December 31, 2015**
Tier I equity capital	**2,292**	2,218
Total exposure	**34,901**	32,454
Leverage ratio (%)	**%**	**%**
Leverage ratio	**6.6**	6.6
Minimum leverage ratio required by the Supervisor of Banks	**5.0**[(1)]	5.0[(1)]

(1) As from January 1, 2018

(7) Dividends

The distribution of dividends by the Bank is subject to certain restrictions determined in the Companies Act and in Proper Conduct of Banking business Directive No. 331, dealing with dividend distribution by banking corporations. The Bank did not distribute dividends in the years 2015 and 2016 (In 2014, the Bank distributed a dividend of NIS 45 million).

(8) Retained earnings and other comprehensive profit

For additional details regarding developments in net earnings and in the other comprehensive profit included in shareholders' equity – see Chapters 7A and 7D above.

9. Regulatory operating segments

A. General

In accordance with the instruction regarding the reporting of operating segments by banking corporations issued by Bank of Israel on December 23, 2001, banking corporations are required to include in their reports qualitative and quantitative information regarding their banking activity by segments of operation.

In accordance with this instruction, an operating segment is defined as a component of a bank having three characteristics:

- It is engaged in business activities expected to produce income and incur expenses;
- The results of its operations are regularly examined by Management and the Board of Directors for the purpose of decisions regarding the allocation of resources and assessment of its performance;
- Availability of separate financial information in respect of the segment.

The information regarding the distribution of assets, liabilities and results of operations by operating segments, as presented by banking corporations under this instruction, derives from subjective definitions of each o bank as to each of the operating segments, in accordance with the specific organizational structure of each bank.

Whereas the distribution of activity to the different segments of operation, stemming from this methodology in the different banks is not uniform, the disclosure by operating segments based on these definitions is subjective and is not comparable.

With the aim of presenting comparable information in this respect, Bank of Israel published on November 3, 2014, an amendment to the public reporting instructions in the matter of operating segments.

The said amendment contains a new guideline, whereby banking corporations are required to include in their financial reports additional information regarding their results of operations by regulatory segments of operations (in addition to the data presented hitherto in the matter in accordance with Management's approach).

The regulatory segments of operations have been defined by Bank of Israel in the amended instruction, based on their customers' characteristics, such as: the nature of their operations (with respect to private customers), or their business turnover (with respect to business customers), in a format which links on a uniform and unique basis the different customers in the banking sector in general and the regulatory segments of operations, as follows:

- **"Households"**: private customers the financial asset portfolio of whom is typical with that of households (lower than NIS 3 million);
- **"Private banking"**: private customers the financial asset portfolio of whom exceeds NIS 3 million;
- **"Minute businesses"**: business customers the annual business turnover of whom is less than NIS 10 million;
- **"Small businesses"**: business customers the annual business turnover of whom is between NIS 10 and 50 million;
- **"Middle market businesses"**: business customers the annual business turnover of whom is NIS 50 and 250 million;

- **"Corporate businesses"**: business customers the annual business turnover of whom exceeds NIS 250 million.

In addition, the amended instruction defined a new segment: "financial management" – which in the main includes banking operations not allocated to the other operating segments (such as: trading, asset and liability management, no-financial investments, etc.). Accordingly, the information that would be presented in the financial statements in accordance with the said definitions would include financial data defined on a uniform and comparable basis, in respect of each of the operating segments.

The disclosure required by the amended instruction shall be included in the periodic financial reports of all banking corporations and shall take effect gradually, as follows:

- Disclosure relating to the balance sheet data of the regulatory operating segments (as defined in the instruction) became effective on December 31, 2015, and is included in the financial statements for the year 2015.
- Other disclosure requirements included in the amended instruction (except for the disclosure regarding the analysis of the results of the "financial management" segment), take effect as from January 1, 2016.

The Bank is applying the disclosure requirements stated in the amended instruction as from their effective date, and has included them in these financial statements (see Note 1D(3) and Note 27 to the financial statements).

B. Methodology

The methodology employed for the allocation of revenues and expenses to the various operating segments is summarized below:

Interest income - to each operating segment is attributed an interest margin which is equivalent to the sum of the following components:

- the difference between the interest income attributed to the segment (from credit operations), and the cost of the interest as calculated by reference to a ‘transfer price’;

- the difference between the cost of the interest (from deposit operations), and the interest income with respect to those same deposits, insofar as the income is calculated by reference to a ‘transfer price.’

The ‘transfer price’ is determined by reference to price quotations for deposits in the institutional market, and is approximately equivalent to the Bank’s marginal cost of raising deposits.

The Bank states an identical transfer price for credit products and deposits (to the extent that the parameters characterizing them, such as: linkage base, interest class and maturity period – are also identical). The equity capital of the Bank (Tier I) is not taken into account in the determination of the price.

In accordance with this methodology, a specific transfer price is adjusted in relation to every credit product or deposit in each of the linked segments. Accordingly, operating segments are subjected to credit risk only and not to market risk.

Non-interest financing income - which include the financial results of transactions in certain derivative instruments, profits or losses from financial operations deriving from changes in market conditions and income from net interest earned on operations not related to customers of the Bank – are attributed to the asset and liability management center (ALM), to which is also credited the income derived from the management of the active capital of the Bank. Such profits and losses are reflected in the "Financial management" segment.

Expenses in respect of credit losses - are charged to the operating segment to which that customer, to whom the provision is related, has been allocated.

Commission income - is credited to the various operating segments to which the relevant customers, charged with the commission fees, are allocated.

Operating expenses – The allocation of operating expenses to the regulatory segments of operation stems from the distribution of operating expenses to operating segments according to Management's approach (see Notes 1D(3) and 27 to the financial statements), which is based on the organizational structure of the Bank. Allocation of operating expenses to segments of operations in accordance with Management's approach, has been made as follows:

- Direct expenses in respect of the workforce of the Bank are charged to the appropriate operating segment in accordance with specific reports.
- Other identifiable direct expenses are charged to the appropriate segment in accordance with the distribution of payroll costs or another specific allocation key.
- Indirect expenses and direct expenses that cannot be attributed precisely are charged to the various operating segments, to the extent possible, on the basis of estimates and assessments undertaken by the Bank’s various departments, or in accordance with the distribution of the direct expenses.

The allocation of operating expenses to regulatory segments of operation stems from the distribution of costs by segments of operation according to Management's approach, as stated, and adjusting them to the segment distribution stated in the new instructions, based on the distribution of income key.

(1) The household segment

- **General**
  Within the framework of the banking activity in this segment, the Bank provides an array of banking services and financial products, including capital market and housing loans services, to private customers characterized by household activity (the volume of their financial assets is lower than NIS 3 million). These services are provided to customers belonging to this segment by means of the branch disposition of the Bank numbering 78 branches countrywide and organized geographically into five regions.
  The Bank views the retail sector, generally, and the household segment in particular, as a central target in its business development and persistently increases its activity in this segment and improves the service to the customers of this segment.

- **Products and services**
  The banking products and services offered to customers of this segment include, inter alia: current account management, credit products, including housing loans, credit card operation, investment products, including deposits in Israeli and foreign currency and investment in securities.

- **Markets and means of distribution to customers of this segment**
  Approach to customers of the segment is being made in different ways, including: advertising through the different media, introduction of designated advertising campaigns to this segment presenting the personal, professional and dedicated service characterizing the Bank as a key factor in tightening the bonds between the Bank and customers of this segment. Through campaigns and benefits, the Bank also encourages different sections of the population belonging to this segment to join the Bank, such as: students, young persons, soldiers and ex-servicemen, etc.
  In addition, the Bank initiates approaches made to specifically targeted populations belonging to this segment, such as, employees of large corporations, employees of institutions, etc. The approaches are made by the staff of the branches, by initiated telephone calls, by marketing messages on the Internet, by mailing customers and by advertising boards and information leaflets available at the branches.

- **Material technological changes**
  Most of the banks have invested in recent years considerable resources in the development of interfaces and technological applications, providing customers, in general, and households, in particular, higher access to banking information and basic banking services, through the use of personal computers, telephones and mobile means of communication at their disposal.
  The development of technological infrastructure enabling additional communication channels for the granting of banking services through digital means, including the development of advanced applications for means of mobile communication, comprises a central layer in the technological development of the banking sector in general, and of the parent company , in particular.
  Alongside these technological developments, customers of the household segment integrate in recent years advanced technologies within the framework of online banking applications being developed for them.
  Moreover, in recent years the Bank had integrated a credit rating system providing automatic credit ratings for the purpose of credit risk relating to private customers and stemming from their risk characteristics.
  This system comprises a decision supporting tool in the process of the granting of credit to private customers of the Bank, and contributes to the simplification of these processes.

For further information regarding the developments in competition and the structural changes expected both in the composition of suppliers of financial services to customers of the household segment, as well as in the integration of additional information channels that would be made available to customers of this segment – see Chapter 12 of the Corporate Governance Report.

(2) Private banking segment

- **General**
  Within the framework of the banking activity in this segment, the Bank provides an array of banking services to private customers, having high financial wealth, mostly on the deposits side, the volume of their savings and investments exceed NIS 3 million.

- **Products and services**
  The banking products and services offered to customers of this segment (private banking) include an array of investment products, including: investment portfolio management, deposits, investments in securities and more.
  The service to customers of this segment is provided through the branch disposition of the Bank and by "specialized consulting" centers, providing specialized banking services to these customers.

- **Markets and means of distribution to customers of this segment**
  Approach to customers of the segment is being made in different ways, including: advertising through the different media, including by television, radio and the press, as well as by personal communication made by the staff of the branches, as well as initiated approaches by the call center and marketing messages via the Internet, mail to customers and information leaflets distributed at the branches of the Bank.
  In view of the high level of prices recorded in recent years on the equities markets and the expectations for the rise in the interest rate, which might impair the economic value of marketable investment products, a slight increase in the weight of bank deposits held in the investment portfolio of the public was recorded in 2016, on account of the marketable investment channels (shares and mutual funds).

For further information regarding the developments in competition and the structural changes expected both in the composition of suppliers of financial services to customers of the private banking segment, as well as in the integration of additional information channels that would be made available to customers of this segment – see Chapter 12 of the Corporate Governance Report.

(3) Small business segment

- **General**
  Within the framework of the banking activity in this segment, the Bank provides an array of banking services and financial products, to small businesses (individuals and companies), the service is provided both by the distribution system of the Bank, which includes 78 branches, and by direct distribution channels: the Internet and the call center.

- **Products and services**
  The services provided by the Bank to customers belonging to this segment mainly include different credit products suitable for the nature of their operations, as well as a variety of investment products, including Israeli and foreign currency deposits and derivative instruments.
  Within the framework of the implementation of the policy of the Bank, which views the retail sector, in general, and the "small and young businesses" segment, in particular, as a central target in the business development of the Bank – the Bank persistently improves the service provided to customers belonging to this segment.

- **Markets and means of distribution to customers of this segment**
  Approach to customers of the segment is being made in different ways, including: advertising through the different media, including by television, radio and the press, as well as by personal communication made by the staff of the branches as well as initiated approaches by the call center and marketing messages via the Internet, mail to customers, signboards and information leaflets distributed at the branches of the Bank.

- **Material technological changes**
  The Bank as other banks in the banking sector, are in recent years in a continuous effort of adoption of advanced technologies and development of banking applications designed for the different information systems and mobile communication (such as: cellular phones and digital tablets) enabling customers of this segment to obtain available information and conduct banking transactions at all hours of the day and night and at lower fees.
  The development of technological infrastructure which provides communication and information channels and the granting of banking services through digital means, comprises a central layer in the technological development of the banking sector in general, and of the parent company , in particular.
  Within the framework of the efforts of the Bank to expand its activity in this segment, and to simplify the process of granting credit to retail customers, the Bank has developed a decision supporting information system, which provides automatic rating for the credit risk relating to customers of this segment, stemming from their risk characteristics, and comprises a decision supporting tool in the process of the granting of credit and contributes to the simplification and efficiency of the processes in this field.

For further information regarding the developments in competition and the structural changes expected both in the composition of suppliers of financial services to customers of the small business segment, as well as in the integration of additional information channels that would be made available to customers of this segment – see Chapter 12 of the Corporate Governance Report.

(4) Middle-market business segment

- **General**
  Within the framework of the banking activity in this segment, the Bank provides an array of banking services and financial products, to middle-market companies. These products and services are modified to their business needs and include different credit products (including: loans, guarantees and letters of credit), capital market investment products and services (including: various deposits and investment in securities). These services are provided to customers belonging to this segment by means of the branch disposition of the Bank numbering 78 branches countrywide.

- **Markets and means of distribution to customers of this segment**
  The marketing of services and banking products to customers belonging to this segment (both existing and potential customers), is based on the branch layout with the assistance of professional functions at the head office of the Commercial Banking Division, including business managers in the commercial group. Use of advertising means or of outside marketing agents is not included in the marketing efforts directed at potential customers of this segment.

(5) Large business segment

- **General**
  Within the framework of the banking activity in this segment, the Bank provides an array of banking services and financial products, to large business companies, including leading corporations in the market (corporate market). The business of such

corporations is characterized by a high level of complexity and sophistication – accordingly the Bank provides to these customers financial products, mostly in the credit field, modified to their operations and specific needs – with an all-inclusive insight of their different businesses.

- **Products and services**
  The products offered by the Bank to customers of this segment include mostly credit instruments modified to their special needs, as well as other financial instruments, including derivative instruments for the hedging of risk and the "loan of bonds" (as an alternative to standard credit products, which may reduce the credit cost to such customers, in accordance with the development in returns on bonds on the capital market).

- **Markets and means of distribution to customers of this segment**
  The marketing of services and banking products to customers belonging to this segment is conducted by the head office of the Commercial Banking Division, by business managers in the commercial and real estate groups, who maintain continuous contact with customers of this segment (for the purpose of providing solutions to their financial needs and assisting in their business operations) and with the branch layout.
  In recent years, customers of this segment began to reduce the amount of their bank credit and turn to the capital market as an alternative source of finance (the raising of funds by way of public offerings or private placements of shares, bonds and other of securities). The roots of this trend are found in several factors:
  - Stricter limitations set by Bank of Israel regarding a "single borrower" and a "group of borrowers", compelled several banks to decrease the credit facilities granted to certain borrower groups, the indebtedness of which, according to the new definitions exceeded the permitted maximum credit limit;
  - The wish of corporations to diversify and improve the structure of their financial sources by shifting from short-term sources to long-term ones;
  - The increasing attractiveness of the raising of funds by means of the capital market, due to the reduction in costs, greater flexibility in providing collateral, etc.;
  - The reduction in the credit facilities offered by the banking sector to customers of this segment, due to a part of the actions taken by banks in order to reduce the volume of their risk assets, in view of the stricter requirements included in the Basel Rules;
  - The granting of credit to large customers generally, and to income producing real estate corporations in particular, comprise a central tool for the improvement of returns on investment portfolios of institutional bodies (as an alternative to investments in the capital market). Accordingly, a growth in the portfolio of credit granted by institutional bodies to large corporations was recorded in recent years.

D. Summarized financial data

The following Tables present information regarding the business activity of the Bank by segments of operation.

(1) Balance sheet data

- **Credit to the public**

The following data presents developments in the net balance of credit to the public by segments of operation:

	31.12.2016	31.12.2015	Rate of change
	NIS (millions)		%
Households	**7,677**	(1) 6,754	13.7
Private banking	**18**	(1) 12	50.0
Small businesses	**9,955**	(1) 9,240	8.2
Middle market businesses	**2,727**	(1) 2,584	5.5
Corporate businesses	**1,564**	(1) 1,771	(11.7)
Institutional bodies	**20**	(1) 56	(64.3)
Total	**22,001**	20,417	7.8

Most of the increase in credit during the reported period stems from the increase in the volume of credit to the "household" and "small business" segments, as a result of the implementation of the strategic program of the Bank, intended to increase activity in the retail sector.

For additional details regarding the scope and classification of the troubled debts at the Bank by segments of operation as of December 31, 2016 – see Note 27 to the financial statements.

Deposits from the public

The following data presents developments in deposits from the public by segments of operation:

	31.12.2016	31.12.2015	Rate of change %
	NIS (millions)		
Households	**10,361**	(1) 9,947	4.2
Private banking	**1,568**	(1) 1,783	(12.1)
Small businesses	**6,996**	(1) 6,638	5.4
Middle market businesses	**1,307**	(1) 1,019	28.3
Corporate businesses	**2,852**	(1) 1,512	88.6
Institutional bodies	**4,115**	4,489	(8.3)
Total	**27,199**	25,388	7.1

The increase in the volume of deposits stems both from the increase in deposits of "household" segment customers and of "small business" segment customers**,** in correspondence with the goals set by the Bank regarding this field (increased activity in the retail sector), and from the increase in deposits in the "large business" segment.

In contrast, the volume of deposits of institutional customers and of "private banking" customers declined.

(2) Income data

• Income

The following data presents developments in income in 2016 as compared with 2015, by segments of operation:

Operating segment	**December 31, 2016**	**December 31, 2015**	**Rate of change**
	NIS millions		**%**
Households	**397**	373	6.4
Private banking	**7**	9	(22.2)
Small businesses	**657**	626	5.0
Middle-market businesses	**117**	109	7.3
Large businesses	**52**	49	6.1
Institutional bodies	**6**	4	50.0
Financial management	**47**	82	(42.7)
Total	**1,283**	1,252	2.5

The income of the Bank for 2016 showed an increase of 2.5% to NIS 1,283 million. On the one hand the income from the "household" and "small business" segment recorded an increase of 5.5%, which was, on the other and, offset by a decrease of 42.7% in income from the "financial management" segment. The decline in income from the said segment is explained mostly by a decline of NIS 27 million in gains from the sale of securities.

• Net profit

The following data presents developments in the net profit of the Bank in 2016 as compared with 2015, by segments of operation:

Operating segment	**December 31, 2016**	**December 31, 2015**	**Rate of change**
	NIS millions		**%**
Households	**11**	12	(8.3)
Private banking	**(7)**	(1)	-
Small businesses	**121**	116	4.3
Middle-market businesses	**31**	23	34.8
Large businesses	**19**	17	11.8
Institutional bodies	**2**	1	100.0
Financial management	**16**	42	(61.9)
Total	**193**	210	(8.1)

The net profit of the Bank decreased in 2016 by 8.1% amounting to NIS 193 million. The decrease in net profit is mostly explained by non-recurring tax expenses of NIS 18 million recognized in 2016 (see Chapter 7B above), by an increase in operating expenses stemming from a non-recurring wage benefit of NIS 30 million, recorded in the corresponding period last year in respect of the wage agreement signed lat year, and from the implications of the efficiency program implemented in 2016 (see

Chapter 21A below), which mainly affected the retail sector – see extended discussion further on.
In addition, a decline of NIS 26 million was recorded in the net profit of the "financial management" segment, stemming mainly from a decrease of NIS 27 million in gains on sale of bonds and from a decrease of NIS 25 million in gains from sale of buildings.

E. Detailed data regarding the results of operations by regulatory segments of operation

(1) Household segment

	December 31, 2016	December 31, 2015	Rate of change
	NIS millions		%
Interest income – from external sources	**324**	287	12.9
Interest expenses – to external entities	**(50)**	(53)	(5.7)
Net interest income – from external sources	**274**	234	17.1
Intersegment interest	**9**	12	(25.0)
Net interest income	**283**	246	15.0
Non-interest income	**114**	127	(10.2)
Total income	**397**	373	6.4
Credit loss expenses	**11**	9	22.2
Operating expenses	**353**	338	4.4
Total operating and other expenses	**364**	347	4.9
Profit before taxes	**33**	26	26.9
Provision for taxes	**22**	14	57.1
Net profit	**11**	12	(8.3)
Composition of interest income			
- Margin from credit activity	**248**	212	17.0
- Margin from deposit activity	**35**	34	2.9
Total interest income	**283**	246	15.0
Average balance of credit to the public	**7,282**	6,289	15.7
Average balance of deposits from the public	**10,136**	9,859	2.8
Average balance of managed assets	**3,536**	3,737	(5.4)

Income of the household segment increased in 2016 by 6.4% in comparison to the previous year, amounting to NIS 397 million. The increase in income is mostly explained by a growth in interest income from credit activity.
In total for 2016, the net profit of this segment decreased by 8.3% in comparison to the previous year, amounting to NIS 11 million. The decrease in net profit, despite the growth

in income, as stated, stems from an increase of 4.4% in operating expenses, mostly explained by a non-recurring wage benefit recorded in the corresponding period last year, and by the implications of the efficiency program implemented in 2016, as well as from a non-recurring tax expense of NIS 7 million recognized in respect of the share of the segment in the implications arising from the changes in the corporation tax rates (see Chapter 7B above).
With the elimination of the said non-recurring items, the profit of this segment would have been higher by NIS 18 million.

(2) Private banking segment

	December 31, 2016	December 31, 2015	Rate of change
	NIS millions		%
Interest income – from external sources	**-**	-	-
Interest expenses – to external entities	**(12)**	(12)	-
Net interest expense – to external entities	**(12)**	(12)	-
Intersegment interest	**15**	15	-
Net interest income	**3**	3	-
Non-interest income	**4**	6	(33.3)
Total income	**7**	9	(22.2)
Credit loss expenses	**-**	-	-
Operating expenses	**17**	11	54.5
Total operating and other expenses	**17**	11	54.5
Loss before taxes	**(10)**	(2)	-
Provision for taxes	**(3)**	**(1)**	**-**
Loss for the year	**(7)**	(1)	-
Composition of interest income			
- Margin from credit activity	**-**	-	-
- Margin from deposit activity	**3**	3	-
Total interest income	**3**	3	-
Average balance of credit to the public	**13**	8	62.5
Average balance of deposits from the public	**1,412**	1,602	(11.9)
Average balance of managed assets	**1,412**	1,428	(1.1)

The income of the "private banking" segment decreased in 2016 by 22.2%, in comparison to the corresponding period last year, amounting to NIS 7 million.

In total for 2016, the loss attributed to this segment increased by NIS 6 million to an amount of NIS 7 million. The increase in the loss is explained both by the decline in non-interest income and by the increase recorded in operating expenses.
The increase in expenses is explained by a non-recurring wage benefit recorded in the corresponding period last year, and by the implications of the efficiency program implemented in 2016.

(3) Small business segment

	December 31, 2016	December 31, 2015	Rate of change
	NIS millions		%
Interest income – from external sources	**541**	507	6.7
Interest expenses – to external entities	**(23)**	(22)	4.5
Net interest income – from external sources	**518**	485	6.8
Intersegment interest	**(6)**	(5)	20.0
Net interest income	**512**	480	6.7
Non-interest income	**145**	146	(0.7)
Total income	**657**	626	4.9
Credit loss expenses	**17**	36	(52.8)
Operating expenses	**431**	396	8.8
Total operating and other expenses	**448**	432	3.7
Profit before taxes	**209**	194	7.7
Provision for taxes	**88**	78	12.8
Net profit	**121**	116	4.3
Composition of interest income			
- Margin from credit activity	**448**	454	7.4
- Margin from deposit activity	**24**	26	(7.6)
Total interest income	**512**	480	6.7
Average balance of credit to the public	**9,564**	9,109	5.0
Average balance of deposits from the public	**6,870**	6,572	4.5
Average balance of managed assets	**1,970**	2,042	(3.5)

The income of the "small business" segment increased in 2016 by 4.9% in comparison to the previous year, amounting to NIS 657 million. The increase in income is mostly explained by a growth of 6.7% in interest income from credit activity.
In total for 2016, the net profit of this segment increased by 4.3% in comparison to the previous year, amounting to NIS 121 million. The increase in net profit is explained by the growth recorded in income, as stated, which was offset by an increase of 8.8% in operating

expenses, mostly explained by a non-recurring wage benefit recorded in the corresponding period last year, and by the implications of the efficiency program implemented in 2016.

(4) Middle-market business segment

	December 31, 2016	December 31, 2015	Rate of change
	NIS millions		%
Interest income – from external sources	**98**	92	6.5
Interest expenses – to external entities	**(3)**	(2)	50.0
Net interest income – from external sources	**95**	90	5.6
Intersegment interest	**(10)**	(9)	11.1
Net interest income	**85**	81	4.9
Non-interest income	**32**	28	14.3
Total income	**117**	109	7.3
Credit loss expenses	**10**	24	(58.3)
Operating expenses	**55**	47	17.0
Total operating and other expenses	**65**	71	(8.5)
Profit before taxes	**52**	38	36.8
Provision for taxes	**21**	15	40.0
Net profit	**31**	23	34.7
Composition of interest income			
- Margin from credit activity	**82**	79	3.8
- Margin from deposit activity	**3**	2	50.0
Total interest income	**85**	81	4.9
Average balance of credit to the public	**2,784**	2,591	7.5
Average balance of deposits from the public	**1,224**	913	34.1
Average balance of managed assets	**848**	810	4.7

The income of the "middle-market business" segment increased in 2016 by 7.3% in comparison to the previous year, amounting to NIS 117 million. The increase in income is mostly explained by a growth of 4.9% in interest income from credit activity, and from the increase of 14.3% in non-interest income.
In total for 2016, the net profit of this segment increased by 34.7% in comparison to the previous year, amounting to NIS 31 million. The increase in net profit is explained by the growth recorded in income, as stated, and by the decrease of NIS 14 million in expenses for credit losses.

(5) Large business segment

	December 31, 2016	December 31, 2015	Rate of change
	NIS millions		%
Interest income – from external sources	**53**	60	(11.7)
Interest expenses – to external entities	**(4)**	(4)	-
Net interest income – from external sources	**49**	56	(12.5)
Intersegment interest	**(7)**	(15)	(53.3)
Net interest income	**42**	41	2.4
Non-interest income	**10**	8	25.0
Total income	**52**	49	6.1
Credit loss expenses	**(3)**	(2)	50
Operating expenses	**24**	21	14.3
Total operating and other expenses	**21**	19	10.5
Profit before taxes	**31**	30	3.3
Provision for taxes	**12**	13	(7.7)
Net profit	**19**	17	11.8
Composition of interest income			
- Margin from credit activity	**39**	40	(2.5)
- Margin from deposit activity	**3**	1	-
Total interest income	**42**	41	2.4
Average balance of credit to the public	**1,788**	1,907	(6.2)
Average balance of deposits from the public	**1,929**	1,333	44.7
Average balance of managed assets	**2,186**	2,328	(6.1)

The income of the "large business" segment increased in 2016 by 6.1% in comparison to the previous year, amounting to NIS 52 million. The increase in income stemmed both from the growth of 4.9% in interest income (by NIS 1 million) and from the growth in non-interest financing income (of NIS 2 million).
In total for 2016, the net profit of this segment increased by 11.8% in comparison to the previous year, amounting to NIS 19 million. The increase in net profit is explained by the growth recorded in income, as stated.

10. Principal investee companies

Tafnit Discount – Portfolio Management Ltd.

The Bank owns 31% of the equity and voting in Tafnit Discount – Portfolio Management Ltd. (hereinafter – "Tafnit").

The total assets of Tafnit amounted at December 31, 2016 to NIS 38 million and its shareholders' equity amounted to NIS 31 million (December 31, 2015 – NIS 31 million and NIS 23 million, respectively). The contribution of Tafnit to the net profits of the Bank in 2016 amounted to NIS 2 million, similarly to that of the previous year.
The volume of investment portfolios managed by Tafnit on December 31, 2016, amounted to NIS 6.5 billion, comprising a decrease of 1.5% as compared with that of December 31, 2015.

Other investee companies

The effect of the other investee companies of the Bank: MDB Underwriting and Investment Promotion Ltd., Merbit Insurance Agency (1996) Ltd. And Golden Gate Bridge Fund is not material in relation to the banking operations of the Group.

Part "C" – Risk review

11. General description of risk and the management thereof

A. General

The Bank’s dealings in financial instruments, including derivative financial instruments, involve risk-taking and risk management. The principal risks are credit risks, market risks, liquidity risks, and operating risks.

It has been realized in recent years that the proper application of risk management principles is an essential factor in maintaining the stability of the banking sector.

Accordingly, Bank of Israel published in recent years a set of proper management of banking business instructions on this subject, including:

- Proper Management of Banking Business Directive No. 310 in the matter of "risk management".
- Proper Management of Banking Business Directive No. 311 in the matter of "management of credit risk".
- Proper Management of Banking Business Directive No. 312 in the matter of "related parties".
- Proper Management of Banking Business Directive No. 313 in the matter of "restrictions on indebtedness of a borrower and borrower group".
- Proper Management of Banking Business Directive No. 314 in the matter of "proper assessment of credit risk and proper measurement of debts".
- Proper Management of Banking Business Directive No. 333 in the matter of "interest risk management".
- Proper Management of Banking Business Directive No. 327 in the matter of "management of leveraged loans".

- Proper Management of Banking Business Directive No. 323 in the matter of "restrictions on the financing of capital transactions".
- Proper Management of Banking Business Directive No. 342 in the matter of "liquidity risk management".
- Proper Management of Banking Business Directive No. 3350 in the matter of "operating risk management".
- Proper Management of Banking Business Directive No. 218 in the matter of "leverage ratio".
- Proper Management of Banking Business Directive No. 221 in the matter of "liquidity coverage ratio.

The said Directives are designed to integrate the risk management concept within the banking sector and to modify it to the principles formed by the Basel Committee.

The principal risks to which the Bank is exposed within the framework of its banking operations include:

Credit risk – defined as a risk of a loss deriving from the inability of a borrower or a counterparty to honour his obligations towards the Bank, in part or in full, and subject to the agreed terms. Significant exposure to credit risk stemming from weaknesses in monitoring, control and management procedures respecting the credit portfolio, together with inappropriate standards in the credit granting processes to borrowers and counterparties, comprises a central factor for losses of banks in Israel and the world over. Exposure to credit risk may arise as a result of several risks, such as: borrower risk, borrower and borrower groups credit concentration risk, sector and/or geographic concentration risk, counterparty credit risk, settlement risk and environmental risk.

Market risk – defined as a risk of impairment in the income and profitability of the Bank, due to possible changes in the fair value of assets and liabilities, (both stated and off-balance sheet), stemming from changes in market prices, such as: change in the rate of inflation, change in interest rates, change in exchange rates and changes in the capital market. The market risk includes the following risk components: linkage base risk, interest risk, equities risk and options risk.

Liquidity risk – defined as a risk to the profitability and stability of the Bank, stemming from its inability to provide its liquidity requirements. Liquidity is defined as the ability of the Bank to finance the growth in its assets and the settlement of its liabilities on their due date, without encountering exceptional losses.

Operating risk – defined as the risk of a loss caused by inappropriate or failure of internal processes, persons or external failure events. This risk is inherent in all the products, operations, processes and systems prevailing at the Bank. In addition, it may happen that failure caused by the realization of an operating risk, would impact, either directly or indirectly, other risks, such as: credit risk, market risk, liquidity risk, reputation risk, etc. The operating risk includes significant risk components, including business continuity risk, legal risk, fraud and embezzlement risk, compliance risk, information technology risk, financial reporting risk, and more. The Bank manages the operating risk in accordance with guidelines contained in Proper Management of Banking Business Directive Nos. 350 and 355, and defines the information technology, compliance and legal risks as a standalone risk category, which is separately disclosed in the risk document published on the Internet at the following address: https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

Information technology risk – defined as a risk stemming from the use of information technology or from non-use thereof or from the dependence of a corporation on such technology.

Cyber risk – defined as a risk of financial or other damage stemming from a cyber attack.
In general, cyber threats are defined as threats, which, if materialized, may lead to a shutdown of operations or of a material service, to a material damage to confidentiality and completeness of the data, and to hostile activities and fraud.
The Bank's central computer systems are based on the computer system of the parent company, which develops, operate and maintains them. Computer and operating services provided to the Bank by the parent company are based upon multi-annual agreements drawn on an economic basis. These agreements detail the scope, quality and availability of the computer services provided to the Bank and ensure their continuity. In addition to the Group systems, the Bank operates also specialized designated systems, but these are generally management systems used by Head Office and not core banking business systems.

Legal risk – defined as exposure of the Bank to loss, inter alia, due to the inability to legally enforce an agreement, or due to legal proceedings brought against the Bank as well as exposure to loss in respect of fines or other punitive actions imposed by supervisory authorities, and in respect of specific arrangements. The legal risk forms part of the operating risk.

Compliance risk and money laundering – defined as exposure of the Bank to legal or regulatory sanctions, to loss or to damage to its image, which the Bank may sustain due to non-compliance with laws, regulations, regulatory instructions, internal procedures and the ethical code applying to the Bank. The compliance risk management includes, inter alia, instructions relating to bank/customer relations, non-consumer instructions, instructions relating to securities laws, instructions regarding cross-border operations and money laundering. Non-compliance with instructions applying to the Bank regarding compliance and money laundering expose the Bank to monetary sanctions, to reputation risk, and to criminal proceedings, which may be brought against the Bank and its employees.

Reputation risk – defined as exposure of the Bank to loss stemming from damage to its image in the eyes of its customers and other relevant entities. The Bank hedges exposure to this risk by strict adherence to procedures and strict application of the ethical code.

Strategic risk – defined as exposure to possible impairment of the capital of the Bank, its financial results and its reputation as a result of mistaken business decisions or of incorrect implementation of business decisions, or due to the lack of proper response to changes in competition and in business developments. The Bank monitors this risk by current tests regarding the implementation of decisions taken and the follow-up of developments occurring in the business environment.

B. Risk appetite - has been defined as the maximum level of risk which the Bank is ready to accept in its ordinary course of business, and is being used for the determination of the level of risk, which the Bank is ready to accept from a forward-looking point of view.

The risk appetite is derived from the business strategy of the Bank comprising a central tool for the supervision over the risks taken by the Bank.

When determining the framework for risk management, the Board of Directors outlines the "risk appetite statement" comprising the basis for the risk management policy, and for prescribing limits and alert levels.

Relevant factors are taken into consideration in the outlining of the risk appetite statement, such as: the business strategy, environmental changes, material risks (existing and developing), effect of stress tests, capital planning principles (including existing constraints in this matter), sources of finance and different commitments of the Bank (such as: requirements and restrictions stemming from legislation and regulation proceedings).

The risk appetite statement is approved by the Board of Directors on an annual basis (based on up-to-date data and indices). Deviations from the limits prescribed by the risk appetite statement is being monitored by the Bank and reported on a current basis to the Board of Directors.

C. Basic principles for risk management

The Board of Directors and Management of the Bank bear responsibility for risk management at the Bank and for determining effective processes for the management of such risks.

Management of the Bank under the supervision of the Board of Directors verifies that the methods and processes determined by the Group's risk management are adequate in relation to the nature of operation of the Bank.

The basic documents for risk management have been formed by the Bank respectively with the parallel documents of the parent company, and in conducting risk management; the Bank relies on the infrastructure, processes and methodologies for risk management developed by the parent company. Deviations from stated limitations for the various risks and developments occurring in the risk profile of the Bank are reported to the parent company on a current basis.

The Bank acts in accordance with the risk management framework determined by the Group, modified to the unique nature of operations of the Bank, to the environment in which it operates and in accordance with guidelines of Bank of Israel. The risk management governance of the Bank is based on three lines of defense:

First line of defence - includes the lines of business**,** including business and operational units of the Bank which accept the risk and bear most of the responsibility for the management of the risk inherent in their operation, by means of risk management core procedures (acceptance of risk, identification, measurement and assessment, control and reduction, monitoring and reporting).

Second line of defence – includes the head office units (legal and accounting) and the risk management function assisting Management in promoting a corporate overview of risk, planning and development of the framework for risk management, formation of methodologies and challenging the risk management of the first line of defence, and the presentation of the total risks to Management and the Board of Directors.

Third line of defence – includes the internal audit which examines the appropriateness and efficiency of controls and the risk management processes and diagnoses potential weaknesses in internal control.

As a general rule, the Bank appoints risk managers from among the staff of the first line of defence, serving as members of Management, and risk controllers from among the staff of the second line of defence. Supervision and control over risk management is conducted by means of risk management processes, forums and key functions at the Bank.

The Bank makes use of forward looking stress tests as a complementary tool for the risk management processes (mostly as regards credit, market and liquidity risks). Stress tests are used in the current process of identification and assessment of risk focal points and vulnerable areas, as part of the appropriateness of the capital adequacy assessment process (ICAAP), when examining appropriateness of the capital planning, including compliance with the risk appetite restrictions determined by the Board of Directors.

Stress tests are conducted according to guidelines of Bank of Israel and in accordance with the methodology determined by the Group, modified to the nature of operation of the Bank.

The Board of Directors and Management are involved in determining targets for stress tests and defining scenarios, and examine the reasonableness of results. The credit, market, and liquidity risk managers maintain alternative plans for the reduction of risks upon realization of stress tests.

D. Additional information

Detailed information regarding the different risks involved in the operation of the Bank and the manner of their management is included in the risk report published on the Internet website of the Bank at the following address:
https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

12. Credit risk

A. Review of credit risk and the manner of management thereof

The structure of risk management at the Bank is compatible with the risk management model (Management Enterprise Risk), adopted by the Discount Group, and includes the definition of authority and responsibility of the factors involved in credit risk management – the Board of Directors, Management and the three independent lines of defence:
First line of defence – risk acceptors (credit divisions: commercial banking and the retail divisions).
Second line of defence – the factors responsible for the independent risk management.
Third line of defence – internal audit.

Credit risk management includes also the management of credit concentration risk and management of environmental risks.

The risk management policy comprises a framework for risk management with the aim of achieving an appropriate return in relation to the risk profile and in accordance with the risk appetite limitations outlined by the Board of Directors. The Bank has strategy documents and credit policy based on the proper management of banking business directives and which had been approved by the Board of Directors. These documents outline the credit principles, from which are derived the credit procedures, business goals, controls and limitations, which are being currently monitored.

B. Analysis of credit quality and troubled credit risk

The credit risk management layout of the Bank includes two units for the treatment of troubled debts:

- A "special credits" unit operating within the framework of the Commercial Banking Division of the Bank deals both with the management, arrangement and collection of troubled debts handled by the Commercial Banking Division, as well as with other credits (under legal proceedings), and with the classification and measurement of provisions for credit losses in respect of such borrowers.

- Supervision and control unit operating under the Retail Division dealing with both the management and arrangement of troubled debts belonging to the Retail Division (prior to instituting legal proceedings) and with the classification and determination of provisions for credit losses in respect of these borrowers.

Following are data regarding the balance of troubled debts at the Bank and risk indices:

(A) Distribution of troubled debts:

1. Troubled credit risk – by classes of debts

	December 31, 2016		
	Balance sheet	Off-balance sheet	Total
	NIS millions		
Impaired debts	**335**	**15**	**350**
Substandard credit risk	**59**	**1**	**60**
Credit risk under special supervision	**166**	**30**	**196**
Total troubled credit risk* (2)	**560**	**46**	**606**
Less/- provision for credit losses	**(105)**	**(12)**	**(117)**
Net troubled credit risk	**455**	**34**	**489**
* Of which: unimpaired debts in arrear for 90 days or over	**63**	**-**	**63**

	December 31, 2015		
	Balance sheet	Off-balance sheet	Total
	NIS millions		
Impaired debts	344	15	359
Substandard credit risk	60	-	60
Credit risk under special supervision	220	39	259
Total troubled credit risk* (2)	624	54	678
Less/- provision for credit losses	105	15	120
Net troubled credit risk*	519	39	558
* Of which: unimpaired debts in arrear for 90 days or over	32	-	32

2. Nonperforming assets

	December 31, 2016		
	Balance sheet	Off-balance sheet	Total
	NIS millions		
Impaired debts(1)	**272**	**15**	**287**
Assets received in settlement of debts	**-**	**-**	**-**
Total nonperforming assets	**272**	**15**	**287**

	December 31, 2015		
	Balance sheet	Off-balance sheet	Total
	NIS millions		
Impaired debts(1)	252	15	270
Assets received in settlement of debts	-	-	-
Total nonperforming assets	255	15	270

(1) Debts that do not accrue interest income.
(2) The data relates to the stated balance of debt of credit risk relating to the public.

(B) Developments in impaired debts:

	December 31,			
	2016		2015	
	Restructured	Other	Restructured	Other
	NIS millions			
Balance at beginning of year:				
- Stated debt balance	**133**	**199**	137	205
- Less provision for credit loss	**(8)**	**(64)**	(8)	(70)
Net balance	**125**	**135**	129	135
Changes in debts during the year:				
- Impaired debts	**51**	**89**	(3) 65	(3) 162
Debts no longer classified as impaired	**(4)**	**(7)**	(3) (7)	(3) (9)
- Collections and write-offs	**(47)**	**(92)**	(3) (53)	(3) (168)
- Failed restructures	**(11)**	**11**	(9)	9
Total changes in debts	**(11)**	**1**	(4)	(6)
Changes in provisions for credit loss:				
- Addition to provisions	**(4)**	**(30)**	(4)	(28)
Reversal of provisions for impaired debts	**1**	**1**	-	(3) 3
- Collections and write-offs	**5**	**22**	4	(3) 33
Total changes in provisions	**2**	**(7)**	-	(6)
Balance at end of year*	**116**	**129**	125	135
*** Composition:**				
Stated balance of debt	**122**	**129**	125	135
Provision for credit losses	**(6)**	**(71)**	(8)	(64)
Total at end of year	**116**	**129**	125	135

(3) Reclassified

1385 debts were restructured by the Bank in 2016, in a total amount of NIS 72 million (2015 – 1,390 debts and NIS 81 million, respectively). In addition, 259 credit failures were recorded in 2016 in respect of debts that had been restructured in the previous year, in a total amount of NIS 7 million (2015 - 344 credit failures in a total amount of NIS 5 million, respectively).

(C) Credit portfolio quality indices:

Following are data regarding certain financial ratios used in the evaluation of the quality of the credit portfolio of the Bank, derived from troubled debt data computed according to the rules contained in the new Directives:

	December 31, 2016	December 31, 2015
	%	%
Ratio of balance of impaired credit to total credit to the public(1)	**1.4**	1.6
Ratio of balance of credit(2) in arrears for 90 days or over (not impaired) to total credit to the public	**0.3**	0.2
Ratio of troubled credit risk(2) to total credit to the public	**2.2**	2.7
Ratio of credit loss expenses to average balance of credit(2)	**0.2**	0.3
Ratio of net write-offs to average balance of credit(2)	**0.1**	0.2

(1) The data relates to the stated debt relating to credit to the public
(2) The data relates only to credit to the public.

(D) Quality of the credit portfolio

(1) General

According to Bank of Israel instructions, banking corporations are required to include in their financial statements qualitative and quantitative information comprising indication regarding the quality of their credit portfolio.

The Bank maintains a credit control system comprising a central factor in the process of maintaining the quality of the credit portfolio and monitoring credit failures.

Within this framework, the Bank has developed models for credit rating, comprising a "decision support" system, and maintains current monitoring for the identification and locating of signs indicating a possible deterioration in the repayment ability of borrowers, inter alia, by monitoring on a daily basis the period of arrears in the repayment of debts.

(2) Quantitative data

Following are data regarding certain financial indices used in the assessment of the quality of the credit portfolio, by groups of credit:

	December 31, 2016			
		Private individuals		
	Commercial	**Housing**	**Other**	**Total**
	%			
Ratio of credit loss expense to total credit	**0.2**	**-**	**0.3**	**0.2**
Ratio of impaired debts to total credit	**2.1**	**-**	**0.5**	**1.4**
Ratio of troubled debts to total credit	**2.9**	**1.7**	**1.3**	**2.4**
Ratio of debts in arrears for over 30 days to total credit	**0.5**	**1.3**	**1.4**	**0.8**

	December 31, 2015			
		Private individuals		
	Commercial	**Housing**	**Other**	**Total**
	%			
Ratio of credit loss expense to total credit	0.4	0.1	0.2	0.3
Ratio of impaired debts to total credit	22	-	0.7	1.9
Ratio of troubled debts to total credit	3.5	1.7	1.9	2.9
Ratio of debts in arrears for over 30 days to total credit	0.1	0.3	0.6	0.4

Management of the Bank follows on a quarterly basis, the developments in these indicators and examines the significance of the results, both in respect of earlier periods and in respect of comparable data of the banking sector. A reduction was recorded in 2016, in the ratio of credit loss expenses in comparison to the data of the previous year. Accordingly, and whereas other parameters (such as: rate of troubled debts including impaired debts), indicate improvement or stability in the qualitative indices, Management of the Bank estimates that the quality of the credit portfolio has not deteriorated in the reported year.

C. Analysis of provision for credit losses

(a) Data regarding developments in the provision for credit losses at the Bank:

	Year ended December 31, 2016					
	Credit to the public					
		Private				
	Commercial	Housing	Other	Total	Banks and governments	Total
	NIS millions					
Balance of provision at beginning of year	**295**	**16**	**55**	**366**	**1**	**367**
Credit loss expenses	**26**	**1**	**10**	**37**	**(1)**	**36**
Accounting write-offs	**(80)**	**-**	**(57)**	**(137)**	**-**	**(137)**
Collection of debts written off in prior years	**59**	**-**	**51**	**110**	**-**	**110**
Net accounting write-offs	**(21)**	**-**	**(6)**	**(27)**	**-**	**(27)**
Balance of provision at end of year*	**300**	**17**	**59**	**376**	**-**	**376**
* Of which: in respect of off-balance sheet credit instruments	**26**	**-**	**2**	**28**	**-**	**28**

	Year ended December 31, 2015					
	Credit to the public					
		Private				
	Commercial	Housing	Other	Total	Banks and governments	Total
	NIS millions					
Balance of provision at beginning of year	267	13	54	334	1	335
Credit loss expenses	58	3	6	67	-	67
Accounting write-offs	(84)	-	(53)	(137)	-	(137)
Collection of debts written off in prior years	54	-	48	102	-	102
Net accounting write-offs	(30)	-	(5)	(35)	-	(35)
Balance of provision at end of year*	295	16	55	366	1	367
* Of which: in respect of off-balance sheet credit instruments	27	-	2	29	-	29

(b) Credit portfolio quality indices

The following table depicts data regarding certain financial ratios used in assessing the level of provisions for credit losses at the Bank and the changes in such data in comparison with the previous year:

	December 31		
	2016	2015	Change
	%	%	Percentage points
Ratio of provision for credit losses[(2)] to total credit to the public[(1)]	**1.6**	1.6	-
Ratio of provision for credit losses[(2)] to impaired credit	**108.1**	101.5	6.6
Ratio of net write-offs to balance of credit loss provision[(2)]	**7.8**	10.4	(2.6)
Ratio of credit loss balance[(2)] to impaired credit and credit in arrears[(3)]	**20.1**	19.8	0.3

(1) The data relate to the stated balance of credit to the public
(2) The data relates only to credit to the public
(3) Unimpaired credit which is in arrear for 90 days or more

D. Distribution of credit risk by economic sectors*

The following table depicts condensed data regarding development of credit to the public risk, troubled debts and the provision for credit losses by economic sectors (in NIS millions):

	December 31, 2016			December 31, 2015		
Economic sector	Total credit risk[(1)]	Troubled debts	Credit loss provision	Total credit risk[(1)]	Troubled debts	Credit loss provision
Private individuals[(2)]	**8,880**	**116**	**76**	8,005	127	71
Construction and real estate[(3)]	**6,273**	**141**	**59**	5,571	186	54
Trading[(4)]	**4,769**	**131**	**98**	4,512	145	102
Industry	**2,526**	**64**	**43**	2,539	70	44
Other business services	**1,522**	**57**	**28**	1,418	42	22
Transportation and storage	**1,190**	**30**	**33**	986	42	32
Public and community services	**1,058**	**13**	**5**	983	6	4
Other (less than 5%)	**1,389**	**41**	**34**	1,357	48	37
Total	**27,607**	**593**	**376**	25,371	666	366

* For detailed information regarding the distribution of credit risk at the Bank by economic sectors – see Appendix No.1 hereunder.

(1) Credit risk - including off-balance sheer credit risk
(2) The growth in credit of NIS 875 million, recorded in the private individuals sector stems mainly from the implementation of the strategic plan of the Bank, according to which, the Bank focused on the development of the banking activity in the retail sector, including in the private individuals segment.
(3) The growth in credit of NIS 702 million, recorded in the construction and real estate sector stems mainly from credit granted to housing construction projects, by the "closed rolling finance" method.
(4) The growth in credit of NIS 257 million, recorded in the commercial sector stems mainly from credit in low amounts granted to companies and businesses in the retail sector.
(5) The reduction in volume of troubled debts in the construction and real estate sector amounting to NIS 45 million stems mainly from a small number of borrowers, who were classified last year as "troubled" due to a deterioration in their financial position. The debt balance of these borrowers was reduced in 2016.

E. Exposure to foreign countries

Following are condensed data regarding exposure of the Bank to credit granted to foreign countries, as defined in Bank of Israel instructions*:

	December 31		
	2016	**2015**	**Change**
	NIS millions		**%**
Governments	**314**	19	223.7
Banks	**317**	484	(1.2)
Other	**261**	271	(13.3)
Total	**892**	719	24.1

* For detailed information regarding exposure of the Bank to foreign countries – see Appendix No.2 hereunder.

Exposure of the Bank to foreign countries increased in 2016 by 24.1%, stemming mainly from an increase of NIS 217 million in exposure to foreign governments (mainly due to the increase in investments of the Bank in US Government bonds).

F. Exposure to foreign financial institutions

In view of the impact of the economic crisis on financial institutions around the world and concerns existing with respect to the stability of certain financial institutions, Management of the Bank examines on an ongoing basis the exposure of the Bank to foreign banks and financial institutions, and is holding discussions regarding the extent of exposure and the adaptation of which to developments in world banking.

Adaptation of the exposure is considered on the basis of the following parameters:

- The scope of exposure of the Bank to the financial institution generally and in relation to its equity in particular.
- The credit rating of the financial institution (as a general rule, the Bank transacts business involving credit risk only with foreign financial institutions that are rated at an "investment" grade or higher).
- The credit rating of the country in which the financial institution operates
- Past experience gained by the Bank with respect to the financial institution.

The scope of the credit exposure in respect of each foreign financial institution is determined by the Board of Directors of the Bank. Deviations from the determined limits are studied by Management on a daily basis with respect to every financial institution.

In the wake of the global economic crisis, Bank of Israel issued a directive whereby banks are required to include in their Directors' Report qualitative and quantitative information regarding credit exposure of banks operating in Israel to foreign financial institutions, as defined in the directive.

As of December 31, 2016, the credit exposure of the Bank to foreign financial institutions[1] amounted to NIS 353 million (December 31, 2015 - NIS 363 million) as detailed below:

December 31, 2016

Independent credit rating	Balance sheet credit risk(2)	Off-balance sheet credit risk(3)	Total credit risk(4)
	NIS millions		
AA- to AAA	**31**	**-**	**31**
A- to A+	**240**	**3**	**243**
BB- to BBB+	**45**	**21**	**66**
With no rating	**1**	**12**	**13**
Total credit exposure to foreign financial institutions	**317**	**36**	**353**

December 31, 2015

Independent credit rating	Balance sheet credit risk(2)	Off-balance sheet credit risk(3)	Total credit risk(4)
	NIS millions		
AA- to AAA	110	-	110
A- to A+	152	3	155
BB- to BBB+	61	23	84
With no rating	1	13	14
Total credit exposure to foreign financial institutions	324	39	363

(1) Including exposure to banks, investment banks, brokers, dealers, insurance companies, institutional bodies and bodies controlled by the above.
(2) Deposits with banks, credit to the public, investments in bonds and other assets in respect of derivative instruments.
(3) Mostly guarantees and commitments to grant credit including guarantees securing debts of a third party.
(4) On December 31, 2016, the balance of deposits of the Bank with foreign financial institutions registered in countries included in the emergency economic program established in their respect by the European Union and the International Monetary Fund, amounted to NIS 3 million (December 31, 2015 – NIS 8 million).

Notes:

1. The principal countries in which the foreign financial institutions are located are: the United States, France, Germany, and Belgium. The maximum exposure of the Bank as of December 31, 2016, in relation to a group of financial institutions operating in any one country, does not exceed 15% of the "capital base "of the Bank (as defined in the instructions of Bank of Israel).

2. The credit rating of the financial institutions noted above was performed by the international rating agency Standard & Poors. The rating agency generally updates the rating once a year. Accordingly, and in the light of recent developments in the banking sector, differences may arise between the last rating prepared by the rating agency and the evaluation of the Bank.

3. All balance sheet exposure to foreign financial institutions, as detailed above is included in the financial statements in the item "Deposits with banks", "Investment in securities" and "Assets relating to derivative instruments". The credit exposure detailed above is included in the report on "total credit risk to the public according to economic sectors" included in Appendix No. 1 to this report.

G. Credit risk involved in housing loans

A growth in demand in the housing market was recorded in recent years with a parallel growth in the volume housing loans, resulting in the rise in prices stemming from the shortage in available housing in relation to the said demand.

The increase recorded in the volume of housing loans (including the increase in the average amount of these loans), is exceptional in relation to the rate of economic growth and to the rate of growth in the standard of living and in income of individuals (households). Accordingly, concern exists that such processes might impair the quality of the housing loan portfolio and increase exposure of the banking sector to credit risk. As a result thereof, the Bank has intensified the control over credit in this sector. The measures adopted by the Bank include:

- Limitation on the volume of loans secured by a "housing unit" (but not for the purpose of residing therein), so that such loans will not exceed 15% of total housing credit.
- Limitation on the volume of loans that might become burdensome to the borrower, as required by an administrative instruction of Bank of Israel, according to which banking corporations may not grant loans, the repayment component inherent therein exceeds 50% of the "repayment ability" of the borrower (it is noted in this respect that in general, the Bank does not approve a housing loan where the expected monthly repayment of such loan exceeds 40% of the borrower's income).
- Limitation on the volume of loans that finance a major part of the value of the mortgaged property, as required by guidelines issued by Bank of Israel in this matter.
- Limitation on the interest rate risk regarding housing loans, as required by the administrative limitations imposed by Bank of Israel in this respect, according to which, the ratio of the loan component carrying "variable interest rate" (as defined in the administrative instruction of Bank of Israel) shall not exceed two thirds of the total volume of loan facilities approved as from September 1, 2013 (or 33% in the case of loans carrying "variable interest rate", which may be revised at a frequency exceeding five years) .
- Use of "safety coefficients" (stability tests) in the process of approval of loan facilities. Namely, prior to approval of a loan facility, the Bank examines anticipated implications regarding theoretical changes in market variables (mainly an increase of 2-3 percentage points in the annual interest rate) on the repayment ability of the borrower.
- Current use of theoretical scenarios, including stress tests, for the analysis of sensitivity to anticipated changes in the exposure of the Bank to credit risk – as a derivative from changes in the examined parameters.
- The ongoing monitoring of developments in the housing market, including: changes in prices of property, changes in volume of monthly repayments on account of loans, etc.
- Entering into specific arrangements with borrowers having difficulties in honouring the repayment terms derived from the original loan agreements.

Following developments in the housing market, Bank of Israel issued an instruction requiring banks to include in their quarterly and annual financial reports disclosure regarding credit risk involved in housing loans and the measures taken by the bank in respect of the management of such risk. The disclosure should also include quantitative data with respect to housing credit exposure as well as other characteristics of the quality of the housing loan portfolio of the bank.

The volume of the housing loan portfolio of the Bank as of December 31, 2016, amounts to NIS 3,744 million (December 31, 2015 – NIS 3,310 million).

The volume of housing loans granted by the Bank in 2016, amounts to NIS 976 million, of which NIS 68 million in respect of recycled loans (2015 – NIS 910 million and NIS 133 million, respectively).

Following are details as regards certain risk characteristics of the housing loan portfolio of the Bank:

	December 31, 2016	December 31, 2015
	%	%
Ratio of housing loans financing over 75% of the value of the property(1)	**2.2**	3.1
Ratio of housing loans, the monthly repayment of each exceeds 35% of the borrower's income	**11.8**	11.0
Ratio of housing loans carrying variable interest to total housing loan portfolio(2)	**69.0**	72.1

(1) Commitments for the granting of loans not yet utilized are not included in computing the ratio.
(2) Computation of the ratio includes loans where the frequency of changes in the interest rate exceeds five years.

Following are data regarding the Bank's activity in the field of housing loans, including details regarding the characteristics of this portfolio:

- Distribution of the housing loan portfolio of the Bank (including loans secured by a pledge on housing property) by principal characteristics:

  - **Distribution by linkage base:**

	December 31, 2016		December 31, 2015	
	NIS millions	%	NIS millions	%
Non-linked	**2,280**	**60.9**	1,828	55.2
CPI linked	**1,248**	**33.3**	1,223	36.9
In or linked to foreign currency	**216**	**5.8**	259	7.9
Total	**3,744**	**100.0**	3,310	100.0

  - **Distribution by levels of credit:**

Credit levels (in NIS thousands)		December 31, 2016		December 31, 2015	
From	To	NIS millions	%	NIS millions	%
-	600	**1,674**	**44.7**	1,532	46.3
600	1,200	**1,306**	**34.9**	1,108	33.5
1,200	4,000	**675**	**18.0**	619	18.7
4,000	-	**89**	**2.4**	51	1.5
Total		**3,744**	**100.0**	3,310	100.0

- **Distribution by quality characteristics of the credit portfolio:**

	December 31, 2016	December 31, 2015	Change
	NIS millions		%
Stated balance of loan	**3,744**	3,310	13.1
Amount in arrears	**50**	44	13.6
Provision for credit losses	**17**	16	6.2
Balance of troubled debts	**8.8**	57	62
Ratio of troubled debts (%)	**1.6**	1.7	(5.9)

- Distribution of housing loans (excluding loans secured by only a pledge on housing property) granted in 2016, in comparison to the previous year, by principal characteristics:

- **Distribution of loans granted by value of the collateral:**

Value of collateral (in NIS thousands)		Year ended December 31, 2016		Year ended December 31, 2015	
From	To	NIS millions	%	NIS millions	%
-	800	**100**	**11.5**	89	12.3
800	1,200	**196**	**22.6**	169	23.4
1,200	3,000	**457**	**52.7**	370	51.3
3,000	-	**114**	**13.2**	93	13.0
Total		**867**	**100.0**	721	100.0

- **Distribution of loans granted by rate of finance (LTV):**

Rate of finance (LTV) (%)		Year ended December 31, 2016		Year ended December 31, 2015	
From	To	NIS millions	%	NIS millions	%
-	45	**226**	**26.0**	207	28.7
45	60	**338**	**38.9**	293	40.6
60	-	**303**	**35.1**	221	30.7
Total		**867**	**100.0**	721	100.0

- **Distribution of loans granted by repayment ability of the borrower:**

Ratio of repayment to income (%)		Year ended December 31, 2016		Year ended December 31, 2015	
From	To	NIS millions	%	NIS millions	%
-	30	**467**	**53.9**	473	65.6
30	40	**296**	**34.1**	164	22.7
40	60	**2**	**0.2**	3	0.4
60	-	**-**	**-**	2	0.3
Deferred loans ("bullet")		**102**	**11.8**	79	11.0
Total		**867**	**100.0**	721	100.0

- **Distribution of loans granted by periods of repayment:**

Period of repayments (in years)		Year ended December 31, 2016		Year ended December 31, 2015	
From	To	NIS millions	%	NIS millions	%
-	20	**278**	**32.0**	321	44.5
20	25	**427**	**49.2**	361	50.0
25	-	**162**	**18.8**	39	5.5
Total		**867**	**100.0**	721	100.0

- Following are data regarding the distribution of housing loans by the rate of finance and by the amounts of loans subject to contractual changes in repayments (variable interest):

		December 31, 2016			December 31, 2015		
Type of collateral	Rate of finance	Fixed interest	Variable interest	Total(1)	Fixed interest	Variable interest	Total(1)
	%	NIS millions					
First pledge	- Up to 60%	**813**	**1,925**	**2,738**	679	1,844	2,523
	- Over 60%	**299**	**660**	**959**	198	542	740
Secondary pledge or no collateral		**45**	**-**	**45**	47	-	47
Total		**1,157**	**2,587**	**3,744**	924	2,386	3,310

(1) of which – loans which include deferred components ("bullets") the balance of which as at December 31, 2016 amounted to NIS 89 million (2015 – NIS 86 million).

The Bank's housing loan portfolio recorded in 2016 an increase of 13.1%, similarly to the developments in the whole banking sector in Israel. The growth in the volume of credit stemmed from the growth in demand in the housing market and from the rise in the level of prices in this market, on background of the low interest environment prevailing in the market in recent years. Most of the growth (about 7.0%) was recorded in housing loans bearing a fixed rate of interest, with the aim of reducing exposure to a possible deterioration in the quality of the loan portfolio due to possible changes in the variable interest rate, and compatible with instructions of Bank of Israel.

In view of the processes taking place in the housing market in general and in housing loans in particular, as described above, banking corporations were required by Bank of Israel to evaluate periodically, whether changes had taken place in the quality of their housing loan portfolios and to express such evaluation in computing the provision for credit losses on a collective basis.

The Bank implements the guidelines of Bank of Israel since their effective date, including an ongoing assessment of the potential losses inherent in the housing loan portfolio, due to possible impairment in the quality of this portfolio stemming from the above described processes.

Assessment of the loss is based upon possible future scenarios, including: a decline in available income of the borrower, an increase in the amounts of current repayments by the borrower stemming from an anticipated increase in the variable interest rate and a decline in the value of pledged assets.

The Bank believes that the possible loss inherent in its credit portfolio, stemming from the above scenarios, amounts as of December 31, 2016 to NIS 4 million (identical to December 31, 2015). The Bank had made a provision in respect of this possible loss and included it as part of the collective provision for credit losses as of December 31, 2016.

In continuation of the above mentioned measures, and in view of the developments occurring in the housing market, as discussed above, which in the opinion of Bank of Israel have increased the risk inherent in the housing loan portfolio of the banking sector, banking corporations were required by Bank of Israel to maintain provisions for credit losses on a collective basis in respect of the above loans, at a rate that shall not fall below 0.35% of the outstanding housing loan portfolio (excluding loans in respect of which the provision for credit loss is based on the extent of default). The implementation of the guideline did not cause a material change in the credit loss expenses on a collective basis in 2016 (identical in 2015).

H. Credit risk in respect of private individuals

In view of the growth recorded in recent years in the scope of exposure of banking corporations to credit risk relating to private individuals, also accompanied, in the opinion of Bank of Israel, by a growth in the level of risk of banking corporations to such customers, Bank of Israel published on February 21, 2017, an amendment to the public reporting instructions, whereby banking corporations were required to expand the disclosure relating to this credit risk.

The Bank has formed a policy and a framework with respect to the granting of credit to private individuals. In this respect, the Bank employs a "decision support" system (hereinafter – "the system"), which studies operating indices and risk indices relating to the private customer and determines in his respect a credit scoring as well as a maximum amount for the granting of credit, which takes into account the level of risk, the sources of income of the borrower as well as additional financial data (such as: collateral).

The recommendation of the system is studied by the credit functions and the decision regarding the amount of credit that would be granted to the customer is received after the analysis of the data at hand and clarification of the customer's needs.

The granting of credit in an amount exceeding that which is recommended by the system requires the application of a detailed and strict underwriting process, which includes:

- Examination of the purpose of the loan and its compatibility with the needs of the customer;
- Repayment ability of the customer;
- Sources of income of the customer;
- Financial stability of the customer;
- The customer's financial wealth;
- History of the financial conduct of the customer in his bank account;
- Obtaining from other sources, to the extent possible, of financial data regarding the customer.

The credit underwriting process is accompanied by detailed documentation, including the considerations standing at the basis of the decision determining the credit facility. The policy of the Bank states a "minimum underwriting requirements" for the granting of credit to such customers, as well as restrictions regarding the rate of credit at a low scoring in relation to the credit portfolio in general relating to private individuals.

Moreover, in order to reduce the credit risk relating to private individuals, the credit policy states restrictions on the authority of credit officers with respect to the granting of credit which deviated from the recommendations of the system (in accordance with the credit scoring determined for the customer) and prohibits the deviation from such recommendations with respect to customers having a low credit scoring.

In addition, the credit policy for private individuals contains principles applying standards for fair conduct as regards customers, including the setting of limitations on the customer population in respect of which the Bank may initiate an approach for the granting of credit, and providing proper disclosure as to the terms of credit and advisability of accepting credit by the customer.

The credit granted to private individuals is being monitored on a current basis by means of information systems that indicate negative developments in customer accounts, including: a reduction in income, arrears in repayment of loans, deviation from credit facilities on current account, etc.

Developments in credit to private individuals are examined by the Bank on a quarterly basis regarding a number of aspects:

- Developments in risk characteristics of the credit portfolio, including:

  - Compliance with the restrictions on risk appetite;
  - Developments in the credit scoring of customers;
  - Developments in the quality indices of the credit portfolio, such as: the rate of troubled debts, the rate of write-offs, the rate of expenses to credit losses, and comparing these parameters to parallel parameters in the banking sector;
  - Developments in macro-economic indices that might have implications on credit risk relating to private individuals, including: the rate of unemployment, rate of participation in the labour market, etc.

- Developments in the credit portfolio to private individuals, by organizational units, including:

  - The rate of growth in the credit portfolio in relation to prior periods and in relation to the average growth rates at the Bank;
  - The rate of credit granted in excess of the recommendation of the "decision supporting" information system;
  - The rate of credit not secured by collateral;
  - The rate of loans where the borrower is exposed to higher repayments due to possible changes in the rate of interest;
  - The rate of credit to borrowers whose bank accounts did not report any income.

  In addition, changes in the private individuals credit portfolio are examined (by customer credit score) on a monthly basis, and a current follow-up is conducted with respect to borrowers whose credit facilities have grown significantly, including a guideline requiring an additional underwriting process conducted in their case.

A growth of 11.6% was recorded in 2016 in the volume of credit granted to private individuals (excluding housing loans), amounting at December 31, 2016 to NIS 3,934 million. The credit to private individuals as of December 31, 2016, comprises 17.6% of the total credit portfolio of the Bank, most of which, comprising credit bearing a variable interest rate.

Following are details regarding the distribution of credit to private individuals:

- Distribution of credit by borrowers' income (deposited with the Bank):

Amount of monthly income	December 31, 2016
NIS thousands	NIS millions
Up to 10*	**3,236**
10 - 20	**608**
Over 20	**90**
Total	**3,934**

* Including borrowers with no reported income in their accounts with the Bank. The balance of credit extended to such borrowers amounted to NIS 1,060 million.

- Distribution of credit by exposure to changes in interest rate:

	December 31, 2016	December 31, 2015
	NIS millions	
Credit at fixed interest rates	**541**	541
Credit at variable interest rates	**3,393**	2,984
Total credit	**3,934**	3,525

The volume of financial assets (deposits and securities) deposited by customers in their accounts at the Bank amounted at December 31, 2016 to NIS 11,617 million.

It is noted that most of the above amount is not recognized as "qualified collateral", and accordingly may not be offset against the total credit extended to private individuals, as detailed above.

I. Credit risk regarding the construction and real estate segment

In view of the growth recorded in recent years in the construction and real estate sector in general, an in the credit extended to this sector in particular, Bank of Israel published on February 12, 2017, a circular letter by which banking corporations are required to expand the disclosure relating to credit risk in this sector.

Following are details regarding the credit characteristics of the construction and real estate sector, risk management and developments in this line of credit recorded in 2016.

Due to the materiality of exposure to this field, the Bank has formed a policy and a framework for the granting of credit to the construction and real estate sector. The policy dictated principles and basic outlines, including:

- Limitations on the rate of risk in the construction and real estate sector in relation to the total credit risk of the Bank;
- A methodology for the financing of transactions;
- Focusing on diversity of the credit portfolio (by types of operations) and transaction of business with customers showing financial solidity;
- Maintaining a proper ratio between credit risk and the collateral securing such credit (in the case of relevant transactions, such as: the financing of construction by the "closed rolling finance" method, the financing of commercial real estate, etc.).

Credit to the public in this sector is divided into four lines of business:

- Financing of housing construction.
- Financing of commercial construction.
- Financing of commercial properties.
- Financing of construction services (including building contractors).

Most of the credit that finances housing construction is extended by the "closed rolling finance" method, while a small part of the credit finances "property acquisition groups". Credit to the construction and real estate sector in Israel, amounted to NIS 6,151 million at December 31, 2016, comprising an increase of 14.1% in comparison to the outstanding balance at December 31, 2015.

Following are data regarding developments in credit risk applying to the construction and real estate sector, by principal characteristics:

- **Distribution by type of finance:**

	December 31, 2016	**December 31, 2015**
	NIS millions	
Housing construction(1)	**2,431**	1,991
Industrial and commercial construction	**1,918**	1,786
With no collateral on real estate*	**1,802**	1,615
Total	**6,151**	5,392

(1) The growth in volume of finance provided to housing construction stems from the growth in volume of building projects by the "closed rolling finance" method.

* Comprises credit extended to finance construction services.

- **Distribution by type of collateral:**

	December 31, 2016	December 31, 2015
	NIS millions	
Open land	**828**	527
Projects in process of construction	**1,717**	1,648
Completed buildings	**1,804**	1,602
With no collateral on real estate*	**1,802**	1,615
Total	**6,151**	5,392

* Comprises credit extended to finance construction services.

J. Credit risk in respect of leveraged finance

Leveraged finance credit risk is defined by the Bank as exposure relating to the granting of "credit financing the acquisition of a controlling interest" (as defined in Proper Management of Banking Business Directive 323)[(1)], the repayment of which is principally based on the resources of the acquired corporation, as well as the granting of credit to borrowers characterized by high leverage ratios, which significantly exceed the ratios accepted in the sector in which they operate.
Following are data regarding exposure of the Bank to leveraged financing, by economic sectors:

	December 31, 2016	December 31, 2015	Change
Economic sector	NIS millions		
Commerce	**67**	73	(6)
Real estate	**78**	84	(6)
Total	**145**	157	(12)

(1) Two new Proper Conduct of Banking Business Directives No. 323 (regarding restrictions on capital transactions) and No. 327 (regarding the management of leveraged loans) took effect of January 1, 2016. These Directives regularize the operations of banks in the matter of "credit of a capital nature".

K. Additional information

Detailed information regarding the credit risk management at the Bank, including qualitative and quantitative aspects involved in such risk, is contained in the risk report published on the Internet website of the Bank, at the following address:
https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

13. Market risk

A. Review of market risk and the management thereof

- **General**

Market risk is defined as the probability that the income and profitability of the Bank may be impaired as a result of changes in the fair value of assets and liabilities (both balance sheet and off-balance sheet) stemming from changes in market conditions, such as, for example, a change in the rate of inflation, a change in interest rates, a change in foreign currency exchange rates and changes in the capital market, etc.

- **Strategies and policies**

Market risk management policy is designed, on the one hand, to lower the level of financial risk that arises as a result of the Bank's continuing operations and, on the other hand, to increase the Bank's profits by way of calculated and controlled exposure.

The issues involved in market risk management, including exposure to market risk and the limits determined for such exposure in relation to the existing position, are being brought for discussion and approval of the Board of Directors once every quarter within the framework of the "risk document".

Market risk management within the boundaries approved by the Board of Directors, including the handling of exceptional development in the financial markets, is outlined and controlled by the reduced financial forum with the participation of senior executives of the finance division and of the risk management division.

- **Structure and organization of the market and liquidity risk management function**

The market and liquidity risks management are the responsibility of the finance division. Reports quantifying risks are produced as part of the follow-up of the various limitations determined for market and liquidity risk exposure. These reports are brought for discussion by the "reduced financial forum", which meets weekly. Decisions and evaluations made by the forum are reported to the General Manager and Management of the Bank.

In addition, discussions of the forum are reported once monthly to the "expanded financial forum" headed by the General Manager and includes, in addition to the members of the reduced forum, also other senior officers of the Bank and of the parent company. As stated, the management of market and liquidity risks financial forums is being supervised by the risk management committee of the Board, which, generally, meets on a monthly basis. The committee discusses the various risks to which the Bank is exposed, including the desirable limitations for market risk exposure. To the extent required, the committee recommends to the Board of Directors changes that should be made to the said limitations.

B. Interest risk

(1) Review of the risk and the management thereof

- **General**

Interest rate risk is defined as the risk of impairment in the profits and capital of a bank as a result of the effect of changes in interest rates. In addition, changes in interest rates may affect also the economic value of a bank, its assets, liabilities and the value of off-balance sheet instruments.

Computation of the risk assets and the allocation of capital in respect of exposure to interest rate risk are made in accordance with the provisions of Proper Management of Banking Business Directive No. 208, with respect to the "marketable portfolio" of the Bank.

The marketable portfolio of the Bank includes the trading bonds portfolio of the Bank as well as future transactions made for trading (IRS transactions, foreign currency forward transactions and purchased currency options). Computation of capital allocation in respect of exposure to interest rate risk is made by the "period to maturity" method.

- **Strategies and processes**

The Bank's policy with respect to interest risks, which stem from an imbalance in the various sectors of operation as between the changes in interest rates that affect assets and those that affect liabilities, is based on a controlled management of those differences whilst, at the same time, allowing for loss exposure to this type of risk to a limited extent only. In accordance with the restrictions authorized by the Board of Directors on this matter on September 25, 2016, the maximum loss (economic), for each 1% change in interest rates, shall not exceed such a differential ratio of the Bank's capital as has been determined for each linkage segment, as follows:
- for the non-linked shekel segment – up to 2.0% of the Bank's capital (in case of a rise in the interest rate) and up to 4% of the Bank's capital (in case of a decline in the interest rate).
- for the CPI-linked segment – up to 3.5% of the Bank's capital (in case of a rise in the interest rate) and up to 7.5% of the Bank's capital (in case of a decline in the interest rate).
- for the foreign currency segment – up to 2% of the Bank's capital.

In addition, a restriction was set for all linkage segments according to which – the total loss of the Bank shall not exceed 2.5% of the Bank's capital (in case of a rise in interest) and 9% of the Bank's capital (in case of a decline in interest).

The greater part of the Bank's possible exposure to loss (economic) in respect of interest risk lies with operations in the CPI-linked segment, insofar as, in this segment, the greater part of the assets and liabilities bear fixed interest rates for relatively long periods. In addition to exposure management to interest risk under the "economic approach", the Bank also examines its exposure to interest rate risk in accounting terms by measuring such exposure under various stress tests.

The bank examines the impact of these scenarios on the Tier I equity capital in the immediate range and in the range of one year. In September 25, 2016, the Board of

Directors decided to limit the implications stemming from the application of such stress tests to a rate of not more than 15% of the equity capital of the Bank.

As part of the interest risk management, the Bank also applies an "interim stress test", which measures the effect of exposure to changes in the interest rate on the Tier I equity capital, and verifies that the maximum reduction in the equity capital of the Bank resulting from such stress test does not exceed the determined limit of 4%.

In order to measure the interest risk the Bank makes use of assumptions that are being reviewed annually as to the scope of premature repayments of mortgage loans bearing a fixed interest rate, and as to the scope of the recycling rate of on-call deposits made by the public. The rate of premature repayments is based on past experience as regards premature repayments in this type of loans. Furthermore, the Bank makes use of assumptions regarding the following:

- Rate of premature withdrawals of savings deposits.
- Rate of the recycling of on-call deposits, based on past experience as to withdrawal of savings deposits at exit points and as to the rate of withdrawals of on-call deposits.
- the distribution of customer non-interest bearing current account balances, based on past experience.

The interest risk in the banking portfolio is being measured on a weekly basis.

In addition to the above, the Bank applies the US accepted accounting principles regarding employee rights. In accordance with the measurement rules prescribed by these guidelines, the Bank's liabilities for the payment of defined benefits to employees (as defined by Bank of Israel instructions) are discounted to their present value using a discount rate based on returns on Israel government bonds with the addition of a spread derived from the difference between the returns on high quality US traded corporate bonds and the returns on US government bonds.

Accordingly, the fair value of these liabilities is exposed to changes in the interest rates applying to the said bonds. In view of the above, as from December 28, 2015, the Bank includes in calculating exposure to interest risk, both the component of liabilities for employee rights and the component of the assets of the plan in their respect.

- **Structure and organization of the interest risk management function**

Interest risks are being managed by the Finance Division. Risk management includes the monitoring of restrictions determined for interest risk management by way of the production of reports quantifying and assessing this risk on a weekly basis.

The reports are being discussed by the "reduced finance forum", which meets on a weekly basis. Decisions and evaluations made by the forum are reported to the General Manager and to Management of the Bank. In addition, discussions of the forum are reported once monthly to the "expanded finance forum" headed by the General Manager and includes, in addition to the members of the reduced finance forum, also other senior officers of the Bank and of the parent company. The finance forums are being supervised by the risk management committee of the Board, which meets at least on a quarterly basis. The committee discusses the various risks to which the Bank is exposed, including the desirable limitations for market risk exposure. To the extent required, the committee recommends to the Board of Directors changes that should be made to the said limitations.

- **Hedge and/or risk reduction policy**

As stated, the policy of the Bank regarding market risk management is based on the hedging of exposure to market risks by imposing quantity limitations on such exposure.

For the purpose of complying with the prescribed limitations, the finance group of the Finance Division operates a system for the measurement of the risks and for verifying compliance with the said limitations. The means used for compliance with the prescribed limitations include:

- Purchase and sale of marketable instruments in all linkage segments (mainly securities of various maturity periods).

- Investment in and the raising of non-marketable -financial instruments (mainly deposits of banks).

- Derivative financial instrument transactions with banks.

(2) Sensitivity analysis of the influence of exposure to changes in interest rate based on the fair value of the financial instruments

- **General**

In accordance with the Directive published by Bank of Israel in the matter of "Disclosure of exposure to interest rate changes", banks are required to include in their Directors' Report information regarding the volume of assets and liabilities exposed to changes in interest rates, based on their fair value, and to include a sensitivity analysis as to the effect of hypothetical changes in interest rates on the fair value of these financial instruments.

- **Principles of the model**

Whereas a "market price" cannot be quoted with respect to most financial instruments of the Bank, as they are not being traded on an active market, their fair value is computed using accepted pricing models, such as: present value of future cash flows discounted at an interest rate reflecting present market interest rates for such financial instruments as well as the risk inherent in them, as evaluated by Management.

Principle methods and assumptions used in computing the fair value of financial instruments:

(1) Marketable financial instruments:
Investment in securities and liabilities in respect of bonds issued by the Bank - fair value is based on market value.

(2) Non-marketable financial instruments:

In principle, the fair value of non-marketable financial instruments is generally determined by capitalizing the anticipated future cash flows at interest rates used by the Bank in similar transactions that were made or that would have been made at the reporting date.

The computations have been made as follows:

Credit to the public - the fair value of the outstanding balance of credit to the public is computed at the present value method of future cash flows, capitalized at an appropriate discount rate. The present value is measured in respect of the future cash flows (principal and interest) for each loan separately at an interest rate reflecting the level of risk inherent in the credit.

Determination of the risk level, as stated, is derived from a borrower rating model used by the Bank which examines the risk level of the borrower based on financial, management and business sector parameters. As a general rule, the interest rates used in capitalizing cash flows are determined according to interest rates used by the Bank in similar transactions at the reporting date.

Cash flows in respect of troubled debts were computed after deducting specific provisions for doubtful debts from the stated balances of credit to the public.

Cash flows in respect of mortgage loans that may be prematurely repaid were assessed according to a forecast of early repayment of such loans based on a statistical model. Capitalization of cash flows, as stated, according to the expected repayment dates instead of the contractual repayment dates of the said loans, reduced the fair value of such credit by NIS 9 million.

In computing the fair value of credit to the public linked to the CPI (with a minimum CPI rate) the embedded option has been separated from this instrument. The separation of the option had a negligible effect on the fair value of the instrument.

Deposits and subordinate debt notes – fair value is computed by the capitalized future cash flows method at interest rates at which the Bank raises similar deposits or similar subordinate debt notes at balance sheet date, based on parameters such as: period of the deposit, type of linkage and sizes of the deposit.

In computing the fair value of deposits optionally linked to the CPI, possible changes in fair value of the deposits have been taken into account considering the time value of the option and anticipated changes in the CPI until the due date of the deposits.

Deposits by the public include also "hybrid instruments" as follows:

- "Savings deposits", being deposits for a relatively long period:

  Based on experience accumulated at the Bank, a part of the depositors withdraw the deposits prior to their contractual due date at their contractual value less an "early withdrawal charge". The projected cash flows in respect of savings deposits are presented based on statistical data that include forecasts for early withdrawals of such deposits. Capitalization of future cash flows according to forecasts of early withdrawals of savings deposits reduced the fair value of these deposits by NIS 55 million.

- Deposits of the public include deposits optionally bearing fixed or variable interest rates. In computing the fair value of such deposits, the option embedded in this instrument has been separated. The separation of the option had a negligible effect on the fair value of such deposits.

- "Savings deposits" with option of changing the linkage base of the deposit and with option of securing the principal amount of the deposit. In computing fair value, the said embedded options have been separated from the deposit. Such separation had a negligible effect on the fair value of the deposits.

- **Off-balance sheet financial instruments –** The fair value of off-balance sheet financial instruments, the balance of which represents credit risk, is assessed in accordance to the commissions charged in similar transactions at the reporting date, subject to adjustment to the balance of period of the transaction and the credit quality of the counterparty.

  Assessment of the fair value of “irrevocable commitments to grant credit not yet implemented” included reference to the interest differential between the contractual interest rate and the interest rate in respect of similar transactions at the reporting date.

- **Derivative instruments –** derivative instruments traded on an active market are stated at market value. Derivative instruments that are not traded on an active market are valued according to models used by the Bank in its current operations and which take into account the risks inherent in the financial instrument.

  Note:

  The assessment of fair value by means of capitalization of the future cash flows is based on discount rates the determination of which is subjective. Therefore, for most financial instruments, the attached fair value assessment does not necessarily indicate the realizable value of the financial instrument at the reporting date.

  Assessment of fair value is made according to interest rates in effect at the reporting date and does not take into account the fluctuations in interest rates. Under assumption of other interest rates, significantly different fair values may be obtained. This relates particularly to financial instruments at fixed interest rates or which do not carry interest.

  In addition, determination of fair value does not take into account commissions receivable or payable in respect of the business operations and does not include the tax effect. Moreover, the difference between the stated value of the items and their fair value may not materialize, as in most cases; the Bank may continue to hold the financial instrument until maturity.

- **Quantitative data and sensitivity analysis**

A. Data based upon Bank of Israel directives

1. Fair value of the financial instruments in NIS millions:

	December 31, 2016				
	Israeli currency		Foreign currency [2]		
	Non-linked	CPI linked	US dollar	Other	Total
Financial assets [1]	**25,690**	**3,737**	**1,545**	**457**	**31,429**
Receivables in respect of derivative and off-balance sheet financial instruments [3]	**481**	**545**	**1,466**	**478**	**2,970**
Financial commitments [1]	**(23,490)**	**(3,389)**	**(2,094)**	**(626)**	**(29,599)**
Payables in respect of derivative and off-balance sheet financial instruments [3]	**(1,471)**	**(300)**	**(945)**	**(303)**	**(3,019)**
Net fair value of financial instruments	**1,210**	**593**	**(28)**	**6**	**1,781**

	December 31, 2015				
	Israeli currency		Foreign currency [2]		
	Non-linked	CPI linked	US dollar	Other	Total
Financial assets [1]	24,878	2,951	1,341	466	29,636
Receivables in respect of derivative and off-balance sheet financial instruments [3]	1,095	1,285	2,454	578	5,412
Financial commitments [1]	(21,106)	(3,776)	(2,162)	(664)	(27,708)
Payables in respect of derivative and off-balance sheet financial instruments [3]	(3,275)	(195)	(1,638)	(393)	(5,501)
Net fair value of financial instruments	1,592	265	(5)	(13)	1,839

(1) Including hybrid financial instruments. Excluding stated amounts of derivative financial instruments and fair value of off-balance sheet financial instruments.
(2) Including Israeli currency linked to foreign currency
(3) Amounts receivable (payable) in respect of derivative financial instruments and off-balance sheet financial instruments, capitalized at interest rates used to compute fair value.

2. The effect of hypothetical changes in interest rates on the net fair value of financial instruments of the Bank, in NIS millions:

	December 31, 2016							
	Net fair value of financial instruments, after effect of interest rate changes (1)						Change in fair value	
	Israeli currency		Foreign currency (2)					
	Non-linked	CPI linked	US dollars	Other	Offsetting effects	Total	NIS millions	%
Immediate parallel increase of 1%	**1,198**	**607**	**(39)**	**(4)**	**-**	**1,762**	**(19)**	**(1.1)**
Immediate parallel increase of 0.1%	**1,208**	**594**	**(29)**	**5**	**-**	**1,778**	**(3)**	**0.2**
Immediate parallel decrease of 1%	**1,270**	**577**	**(17)**	**8**	**-**	**1,838**	**57**	**3.2**

	December 31, 2015							
	Net fair value of financial instruments, after effect of interest rate changes (1)						Change in fair value	
	Israeli currency		Foreign currency (2)					
	Non-linked	CPI linked	US dollars	Other	Offsetting effects	Total	NIS millions	%
Immediate parallel increase of 1%	1,576	306	2	(14)	-	1,870	31	1.7
Immediate parallel increase of 0.1%	1,590	270	(4)	(12)	-	1,844	5	0.3
Immediate parallel decrease of 1%	1,599	221	(13)	(12)	-	1,795	(44)	(2.4)

(1) The fair value of financial instruments presented in each linkage sector is the net fair value in such sector on the assumption that the change in interest rates noted in that sector has occurred. The total net fair value of the financial instruments is the net fair value of all financial instruments (excluding non-monetary items) on the assumption that the noted change in interest rates in all linkage sectors has occurred.

(2) Including Israeli currency linked to foreign currency.

B. Data used for interest rate exposure management

Interest rate exposure management at the Bank is based on a model within the framework of which future cash flows are capitalized at discount rates that are not identical with those used by the Bank for reporting exposure of the Bank to changes in interest rates (in particular with respect to interest spreads regarding credit risk).

Following are quantitative data regarding the fair value of financial instruments and the effect of hypothetical changes in interest rates on the fair value of financial instruments, based on the model used by the Bank in the management of interest rate exposure.

1. Fair value of the financial instruments in NIS millions:

	December 31, 2016				
	Israeli currency		Foreign currency [2]		
	Non-linked	CPI linked	US dollar	Other	Total
Financial assets [1]	**27,543**	**3,852**	**1,619**	**476**	**33,490**
Receivables in respect of derivative and off-balance sheet financial instruments	**442**	**532**	**1,507**	**481**	**2,962**
Financial commitments [1]	**(23,415)**	**(3,880)**	**(2,083)**	**(626)**	**(30,004)**
Payables in respect of derivative and off-balance sheet financial instruments	**(1,465)**	**(292)**	**(938)**	**(307)**	**(3,002)**
Net fair value of financial instruments	**3,105**	**212**	**105**	**24**	**3,446**

	December 31, 2015				
	Israeli currency		Foreign currency [2]		
	Non-linked	CPI linked	US dollar	Other	Total
Financial assets [1]	26,245	3,096	1,401	482	31,224
Receivables in respect of derivative and off-balance sheet financial instruments	1,065	1,273	2,499	576	5,413
Financial commitments [1]	(21,028)	(4,317)	(2,164)	(664)	(28,173)
Payables in respect of derivative and off-balance sheet financial instruments	(3,264)	(200)	(1,640)	(392)	(5,496)
Net fair value of financial instruments	3,018	(148)	96	2	2,968

(1) Including hybrid financial instruments. Excluding balance sheet amounts of derivative financial instruments and fair value of off-balance sheet financial instruments.

(2) Including Israeli currency linked to foreign currency.

2. The effect of hypothetical changes in interest rates on the net fair value of financial instruments of the Bank, in NIS millions:

	December 31, 2016							
	Net fair value of financial instruments, after effect of interest rate changes [2]						Change in fair value	
	Israeli currency		Foreign currency [1]					
	Non-linked	CPI linked	US dollars	Other	Offsetting effects	Total	NIS millions	% [2]
Immediate parallel increase of 1%	**3,116**	**259**	**101**	**17**	**-**	**3,493**	**47**	**1.4**
Immediate parallel increase of 0.1%	**3,106**	**217**	**105**	**23**	**-**	**3,451**	**5**	**0.1**
Immediate parallel decrease of 1%	**3,094**	**158**	**110**	**26**	**-**	**3,388**	**(58)**	**(1.7)**

	December 31, 2015							
	Net fair value of financial instruments, after effect of interest rate changes (2)						Change in fair value	
	Israeli currency		Foreign currency (1)					
	Non-linked	CPI linked	US dollars	Other	Offsetting effects	Total	NIS millions	%(2)
Immediate parallel increase of 1%	3,020	(70)	102	1	-	3,053	85	2.9
Immediate parallel increase of 0.1%	3,018	(140)	97	2	-	2,977	9	0.3
Immediate parallel decrease of 1%	3,014	(237)	89	3	-	2,869	(99)	(3.3)

Notes:

(1) Including Israeli currency linked to foreign currency.

(2) The fair value of financial instruments presented in each linkage sector is the net fair value in such sector on the assumption that the change in interest rates noted in that sector has occurred. The total net fair value of the financial instruments is the net fair value of all financial instruments (excluding non-monetary items) on the assumption that the noted change in interest rates in all linkage sectors has occurred.

(3) In addition, the Bank uses a model for the measurement of changes anticipated in the coming year in the accounting profit, in respect of changes in the interest graph. The model is based on various assumptions regarding anticipated developments in balance sheet items and in various market variables. The rate of decrease expected in the accounting profit of the Bank in relation to equity in the coming year (based on this model), due to a parallel decrease at the rate of 1% in the interest graph in the "non-linked", "CPI linked" and foreign currency segments, amounts to 2.10%, 0.10% and 0.79% respectively (December 31, 2015 – 1.53%, 0.09% and 1.02%, respectively).

(4) The range of changes in fair value in respect of interest rate changes, recorded in the reported period, is as follows: in respect of a parallel increase of 1%: 1.34%-3.78% (2015 – 1.12%-3.48%); in respect of a parallel increase of 0.1%: 0.14%-0.39% (2015: 0.12%-0.37%); in respect of a parallel decrease of 1%: (-1.63%) – (-3.87%) (2015: (-0.99)% - (-3.76)%).

3. Quantitative information regarding exposure of the Bank to changes in interest rates

The following table summarizes, by operating segment, the data relating to the differences in average maturity period and its effect on the interest rate exposure of the Bank:

	December 31, 2016			December 31, 2015		
	Non-linked	CPI-linked	Foreign Currency (2)	Non-linked	CPI-linked	Foreign Currency (2)
Average maturity of assets (years)	**0.53**	**2.46**	**1.20**	0.45	2.16	0.64
Average maturity of liabilities (years)	**(0.49)**	**(3.13)**	**(0.67)**	(0.39)	(3.26)	(0.79)
Difference in average maturity (years)	**0.04**	**(0.67)**	**0.53**	0.06	(1.10)	(0.15)
Maximum loss in relation to capital (1) (percentages)	**0.5**	**2.4**	**0.5**	0.2	4.2	0.3

(1) For each 1% change in interest rates
(2) Including Israeli currency linked to foreign currency

The average maturity data allow for the measurement of the sensitivity of assets and liabilities to changes in interest rates.

Data relating to exposure to changes in interest rates as of December 31, 2016 indicate that, in the non-linked segment and in the foreign currency segment (denominated in, or linked to, foreign currency), most of the assets and liabilities are either short-term in nature with maturity periods of up to three months or alternatively, bear variable interest rates. The Bank's exposure to interest risk in these segments is accordingly relatively low.

In the reported period, the Bank issued to the public non-linked bonds, redeemable at the end of six years from date of issue. The resulting increase in interest risk stemming from this issue was hedged by investment in bonds carrying a fixed interest rate.

In the foreign currency segment, the Bank executes interest rate swap (IRS) and forward rate agreements (FRA), thereby reducing the risk exposure associated with changes in interest rates.

In the CPI-linked segment, as of December 31, 2016, the average maturity of liabilities exceeded the average maturity of assets by approximately eight months (December 31, 2015: thirteen months)

The computation of the average maturity of asset and liability financial instruments having several optional maturity periods, are based on assumptions as to the dates of maturity of those instruments. Following are details of the types of the said instruments, assumptions in their respect and their effect on the average maturity of the said instruments:

(1) Credit to the public includes housing credit granted for relatively long periods. However, past experience shows that a part of the borrowers repay their debts prior to the contractual repayment date. The cash flow projection for such credit, based on a model that estimates the anticipated repayment period on the basis of past experience and not according to the contractual repayment dates, reduced the average maturity of assets in this segment as follows:

- In the CPI linked segment – by seven months;
- In the non-linked and foreign currency linked segments – by one month.
- In the foreign currency segment – by an immaterial period.

(2) Deposits of the public include funds of savings schemes deposited for relatively long periods. However, past experience indicates that a part of the depositors withdraw their deposits prior to the contractual date determined for the scheme. The cash flow projection in respect of these savings schemes, based on statistical data, which includes a forecast of the premature withdrawal of such deposits, and not on the basis of the contractual withdrawal dates, reduced the average maturity of the liabilities by approximately two months.

4. Use of derivative instruments

The Bank hedges its exposure to changes in interest rates by means of transactions in derivative instruments (mostly IRS type instruments in the foreign currency and shekel segments).
These instruments reduced the Bank's average period to maturity difference and exposure to interest rate changes, as follows:

	31.12.2016			31.12.2015		
	Non-linked	**CPI linked**	**Foreign currency**	**Non-linked**	**CPI linked**	**Foreign currency**
Average period to maturity difference (years):						
Prior to transactions in derivatives	**0.09**	**(0.68)**	**1.77**	0.10	(0.49)	0.95
Effect of derivative transactions	**(0.05)**	**0.01**	**(1.24)**	(0.04)	(0.61)	(1.10)
Net average period to maturity difference	**0.04**	**(0.67)**	**0.53**	0.06	(1.10)	(0.15)
Maximum loss in relation To capital (%) [(1)]:						
Prior to transactions in derivatives	**-**	**2.4**	**-**	(0.4)	4.1	(0.8)
Effect of transactions in derivatives	**0.5**	**-**	**0.5**	0.6	0.1	1.1
Net maximum loss[(1)]	**0.5**	**2.4**	**0.5**	0.2	4.2	0.3

(1) The maximum rate of loss is computed in relation to the capital of the Bank in respect of 1% change in the interest graph.

Detailed information regarding exposure of the Bank to changes in interest rates in the different linkage segments is contained in Appendix No. 3 to this report.

5. Additional information

Detailed information regarding the interest risk management by the Bank, including qualitative and quantitative aspects involved in such risk, is contained in the risk report published on the Internet website of the Bank, at the following address: https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

C. Exchange rate risk (base risk)

(1) Review of the risk and manner of management thereof

A base risk is defined as the exposure of a bank to a loss that may arise as a result of changes in the inflation and foreign currency exchange rates. The risk is measured by reference to the difference between the bank's financial assets and liabilities (the "active capital") in each of the linkage segments.

The Bank's policy with regard to the base risks intertwined with the management of the portfolio of assets financed by its active economic capital sources, stipulates that (-40)% to 100% of this capital shall be invested in CPI-linked assets, and that (-10)% to 25% shall be invested in assets denominated in, or linked to, foreign currency, the resultant balance being held in non-linked shekels.

Subject to the determined restrictions, the decisions regarding the investment of the active capital of the various segments are based on an analysis, an examination and forecasts with respect to economic developments, interest rates in the various segments, and expected changes in the Consumer Price Index and in foreign currency exchange rates. For the purpose of managing base risks, the Bank is aided by off-balance sheet financial instruments.

Other aspects relating to the management of this risk, including the organizational structure of the risk management function and the hedge policy relating to this risk – are discussed in Section B to this Chapter.

(2) Quantitative review

The following table summarizes data relating to base risk exposure by linkage segment as of December 31, 2016, in comparison to last year and before and after the effect of transactions in derivative instruments (in NIS millions):

"Accounting" exposure

	31.12.2016			31.12.2015		
Linkage segment	**Before derivatives**	**Effect of derivatives**	**Net exposure**	**Before derivatives**	**Effect of derivatives**	**Net exposure**
Non-linked shekel	**2,152**	**(1,017)**	**1,335**	3,512	(2,173)	1,339
CPI linked shekel	**440**	**319**	**759**	(726)	1,155	429
Foreign currency[2]	**(705)**	**698**	**(7)**	(1,027)	1,018	(9)
Total	**1,887**	**-**	**1,887**	1,759	-	1,759

"Economic" exposure [1]

	31.12.2016			31.12.2015		
Linkage segment						
Non-linked shekel	**2,828**	**(1,017)**	**1,811**	4,175	(2,178)	1,997
CPI linked shekel	**(145)**	**319**	**174**	(1,325)	1,155	(170)
Foreign currency[2]	**(1,016)**	**698**	**13**	(1,016)	1,023	7
Total base exposure	**1,998**	**-**	**1,998**	1,834	-	1,834

(1) Basis risk exposure is managed by reference to 'economic exposure' data. The principal components of the difference between economic exposure and accounting exposure (defined as the difference between the balances of financial assets and liabilities, as measured in accordance with generally-accepted accounting measurement principles) are as follows:
- Certain provisions, such as net provisions for employee rights are classified to the CPI linked segment.
- The assets covering the liability for severance compensation are classified to the appropriate segment relating to each financial instrument included in these assets, separately.
- CPI-linked loans classified as impaired debts, are reflected in the non-linked segment (instead of in the base segment derived from the loan agreement).
- Financial instruments containing an embedded option are classified within the appropriate linkage segment, as determined by an option pricing model.
- Deposits, the linkage base of which is not constant throughout the period of the deposit, are classified within the linkage segment that was used for deposit pricing purposes.
- The net provision for credit losses on a collective basis (in respect of net performing debts) is not included in the economic exposure.

(2) Including linked to foreign currency.

Following is an analysis of the changes during the reported period in the exposure of the Bank to linkage base risk (on an economic basis):

As of December 31, 2016, the surplus liabilities in the CPI-linked segment totaled approximately NIS 174 million. The rate of investment of the active capital in the non-linked segment reached 8.7% as compared to surplus liabilities of 9.3% in the previous year. The surplus assets in the foreign currency and foreign currency linked segment, in relation to the active capital, amounted at December 31, 2016 to a negligible rate, similar to that of the previous year.

In 2016, the Bank shifted a part of its surplus assets from the non-linked segment to the CPI-linked segment. This shifting of surplus assets, stemmed from the anticipated surplus return in this segment due to expected positive rise in the CPI.

Risk assets in respect of the Bank's exposure to exchange rate risk amount at December 31, 2016, to NIS 18 million (December 31, 2015: NIS 27 million), and reduced the Bank's capital adequacy ratio as of December 31, 2016, by 0.01% (December 31, 2015: identical).

Sensitivity analysis to changes in exchange rate

The sensitivity analysis is being made with respect to theoretical scenarios of changes in exchange rates of the major currencies, at a range of between +10% to -10%. The analysis examines the effect of the above scenarios on the capital of the Bank as of December 31, 2016, based on the balances of financial assets and liabilities in those currencies (including transactions in off-balance sheet instruments) as of December 31, 2016, subject to certain adjustments (principally in respect of "impaired debts"). Following are the summary results of the sensitivity analysis (in NIS millions):

	10%	5%	-5%	-10%
US dollar	(1)	*	*	1
Euro	*	*	*	*
Pound Sterling	*	*	*	*
Swiss Franc	*	*	*	*
Japanese Yen	*	*	*	*
	(1)	*	*	1
Effect of options**	*	*	*	*
Total effect	(1)	*	*	1

* An amount lower than NIS 0.5 million.
** Not including embedded options.

(3) Additional information

Detailed information regarding exposure of the Bank to base risks is found in Note 30 to the financial statements.

D. Share price risk

(1) Review of the risk and manner of management thereof

- **General**

A share risk is defined as the exposure of a bank to a loss as a result of the decline in market prices of shares held in the securities portfolio of a bank. Computations of risk assets and the allocation of capital in respect of exposure to share risk are made in accordance with guidelines included in Proper Management of Banking Business Directive No. 208 regarding the marketable portfolio of the Bank. As of December 31, 2016, the marketable portfolio did not include any shares (December 31, 2015 – same).

- **Strategy and processes**

In principle, the Bank avoids in general financial investments in shares in its banking portfolio. As of December 31, 2016, the banking portfolio includes four classes of shares:
- A 31% stake in the equity capital of an affiliated company – Tafnit Discount – Investment Portfolio Management Ltd., engaged in the management of investment portfolios of customers of the Discount Group.
- Investment in venture capital funds engaged in capital investment and in the granting of credit to hi-tech startup companies
- Non-financial investment in A.I. America Israel Ltd. (14.8% stake in equity).
- Non-financial investments of negligible amounts in a small number of companies, stemming from agreements for the arrangement of troubled debts entered into between the Bank and the borrowers.

- **The organizational structure of the risk management function**

As a general rule, the "securities center" (which is subject to the Finance Division) is the organ responsible for investment in securities in general, and in shares in particular.

Notwithstanding the above, whereas a part of the investments included in the banking portfolio stem from credit transactions made by the Commercial Banking Division, or which constitute an alternative to credit transactions made by the Bank, responsibility for risk management in the first line of defense in respect of these investments lies with the business group of the Commercial Banking Division of the Bank.

The Risk Management Division takes responsibility for risk management in the second line of defense, in respect of the risk involved in exposure of the Bank to investment in shares.

- **Policy and accounting treatment of investment in shares**

Following are details of the accounting treatment of shared included in the banking portfolio of the Bank:

- Investment in venture capital funds is stated at cost.
- Where the fair value of the investment in venture capital funds is lower than cost, a provision for impairment is recognized in profit and loss.
- The investment in Tafnit Discount – Investment Portfolio Management Ltd. is stated on the equity value basis.
- Non-financial investments are stated at their fair value or in accordance with Management's assessment, not exceeding fair value.

(2) Quantitative review

- **Following are data regarding the cost of shares and their fair value in the banking portfolio of the Bank:**

	December 31, 2016	December 31, 2015
	NIS millions	
Cost(1)	**18**	15
Adjustment to fair value	**2**	2
Fair value(2)	**20**	17

(1) In respect of these shares, a provision for impairment of a nature other than temporary was recognized at December 31, 2016, in the amount of NIS 5 million (December 31, 2015 – identical).
(2) Fair value data at December 31, 2016, do not include balances based on market quoted price (December 31, 2015 – identical).

- **Following are data regarding the distribution of investment in shares by marketability:**

	December 31, 2016	December 31, 2015
	NIS millions	
Non-marketable investments	**20**	17
Marketable investments	**-**	-
Total	**20**	17

(3) Additional information

Detailed information regarding the share price risk management by the Bank, including qualitative and quantitative aspects involved in such risk, is contained in the risk report published on the Internet website of the Bank, at the following address: https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

14. Liquidity and financing risks

A. Liquidity risk

(1) Review of the risk and manner of management thereof

- **General**

Liquidity risk is defined as a possible exposure to loss and to impairment in the stability of the Bank, stemming from the inability of the Bank to provide for its liquidity requirements. This risk derives, inter alia, from the conduct of customers and its realization may be expressed in the availability and price of financial resources.

- **Short-term and long-term liquidity management**

  In accordance with of Bank Israel instructions regarding "management of liquidity risk", banking corporations are required to maintain a "minimum liquidity ratio" (defined as the ratio between the "liquidity cushion" and the net forecasted payments in the following month) of not less than 1 at any time.

  Furthermore, banks have been instructed to monitor the "stable finance ratio", defined as the ratio between their stable sources of finance expected to be repaid within the range of one year and over, and the long-term applications expected to materialize during this period – and define a target for such ratio. In view of Bank of Israel guidelines, the Bank has set a target for the stable financing ratio of not less than 1, as approved by the Board of Directors of the Bank.

  The Bank manages the liquidity risk using administrative and computer tools developed for this purpose. These include means for the supervision, monitoring and control of the short-term liquidity data. In this respect, the Bank has developed an up-to-date model for the management of liquidity risk.

  The model is used for liquidity risk management, examining the "liquidity gap" (defined as the gap between the liquid assets and the liabilities due for payment of the Bank), the "liquidity ratio" different ranges and scenarios, as well as the "survival horizon" of the Bank (defined as the future period in which the Bank is expected to operate with no liquidity deficits), under various scenarios. Moreover, within the framework of liquidity risk management, the Bank tests the changes that have occurred in this risk, using additional tools and indices, including:

  - Use of "reverse stress tests", with a view of monitoring scenarios that might lead to deterioration in the minimum liquidity ratio to below the required minimum.
  - Examination of the mix and extent of concentration of the resources of finance.
  - Monitoring and analysis of the position of non-pledged assets.
  - Use of indicators for the early identification of signs indicating a possible deterioration in the liquidity position of the Bank.
  - Monitoring the contractual cash flows of financial instruments and the liquidity gaps in respect of such cash flows.

(2) Liquidity coverage ratio

On September 28, 2014 Bank of Israel published a Proper Management of Banking Business Directive No.221 in the matter of "liquidity coverage ratio", intended to adapt the liquidity risk management of the banking sector in Israel to the principles determined by the Basel Committee. This Directive requires banks to maintain a liquidity coverage ratio (defined as the ratio between the inventory of qualitative liquid assets and the total amount of net cash outflows during a future period of thirty days) of not less than 100%.

The guidelines contained in the Directive took effect on April 1, 2015, and are being applied by the Bank as from that date. In order to facilitate the implementation of the Directive, Bank of Israel published transitional instructions taking effect gradually, as follows:

- Starting with January 1, 2016, banking corporations are required to maintain a liquidity coverage ratio of not less than 80% (2015 – 60%).
- The relief will be totally eliminated on January 1, 2017.

Following are data used in the computation of the liquidity coverage ratio of the Bank:

	December 31, 2016	December 31, 2015
Quantitative data	**NIS millions**	**NIS millions**
High quality liquid assets	**7,603**	(1) 7,270
Net cash outflow	**5,287**	(1)5,996
Liquidity rates	**%**	**%**
Liquidity coverage ratio	**143.8**	(1) 121.2

(1) Restated

(3) Redemption period of assets and liabilities by linkage base

Following are data regarding the surplus and deficit in the cash flow of the Bank as of December 31, 2016:

A deficit exists in the shekel segment for periods to redemption of up to one month (including the effect of future transactions) amounting to NIS 10.8 billion, stemming, inter alia, from a Bank of Israel instruction according to which, credit granted under revolving credit terms without a credit facility or which has exceeded the approved credit facility (amounting to NIS 2.1 billion) is to be classified as an asset having no repayment date. A part of this deficit is covered by surplus of NIS 0.3 billion in a period for redemption of up to three months. The said data is based on the contractual repayment dates of assets and liabilities of the Bank. Notwithstanding the above, in view of past experience, most of the deposits classified for short repayment periods, are being renewed on an ongoing basis. Accordingly, and based on the liquidity model used by the Bank for liquidity risk management (see below), at December 31, 2016, the Bank has in actual fact a positive liquidity gap in this segment (including in the segments linked to the CPI and to foreign currency), for a future time-range of one month, amounting to NIS 4.4 billion. In addition, liquidity gaps in different time periods might be bridged over by the securities portfolio operations.

In the foreign currency segment a deficit exists for maturity periods of up to one year, amounting to NIS 1.2 billion. This deficit is covered in the longer periods (on assumption that the deposits would be renewed on an ongoing basis). Also in this segment it is possible to bridge over time differences between repayment dates of liabilities and assets by operations in the securities portfolio of the Bank. It is noted in this respect, that, based on the liquidity model used by the Bank for the purpose of the short-term liquidity risk management, as stated, this segment has a positive liquidity gap for the future time-range of one month, amounting on December 31, 2016 to NIS 1.1 billion.

The Bank's volume of transactions in options at December 31, 2016 is negligible. Accordingly, the effect of possible changes in prices used to determine the fair value of options on base exposure and on liquidity risk exposure at the Bank is not material.

The Bank has also imposed restrictions in respect of various parameters used in the management of the liquidity risk, including "liquidity differential", "liquidity ratio" and "liquidity horizon". According to these restrictions, the short-term liquidity ratio shall not fall below 1, also in stress tests.

(4) The short and long term liquidity position

Following the global economic crisis of 2008, central banks in Israel and the world over applied an expansionary monetary policy, marked by a very low interest environment. Accordingly, in recent years a growing trend is noticed where customers reduce the period of bank deposits (by preferring "on-call deposits" on account of the relative weight of "time deposits"). Concurrently, the public showed preference for financing its activities by long-term resources. The above developments contributed to an increase in exposure of the Bank to liquidity risk.

Inter alia, the Bank hedges its exposure to liquidity risk by applying a strategy for increasing the resources raised from households and small businesses, which are marked by high recycling rates. This strategy is in line with the rules published by Bank of Israel in Proper Management of Banking Business Directive No. 221, in the matter of "liquidity coverage ratio", which states high recycling ratios (of 80%-97%), for deposits due in the coming month, deposited by customers belonging to the retail segment.

Within the framework of liquidity risk and long-term finance risk management, the Finance Division and other relevant forums currently hold discussions regarding the raising of long-term funds (for over one year).

The requirement for a structured long-term liquidity management, derives also from the expected implementation of the guidelines of Bank of Israel in the matter of "stable finance ratio" (NSFR), defined as the ratio between the total stable finance resources (defined as existing finance resources, expected, with high probability, to be available to the Bank in a time-range exceeding one year), and the total long-term applications (defined as existing applications, which the Bank is expected to continue and finance in a time-range of one year and over).

At this stage, and until binding guidelines are published in the matter, the stable finance ratio at the Bank is measured in accordance with criteria determined by the Bank and with targets determined by the Board of Directors.

As part of the long-term liquidity risk management, the Bank raises long-term deposits from among its customers, inter alia, by means of permanent order deposits. In addition, within the framework of the financial strategy for the diversification of the long-term resources, the Bank (through a subsidiary) issued in March 2016, a series of marketable bonds in the amount of NIS 253 million. The bonds are non-linked and carry interest at the rate of 2.07 per annum (which exceeded by 0.79 percentage points the returns according to which similar government bonds were traded on date of issue) and are redeemable at the end of six years from date of issue.

For further information regarding the shelf prospectus for the raising of long-term financial resources published on December 21, 2916, see Chapter 8A above.

Another aspect involved in the management of this risk derives from the Group risk management concept. Whereas the Bank is a member of the Israel Discount Bank

Group, the transfer of liquidity between the Bank and the parent company is made possible within the framework of the business relations between the parties.

Notwithstanding the above, as part of the Group liquidity risk management policy applied by the Bank and by the parent company, the entities included in the group are instructed to maintain financing capabilities independently of the members of the Group. The Bank acts in accordance with this policy.

(5) Raising of resources policy

- **Macro environmental factors**

  On background of the moderation recorded in the inflationary trend in the years 2012-2016, and in view of the continued economic slowdown in part of the Eurozone states and its possible implications on the Israeli economic activity, Bank of Israel continued implementing the expansionary policy adopted by it in the years 2012 – 2015. Accordingly, also in 2016 Bank of Israel maintained a very low interest level in the monetary tender of only 0.10%.

  Following are data regarding the economic indicators, which marked the year 2016:

  - A moderated inflationary environment: in 2016, a reduction of 0.2% was recorded in the CPI, indicating continuation of the trend of moderation in the level of demand in the market.
  - A mixed trend in the development of exchange rate between the shekel and foreign currencies: reflected in fluctuations at the rate of up to 4.0%, recorded in the exchange rate of the shekel as against the central foreign currencies.
  - A decrease in the volume of debt raised by the Israeli Government by means of bond issues: in 2016, net redemptions of NIS 5.3 billion were recorded in government bonds, in contrast to a net amount of NIS 5.9 billion, raised by the Government from the public through bond issuance in the corresponding period last year.
  - A slight rise in the inflationary expectations of the public: these amounted to 0.5% at the end of 2016, in contrast to 0.1% at the beginning of the year.

  On background of the low level of the monetary tender interest rate year in 2016, as stated, price fluctuations were recorded in most investment channels in Israel. Following these developments, changes were recorded during 2016 in the composition of the asset portfolio of the public, as follows:

  - Reduction at the rate of 0.4% in the weight of mutual funds in the asset portfolio.
  - An increase of 1.3% in the weight of bank deposits in the asset portfolio.
  - Reduction of 1.1% in the weight of shares in the asset portfolio.

  The above data reflect stability in the savings channels of the public, accompanied by a slight preference for the more solid channels (bank deposits), on account of the marketable channels (mutual funds and shares).

- **Policy of the Bank**

As part of the preparation of the annual financing program, the Finance Division holds discussions, in participation with other relevant forums, regarding the implementation of Management's policy with respect to the liquidity risk management.

Discussions include evaluations of the liquidity cushion required to finance the annual work plan from the aspect of risk management, including: the expected growth in applications, and the effect of the pricing policy on the sources of finance and on the liquidity situation.

The Bank's resources raising policy is directed towards creating a long-term infrastructure for stable and profitable financing resources.

The principal source for financing the operations of the Bank is its customer population at the various branches nationwide, which include commercial and corporate customers, not-for-profit organizations, retail customers and households.

Within the framework of the efforts made for the establishment of an infrastructure for stable financing sources, for diversifying the mix of sources and for improving the liquidity structure of the Bank, marketing efforts were made in 2016 with the aim of enlarging the activity of the small and middle market customer base in bank deposit products in general, and in monthly payments to savings deposits in particular, an activity contributing to the long-term relations with the customer and to current amounts being deposited in savings deposits. Within the framework of these efforts, the Bank operates "private banking" centers serving the circle of customers having financial wealth.

Following are details regarding developments in the Bank's sources of finance in 2016, by the various segments:

Non-linked deposits – The volume of these deposits increased in 2016 by 11.6%, amounting at December 31, 2016 to NIS 22,101 million. This increase in deposits stems from developments in the retail activity of the Bank in 2016, conducted mostly in this linkage segment. In its policy of raising non-linked deposits, the Bank endeavors to expand the infrastructure of customers and increase the spread of the deposit portfolio, while maintaining a cost level similar to that accepted by the banking sector as a whole. In parallel, the Bank operates a "shekel transaction" room intended to service large deposits, and being flexible as regards benefits granted to such deposits.

CPI linked deposits – The volume of CPI linked deposits amounted at December 31, 2016, to NIS 2,500 million, a reduction of 12.4% in comparison with their balance at the end of the previous year. This reduction in CPI linked deposits stems, inter alia, from the low inflationary environment prevailing in 2016.

Most of the funds raised in this segment in 2016 resulted from one-time deposits for periods of two years, and from savings deposits by monthly standing orders.

Deposits in or linked to foreign currency– These deposits amounted at December 31, 2016, to NIS 2,598 million, a reduction of 4.9% in comparison with their balance at the end of the previous year. This reduction stems mostly from the low interest environment prevailing in this segment.

Subordinate debt notes

In accordance with the policy of the Bank for the diversification of its sources of finance and improvement of its capital adequacy ratio, the Bank raised funds in the past through issuance of subordinate debt notes. As of December 31, 2016, the outstanding balance of the subordinate debt notes of the Bank amounted to NIS 669 million (December 31, 2015 – NIS 672 million).

The debt notes have been allotted a grade of "AA" by Ma'alot – S&P (hereinafter – "the rating agency"), which is one grade lower than the grade allotted to the other liabilities of the Bank ("AA+"). The difference in the rating stems from the rating methodology of the international rating agency S&P (the parent company of Ma'alot – S&P), according to which subordinate debt notes are downgraded one grade lower than the grade allotted to the issuing entity.

The present rating of the subordinate debt notes ("AA") was last updated on December 20, 2016, being a one grade improvement over the rating granted to these debt notes last year ("AA-").

For additional details regarding new restrictions that apply to the issuance of subordinate debt notes, following the application of the Basle III rules– see Chapter 8B above.

Bonds – as part of the action taken by the Bank for the diversification of the mix of sources and increasing the weight of long-term sources, the Bank issued, through an investee company, non-linked marketable bonds in the amount of NIS 253 million. The bonds carry a fixed interest at the rate of 2.07% (0.79 percentage points higher than the interest rate at which government bonds were traded at date of issue), and are redeemable at the end of six years from date of issue.

- **Liquid assets**

Details of the Bank’s liquid assets are set out below:

- Approximately 10.4% of the Bank’s assets are comprised of cash and deposits with banks for periods of up to three months. Approximately 83.2% of the deposits are deposited with Bank of Israel (December 31, 2015 – 18.0% and 94.1%, respectively).

- Approximately 15.7% of the Bank’s assets are marketable securities (December 31, 2015 – 9.4%).

It will therefore be seen that approximately 26.0% of the Bank’s assets can be realized at short notice (December 31, 2015 – 27.4%). The high volume of liquid assets stems from the implementation of the policy designed to maintain high liquidity ratios at the Bank, on background of the uncertainty and economic recession prevailing all over the world derived from the continued economic and financial crisis prevailing in many countries.

(6) Conduct characteristics of financial assets and liabilities

As part of liquidity risk management, assessments are made regarding the conduct characteristics of financial assets and liabilities (principally with respect to possible deviations from the contractual due dates of these instruments). Assessments of these characteristics are base on internal models and on guidelines of Bank of Israel, as stated in Proper Management of Banking Business Directive No. 221, for the purpose of calculating the liquidity coverage ratio. The conduct aspects of assets and liabilities have been defined by Bank of Israel within the framework of the guidelines included in this Directive. The conduct characteristics of the financial assets and liabilities as determined in the internal models used by the Bank, are based on assessment of experts (including evaluations of business factors), on comparison with accepted parameters of the banking group to which the Bank belongs, and on rules determined by Bank of Israel.

(7) Disclosure regarding large depositors

Following are details regarding the volume of deposits made with the Bank by large depositors:

	December 31, 2016	December 31, 2015
Depositor groups	**NIS millions**	**NIS millions**
Group "A"	**972**	1,301
Group "B"	**960**	756
Group "C"	**675**	526
Total	**2,607**	2,583

(8) Additional information

Detailed information regarding the liquidity risk management by the Bank, including qualitative and quantitative aspects involved in such risk, is contained in the risk report published on the Internet website of the Bank, at the following address: https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

B. Financing risk

(1) Review of risk and the management thereof

The financing risk is defined as exposure of the Bank to impairment of the availability of financial resources, including impairment of the composition thereof (which may compel the Bank to rely on less stable resources).

In order to hedge against this risk, Management of the Bank acts towards the diversification of the of financing sources and the creation of an infrastructure for stable financial resources, among other, by expanding the deposit base in the retail customer segment, which are marked by high stability rates.

In addition, the Finance Division, in cooperation with other relevant forums, hold discussions regarding the financing program of the Bank, in which, the ability of the

Bank to provide appropriate financing resources for the expected growth in assets is being examined, including determination of the required scope of deposits by various distributions, such as: classes of depositors, period of deposits and their linkage segments.

(2) Compliance with the business plan

Within the framework of the financing risk management, and with the aim of maintaining a proper structure of resources, including the diversification of resources and attaining as wide as possible distribution of depositors, by means of the effort made to reduce the proportionate weight of wholesale deposits, the Bank has determined quantitative targets in this respect, including the ratio of retail deposits to be raised to total deposits.

Deviation from these targets may lead to an increase in the weight of wholesale deposits, resulting in a reduction in the liquidity indices of the Bank, computed on the basis of the internal liquidity model.

(3) Restrictions in 2016

No restrictions have been determined by the Bank in the matter of the raising of financial resources, except for the indirect restrictions determined by Bank of Israel within the framework of the instruction regarding the liquidity coverage ratio, which applies a low weight to the recycling of non-retail deposits.

(4) Quantitative indices

Below is presented the distribution of deposits with the Bank as of December 31, 2016, by size of deposit, and the change in composition of these deposits in comparison with the corresponding period last year:

Deposit level (in NIS thousands)		**31.12.2016**		**31.12.2015**		
From	**To**	**NIS millions**	**%**	**NIS millions**	**%**	
-	1	**11,421**	**42.0**	10,866	42.8	(0.8)
1	10	**6,609**	**24.3**	6,247	24.6	(0.3)
Over 10		**9,169**	**33.7**	8,275	32.6	1.1
Total		**27,199**	**100.0**	25,388	100.0	7.1

(5) Credit facilities at the disposal of the Bank and their terms

The Bank is entitled to utilize credit facilities provided by Bank of Israel for the banking sector. These bear annual interest at the rate of 0.2% (according to the rates prevailing at the end of 2016), subject to providing collateral of a scope defined by Bank of Israel.

The potential scope of credit, which the Bank may utilize within the framework of the above rules, amounted at December 31, 2016, to NIS 2.7 billion (December 31, 2015 – NIS 4.9 billion). The scope of this credit stems from the balance of deposits made by the Bank with Bank of Israel as part of the monetary tenders, as well as from the credit balances on current accounts of the Bank with Bank of Israel and from the volume of bonds deposited by the Bank with Bank of Israel.

The Bank has no credit facilities with other financial bodies.

(6) Additional information

Detailed information regarding the financing risk management by the Bank, including qualitative and quantitative aspects involved in such risk, is contained in the risk report as of December 31, 2016, published on the Internet website of the Bank, at the following address: https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

15. Operating risk

A. Review of the risk and the management thereof

The operating risk management concept is based on risk management principles detailed in Proper management of Banking Business Directive No. 310 and on globally accepted risk management principles, within the framework of which, the different units of the Bank accepting risk , take full responsibility for the risk management process and for the implementation of a proper control environment over their operations. This concept is compatible with the risk management governance concept detailed in Proper Management of Banking Business Directives No. 350 and 355.

The risk management framework is based on a designated policy document approved by the Board of Directors, on internal work procedures and on work processes and systems. In this respect, the risk appetite, the internal exposure restrictions, the manner of risk management, the responsibility and authority of the functions involved in risk management, methodologies and tools for the identification, measurement assessment and monitoring of risk, control and reporting mechanisms have been defined. The risk management framework is compatible with directives of Bank of Israel, and is based on the risk management framework of the parent company, subject to adjustments stemming from the type of operation of the Bank. The operating risk management governance is based on three defense lines.

B. Quantitative indices

The Bank's risk appetite statement defines quantitative and qualitative restrictions in relation to the operating risk management. These internal restrictions, such as: restriction on the amount of operating risk at a high and very high residual risk level, which does not exceed the risk appetite level approved by the Board of Directors and the restrictions regarding risk having a high damage potential, are measured and monitored once in every period by the Risk Management Division.

The Bank computes its exposure to operating risks according to the "standard approach", determined in Proper Conduct of Banking Business Directive No. 206, which is based on the division of the operation of the Bank to the business lines defined in the Directive, and the calculation of the capital required for each of these business lines. In accordance with these guidelines, the Bank's exposure to operating risk stems from the said capital requirements and from the minimum capital ratios determined by Bank of Israel.

Following are data regarding the capital requirements and exposure of the Bank to operating risks as of December 31, 2016, as compared with the corresponding data last year:

	December 31,		
	2016	2015	Change
	NIS millions		
Capital requirement	**244**	235	9
Exposure to operating risk	**1,930**	1,871	59

No material change was recorded in 2016 in the scope of operating exposure. Accordingly, no material change was in the capital requirement stemming from such exposure.

C. Additional information

Detailed information regarding the operating risk management by the Bank, including qualitative and quantitative aspects involved in such risk, is contained in the risk report as of December 31, 2016, published on the Internet website of the Bank, at the following address: https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

16. Other risks

A. Data protection and cyber risks

The activities of banking corporations rely on advances technological infrastructures and on technological innovations, including "open" computer infrastructure and the outsourcing of computer services, which allow the offer of timely banking services "at any time and at any place". These advanced infrastructures expose banking corporations to data protection risks and to cyber risks, the realization of which might disrupt their regular operations and lead to damage to their reputation, to reduction in public confidence, and even cause in extreme cases, impairment of their stability.

The Bank is adopting measures for reducing data protection risks and cybernetic incidents (both as regards the internal networks and the Internet), which include a variety of means and processes, as follows:

- Integration of control systems and management of detaching means connected to work stations.
- Integration of a system used for the secured and multi-layered transfer of files from outside networks to the internal network, which matches the standards determined by Bank of Israel in the matter of "hostile codes".
- Integration of protection tools for data bases.
- Integration of user identification mechanisms.
- Stricter communication criteria in respect of "outside approach" systems.
- Improving separation means between different groups of users.
- Integration of improved protection of communication with Bank branches.

- Integration of advanced technological infrastructure having high resistance to cybernetic incidents.
- Integration of "IPS" mechanisms for the reduction of exposure to assaults on communication lines.
- Integration of protection means against hostile factors in end units.
- Introduction of exercises simulating cyber attacks, both as regards business continuity and as regards the monitoring of the conduct of the staff and compliance with Bank procedures.
- Increasing awareness to this subject among the clerical staff and managers through lectures and training sessions as well as exercises at the branches and at head office unites.

In view of the high standards of operations applied by the Bank and its parent company and the protection measures employed by them in this field, as stated above, no significant data protection events or cybernetics incidents occurred in 2016, causing financial or other damage.

B. Legal risks

Legal risk is defined as exposure on the part of the Bank to loss, inter alia, as a result of the Bank’s inability to legally enforce agreements, or due to legal actions taken against the Bank, as well as exposure to fines or other punitive actions taken against the Bank in respect of regulatory actions or specific arrangements.

As part of its procedures for managing its exposure to legal risk, the Bank has prepared a policy document entitled ‘Management of Legal Risks,’ which defines the various legal risks, methods monitoring such risks and the steps that may be taken to minimize the risks involved. This document was approved by the Board of Directors. Current updating in this respect is regularly brought to the attention of the risk management committee of the Board and to the Board of Directors itself, within the framework of the presentation of the “risk document”.

C. Compliance risk

Compliance and regulation risks are defined as exposure of the Bank to fines and sanctions imposed by compliance authorities and damage to the reputation of the Bank due to failure to comply or the non-fulfillment of the provisions of the law (including directives issued by the Supervisor of Banks).

In order to regularize appropriate standards for the management of this risk by banking corporations, Bank of Israel published on June 3, 2015, an amendment to Proper Management of Banking Business Directive No. 308 in the matter of "compliance with the compliance function of a banking corporation". In addition, banking corporations are required to form a policy in writing in the matter of "Compliance policy", to be approved by the Board of Directors.

The Bank had formed a policy document in the matter, which was approved by the Board of Directors on December 28, 2015.

Within the framework of the management of exposure to compliance risk (in the matter of the Acts prohibiting money laundering and the finance of terror), the Bank and the parent company had taken a decision in the past to terminate the rendering of financial services to banks operating within the areas governed by the Palestinian Authority. This decision was implemented in respect of banks operating in the Gaza Strip, but was withheld in part, at the request of the State, with respect to certain services rendered to foreign banks operating in the Judea and Samaria areas (hereinafter – "the Palestinian banks").

On May 1, 2016, the parent company applied to the Supervisor of Banks and to the Director General of the Ministry of Finance, requesting permission to terminate completely the services rendered by member banks of the Discount Group to the Palestinian banks, or alternatively, provide appropriate response to the risk involved in the rendering of such services. In view of the risks involved in the said operation, the Board of Directors of the Bank joined on June 28, 2016, the position of the parent company.

Following this action, the Bank informed the Palestinian Banks on January 17, 2017, of the termination of cash services rendered to these banks, with effect as from April 20, 2017.

It is noted that in recent years many countries passed a series of laws intended to locate funds of their citizens held outside their borders (inter alia, in order to evade taxes imposed on them in these countries). These legislation measures include, inter alia, a tax law initiated by the US Government ("FATCA") and standards for the automatic exchange of information regarding tax matters published by the OECD.

In order to regularize banking activity in the matter, Bank of Israel published on March 16, 2015, a letter in the matter of "the management of risk stemming from cross-border operations", in which banking corporations are required, inter alia, to classify customers and countries marked by a high potential for the realization of cross-border risks, and obtain from their customers declarations regarding the tax returns submitted by them, as well as waiver letters allowing the banks to deliver relevant information to foreign tax authorities, if and when required to do so.

Furthermore, following the amendment of the Prohibition of Money Laundering Act (Amendment No. 14), 2016, (hereinafter – "the Act"), within the framework of which, serious tax offences had been defined as "offences of origin" within their meaning in the Act, Bank of Israel published on November 24, 2016, a letter containing guidelines designed to assist banking corporations in their preparations for the implementation of the provisions of the Act (see also Chapter 10I (3) to the corporate governance report. The Bank implements the guidelines published by Bank of Israel as from their effective date.

17. Assessment of the Bank's exposure to risk factors

The Table below summarizes the various risk factors to which the Bank is exposed during the course of its ordinary operations and the extent to which each of the risk components may affect the Bank:

Risk Factor	Effect of Risk
1. Total effect of credit risks	Medium
• Risk in relation to the quality of borrowers and collateral (1)	Medium
• Risk in relation to industry concentration (2)	Medium
• Risk in relation to concentration of borrowers / groups of borrowers (3)	Low to medium
2. Total effect of market risks	Low to medium
• Interest risk (4)	Low to medium
• Inflation risk (5)	Low
• Exchange rate risk (6)	Low

- Share price risk [7] Low

3.	**Liquidity risk** [8]	Medium
4.	**Operating risk** [9]	Medium
5.	**Data protection and cyber risks**[10]	Medium to high
6.	**Legal risk** [11]	Low to medium
7.	**Reputation risk** [12]	Low to medium
8.	**Compliance risk**[13]	Medium

The reasoning behind the above risk evaluations are set out below:

(1) **Risk in relation to the quality of borrowers and collateral**

The average rating accorded to the Bank's borrowers, ranges from "reasonable to good". Furthermore, Management believes that the Bank's policy as regards seeking collateral from borrowers and the quality of this collateral are not materially different from the accepted practice in the banking sector as a whole. It should be noted that in 2016 the rate of the provisions for credit losses amounted to 0.16% of the outstanding credit balance, being a decrease of 0.17% in comparison with the rate of the provisions recorded last year (0.33%). The reduction in the rate of expense for credit losses stems, inter alia, from the reduction in the credit loss expense on a collective basis (explained mostly by the reduction in the amount of troubled debts), and by the increase in collection of debts that had been written-off in the past.

Notwithstanding the above, in view of the growth recorded in recent years in the volume of the credit portfolio of the Bank, and in view of the assessments of Bank of Israel regarding the growth in risk level of certain economic segments of the credit portfolio of the banking sector as a whole (such as: private individuals and real estate), Management considers the level of exposure of the Bank in respect of this component as "medium".

(2) **Risk in relation to industry concentration**

The highest proportion of the Bank's lending, by industry sector, relates to borrowers in the construction industry. As of December 31, 2016, the rate of lending to borrowers in this sector, in comparison with the Bank's overall lending, was approximately 22.7% (December 31, 2015 –21.5%).
On the other hand, the ratio of credit granted to private individuals to the Bank's overall lending (32.1%) was lower than the accepted ratios in the banking sector.

In addition, according to accepted indices for the management of industry concentration ("Harfindel Index"), the "industry concentration" item of the Bank, according to this index, exceeds the average item at the five large banking groups in Israel. In view of the above, Management of the Bank considers the exposure in respect of this risk component as "medium".

(3) **Risk in relation to concentration of borrowers/groups of borrowers**

Bank of Israel directives have determined limits with respect to the total lending that a bank may extend to a "single borrower", a "group of borrowers" and the "total indebtedness of large borrowers" (as those terms are defined in Bank of Israel directives).

As of December 31, 2016, the total lending provided by the Bank to borrowers and groups of borrowers in relation to the capital resources of the Bank, is as follows:

- to the largest borrower – approximately 5.1%, which is 66.0% below the limit determined by Bank of Israel.

- to the largest group of borrowers – approximately 11.5%, which is 54.0% below the limit determined by Bank of Israel.

- total indebtedness of the largest borrowers – 11.5%, approximately 90.4% below the limit determined by Bank of Israel – 120% of the capital of the Bank.

In addition, the Bank has determined further limits designed to reduce concentration of credit, including a limitation on the number of large borrowers at the Bank. In view of the relatively large gap between the rates of concentration existing at the Bank in relation to the restrictions set by Bank of Israel (and the improvement trend recorded in respect of this data in recent years) – and whereas alternative measurement of credit distribution at the Bank (the Jeenie Index) also indicates a relatively low level of concentration of credit at the Bank (which is even improving in recent years), Management decided in the reported period to reduce the evaluation as to the Bank's exposure with respect to this risk component from "medium" to "low to medium".

(4) **Interest risk**

In the view of Management, the relevant restrictions set by the Board of Directors (as detailed above) are conservative and the Bank's exposure in practice is lower than that set by these limits. As part of the computation of exposure to this risk, the long-term liabilities in respect of the payment of employee rights are also taken into consideration, based on their fair value stemming from prevailing interest rates (as required by the implementation of US accepted accounting principles in this respect).
In view of the volume of the components exposed to changes in interest rates, Management of the Bank's estimates that the Bank's exposure with respect to this risk component is at a level of "low to medium".

(5) **Inflation risk**

The restrictions placed by the Board of Directors on the investment of the active economic capital in the linked segment (as described above) leaves Management with considerable freedom of action. Nevertheless, in light of the relative stability recorded in the inflationary environment of the domestic economy (including expectations for the continuation of this trend), and whereas the Bank follows closely the changes in macro-economic forecasts and reacts dynamically to changes in those forecasts, Management considers the Bank's exposure with respect to this risk component as "low".

(6) **Exchange rate risk**

In the view of Management, the relevant restrictions set by the Board of Directors (as detailed above) are conservative. In practice, the exposure of the Bank's active economic capital in relation to the foreign currency segment is significantly lower than that reflected by the determined restrictions, and accordingly, Management considers the Bank's exposure with respect to this risk component as "low".

(7) **Share price risk**

In light of the Bank's low rate of investment in this medium, Management generally considers the Bank's exposure with respect to this risk component as "low".

(8) **Liquidity risk**

The Bank applies a policy intended to maintain a high level of liquid assets. In addition, the Bank focuses on increasing the distribution and improving the mix of deposits and makes use of various models and abides by specific restrictions in relation to its management of liquidity risk (as described above). These actions of the Bank are expressed in a relatively high level (142.1%) of the average liquidity coverage ratio for the fourth quarter of 2016, as defined in Proper Conduct of Banking Business Directive No. 221 (as of September 30, 2016, the average liquidity coverage ratio of the whole banking sector amounted to 123%). Notwithstanding the above, whereas other indices used to measure the level of liquidity of the Bank recorded a reduction in 2016 (such as: the liquid assets ratio to total assets which declined in 2016 by 1.4% to a level of 26.0%), and whereas the rate of increase in credit to the public in 2016, was higher than the rate of growth in deposits from the public, Management decided in 2016 to raise the assessment of exposure of the Bank with respect to this risk component from "low to medium" to a level of " medium".

(9) **Operating risk**

In recent years, the Bank began to introduce several central operating processes, including: the shifting of operational activities from the branches to a designated back-office operational unit, and the unification of work processes at the branches through changes in work format.

Following the progress made in 2016 in the implementation of these processes, during which no material losses have been recorded, Management of the Bank decided to reduce the risk assessment in respect of this risk component to a level of the "medium".

(10) **Data protection and cyber risks**

The risk is defined as exposure of the Bank to damage to its business operations and to other damage being the result of cyber attacks on its computer systems. The information systems serving the Bank are based on the central computer system of the parent company, which operates and maintains them.

The parent company allocated resources to combat these risks and is improving the quality of the risk management, including the implementation of regulatory requirements, determination of policy and procedures and enforcement of tools for the monitoring and control of the risk.

In addition, the Bank invests resources in conducting exercises, which simulate cyber attacks and in increasing awareness to this matter among employees and managers, by means of training sessions and lectures, as well as exercises at the branches and at head office units.

Notwithstanding the above, following increasing cyber attack threats and the growth recorded in their power and probability, Management considers the level of exposure of the Bank to this risk component as "medium to high".

(11) **Legal risk**

As stated above, legal risk is defined as "exposure on the part of the Bank to damage to its business operations or to its financial position that may be incurred as a result of the Bank's inability to enforce agreements, or the realization of legal actions against the Bank or misguided judgment on the part of the Bank". Exposure to this risk includes also exposure to fines or penalties stemming from regulatory activities or specific arrangements.

The Bank is preparing to monitor and control such risks, and as of now, no significant losses of this nature had been recorded. However, in view of the increase in legislation applying to banking corporations, including many restrictions and duties imposed in this respect on the banking sector and the growing enforcement measures in the legal field in Israel and abroad, Management of the Bank decided in 2016, to raise the rate of exposure of the Bank with respect to this risk component from the level of "low" to a level of "low to medium".

(12) **Reputation risk**

This risk is defined as "exposure of the Bank to loss stemming from damage to its image in the eyes of its customers, investors, analysts and other relevant entities, which may adversely affect the ability of the Bank to develop or maintain business relations in a manner that may impair its ability to raise financing sources". A rise is noticed in recent years, in consumer awareness by the public as regards the services provided by the banking sector and their cost, and also in the publications appearing in the media in this respect with growing frequency. However, In view of the improvement experienced in the quality of management of this risk, including the increase in resources and in the executive attention awarded to this subject, Management of the Bank decided to lower the rate of the Bank's exposure with respect to this risk component from the level of "medium" to a level of "low to medium".

(13) Compliance risk

This risk is defined as exposure of the Bank to fines and sanctions imposed by enforcement authorities, and to damage to the reputation of the Bank due to non-fulfillment of failure to comply to legislative instructions (including instructions published by the Supervisor of Banks). The Bank monitors exposure to this risk by the establishment of a proper infrastructure (from the organizational and work procedures aspects), including:

- Appointment of a designated and independent compliance function.
- Adoption of a compliance policy implementing the rules determined by Bank of Israel in this respect.
- Adoption of an internal enforcement program in the matter of consultation provided to customers as regards the capital market, based on criteria determined by the Israel Securities Authority.

Notwithstanding the above, the scope of regulatory requirements has grown in recent years, both in Israel and abroad, and a trend is noticed for the intensification of these requirements, inter alia, by legislation for the automatic exchange of information between countries, and the definition of tax offences as "offence of origin" with respect to money laundering laws, followed by expansion of enforcement measures by the authorities in Israel and abroad (including cross-border legislation). In view of the above, Management considers the exposure level of the Bank to this risk component as "medium".

Detailed information regarding additional risk factors and the manner of management thereof is contained in the risk report published on the Internet website of the Bank, at the following address: https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

Remark:

As part of the process of risk evaluation and its implications, the Bank uses, among other things, models with respect to risk exposure that may be quantitatively assessed. Notwithstanding this, as to a part of the types of risk, it is required to make assumptions regarding the volume of a future event and with respect to the probability that such an event would in fact happen. The evaluations of risk and its implications, as portrayed in the above Table, are subjective assessments of Management. In light of the above comments, care must be taken with respect to the review of risk factors and their implications, and with comparisons of such factors with those of other banks.

Part "D" Accounting policy on critical matters and controls

18. Accounting policy on critical matters

The Bank's financial statements are prepared in accordance with accounting rules and principles, the most significant of which are set out in Note 1 to the financial statements.

The application of these accounting rules by Management during the course of preparation of the financial statements may require the adoption of various assumptions, evaluations and estimates that may affect the reported amounts of assets and liabilities (including contingent liabilities) and the Bank's reported financial results. It is likely that the actual financial outcome of the events evaluated or estimated may differ from the original amounts that were used in the preparation of the financial statements.

Some of the estimates and evaluations used may be closely linked to uncertainty or insensitivity with regard to changing variables. Estimates and evaluations of this type, the variability of which may significantly affect the financial results as presented in the financial statements are considered to be estimates and evaluations on critical matters.

Management believes that the estimates and evaluations used in the preparation of the financial statements are proper estimates and evaluations, and that these were made in accordance with its best judgement and professional discretion.

Further to that stated above, a brief review of accounting evaluations and estimates on critical matters is set out in Chapter 19, below.

19. Critical accounting assessments

A. Provisions for credit losses

(1) Provisions for credit losses on a specific basis

Once every quarter, Management reviews on a specific basis most the credit portfolio of the Bank, which includes all indebtedness the balance of which exceeds NIS 0.5 million (until December 31, 2015 – NIS 50 thousand) with a view to evaluating possible latent losses. The process of evaluating possible latent losses is carried out in two stages:

- Identification of those customers whose credit-ratings have deteriorated in the wake of their inability to meet their obligations towards the Bank or due to other business characteristics, and the classification of their debts as a result thereof as troubled debts. This classification is made in accordance with categories laid down by directives of Bank of Israel (under criteria set out in the directives). Debts may be classified as impaired debts, substandard debts or debts under special supervision.

- Evaluation of provisions for credit losses on a specific basis in respect of borrowers classified as impaired debts (defined as borrowers who in the opinion of the Bank would be unable to honour their obligations towards the Bank in accordance with the contractual terms of the loan). In determining the extent of a provision for credit losses on a specific basis, Management relies upon the information in its possession regarding the debtor, such as the collateral provided by the borrower to secure the loan, other receipts expected from the borrower, and the dates for the realization of the collateral or for the other receipts.

For additional information regarding the change in the accounting policy of the Bank in the matter of "the minimum amount of debts measured on a specific basis as from January 1, 2016 – see Section G(2) below.

As of December 31, 2016, the total net balance of impaired debts examined on a specific basis included in the credit portfolio of the Bank amounted to approximately NIS 245 million, net, this amount representing approximately 2.1% of total outstanding borrowings examined on a specific basis as of that date (December 31, 2015: NIS 260 million and 1.6%, respectively). The provision for credit losses created in respect of these debts as of the date of the balance sheet amounted to approximately NIS 77 million. Of this sum, approximately NIS 92 million was recognized as income in 2016 in respect of the net collection of provisions (2015 – NIS 72 million and NIS 85 million, respectively).

The process of evaluating the provision for credit losses in respect of credit examined on a specific basis, as described above, is based on significant estimates which are largely uncertain (such as the fair value of collateral and the repayment ability of the debtor, etc.), and on subjective evaluations, both with respect to the categorization of the troubled debt (e.g., whether the debt is a debt under special supervision or is a substandard debt) and with respect to the factors considered in determining the extent of the provision (e.g., dates of realization of the collateral and expectations for other receipts). The assessments used in this process are partly based on economic parameters or on market variables, and partly on estimates relying on past experience (but subject to current revisions, where required).

Accordingly, changes in the estimates and evaluations described above may have a significant effect on the provision for credit losses reflected in the Bank's financial statements.

In view of the above, the assessments and estimates used in the determination of the provisions for credit losses in respect of impaired debts, are being reviewed by Management once every three months; in order to validate or update such assumptions and estimates, as the case may be.

(2) Provision for credit losses on a collective basis

In addition to the specific provision for credit losses, as discussed above, banking corporations are required, under the provisions of Bank of Israel instructions, to include in their financial statements an additional provision for credit losses computed on a collective basis.

These provisions for credit losses on a collective basis are computed in respect of losses inherent in the credit portfolio of a bank, in respect of which no specific provisions for credit losses have been included, and comprise an assessment of anticipated credit losses in respect of these credits (both performing and troubled).

Assessment of the said provisions is based on rules determined in the public reporting instructions regarding "provision for credit losses on a collective basis" (hereinafter – "the instruction) published by Bank of Israel on January 19, 2015.

The instruction applies to all credit instruments of a bank (excluding debts classified as "impaired" and housing loans the provision for credit losses in their respect is based on the extent of arrears).

In accordance with the guidelines of the instruction, the provision for credit losses on a collective basis is computed in respect of these debts as a multiplication of the stated balances of credit to which the instruction applies (classified by economic sectors) by a "provision for credit loss coefficient" (as explained below) for each of the economic sectors, as stated, while differentiating between "troubled credit" and "other credit" (performing debts).

In accordance with the said instruction, the provision for credit loss coefficient comprises a combination of the two following components:

- **"Decision coefficient"** – derived from historical write-offs data recorded during a period of five calendar years (hereinafter - the "provision range") and represents the best assessment of losses inherent in the credit portfolio in each of the economic sectors, based on past experience (for additional information regarding the change in guidelines of Bank of Israel in he matter of the provision range – see Section G(1) below).
- **"Adjustment coefficient"** – comprises an additional component in respect of environmental factors not included in the decision coefficient, such as: economic developments in the sector, developments regarding troubled debts in the sector, etc.

The balance of the provisions for credit losses on a collective basis as of December 31, 2016, amounts to NIS 288 million, comprising 1.03% of the stated balance of total risk of credit to the public of the Bank (December 31, 2015 – NIS 282 million and 10.9%, respectively).

The process of computing the provisions for credit losses on a collective basis, in respect of each of the above two components involve subjective assessment and estimates as follows:

- Determination of the "decision coefficient" – based on subjective evaluations regarding the correlation between the average historical loss rates and the unidentified credit losses inherent in the credit portfolio of the Bank (for performing credit and for troubled credit).
- The process for determining the "adjustment coefficient" – performed by means of a structured model that includes data and parameters relating to both specific characteristics of the Bank and sector and market characteristics, in accordance with rules detailed in the public reporting instructions of Bank of Israel.

  The computation made by use of this model comprises an assessment of the additions to the provisions for credit losses in respect of environmental factors and macro-economic factors.
  The model makes use of significant assessments involving a considerable degree of uncertainty (including evaluation as to expected economic development and their implications on the quality of the credit portfolio of the Bank), and relies on subjective estimates (including estimates as to the quality of the credit portfolio, the quality of management of this portfolio, and the relative weight determined in the methodology to characteristics found at the base of the model).

In view of the above, the process for determining the provision for credit losses on a collective basis is sensitive to possible changes in assessments or to subjective evaluations, as described above, in a way that possible changes in these factors may materially affect the amount of the provision for credit losses on a collective basis stated in the financial statements.

B. Contingent liabilities

Legal claims remain pending against the Bank on various matters, including the unlawful charging of interest or otherwise not in accordance with the agreement between the Bank and the customer, subjecting the availability of a particular service to the purchase of another service, the unlawful charging of commissions and the debiting of accounts, a failure to implement instructions and the exercise of discretion in a misguided manner.

In evaluating the potential losses that may arise as a result of these claims, Management relies on the opinion of its legal advisors who represent the Bank in Court, and, in addition, classifies the claims by reference to the following three groups:

- Claims with respect to which a loss is anticipated. For these claims, a provision based on the facts of the matter as known to the Bank is made in the financial statements;

- Claims with respect to which a loss is unlikely. For these claims, no loss provision is made in the financial statements, although disclosure of the matter is made where the amount of the claim is very significant;

- Claims that may succeed. For these claims, no loss provision is made in the financial statements, although disclosure is made of the total amount of the Bank’s exposure as a result thereof. According to directives of Bank of Israel, disclosure must be made of claims in this category when the amount of the claim is significant.

As stated, in assigning a claim to one of the above categories, and in the making of a loss provision where required, Management relies on the opinion of relevant legal advisors.

These legal opinions are subjective and certain of which relate to cases, such as motions for approval of an action as a class action, where the background information and experience available at the time of the opinion are insufficient.

Accordingly, the actual outcome of a claim may well differ from the outcome postulated in the original legal opinion. In light of the extent of the claims remaining pending against the Bank, it is probable that the success of claims, notwithstanding the original opinions of the Bank's legal advisors that success was unlikely, may well have a significant effect on the Bank's financial results.

Management and the Bank's legal advisors review the claims every three months with reference to developments that had taken place in the proceedings being conducted in these cases, and accordingly revise the provisions, where necessary.

C. Rights of employees

(1) General

In accordance with instructions issued by Bank of Israel, banking corporations are required to compute the provisions for employee rights, respecting their liabilities for the payment of various rights to their employees in accordance with US accounting principles (see Note 1P to the financial statements).

Computation of the provisions for employee rights in accordance with these accounting principles involves the use of parameters and assessments based in part on past experience (such as: the cost of money relevant to the Bank) and in part on future forecasts (such as: expected rates of return on the different capital markets). Accordingly, the provisions for employee rights deriving from the new measurement rules are sensitive to changes in the parameters and forecasts on which they are based, in a way that possible changes in these factors may materially affect the amount of the liability for employee rights stated in the financial statements of the Bank.

Following are data regarding the financial implications stemming from possible changes in the capitalization rate (a reduction of 1 percentage point) on the provisions of the Bank for employee rights:

	Increase in liabilities	
	31.12.2016	**31.12.2015**
Type of benefit	**NIS millions**	
Liability for payment of severance compensation	**64**	62
Liability for payment of jubilee awards	**-**	6
Liability for payment of post-retirement benefits	**9**	9

(2) Liability for the payment of severance compensation

The provisions for the Bank's liability for severance compensation to its employees are made on an actuarial basis, which includes assessments as to the number of employees expected to retire at a date earlier than that stated in the employment agreements (for whatever reason), and as regards additional benefits expected to be granted to these employees. The computation of the provisions for the Bank's liability for severance compensation on an actuarial basis, as stated, are based on past experience and on statistical parameters and forecasts as regards the future, such as: the expected life expectancy, the rates of early retirement, the age of employees at date of early retirement, the average rates of future increases in real-term salaries, and more. Accordingly, the provision for the liability of the Bank stemming from such actuarial estimates, is sensitive to changes in the parameters and forecasts on which it is based, in a way that possible changes in these factors may materially affect the amount of the liability stated in the financial statements of the Bank.

The following assumptions are included in the basis of the actuarial computation:

- The future rates of employee retirement are based on the average retirement rates observed in the years 2011-2016(see extended discussion of this item in Section G(5) below).
- The amounts of the additional potential benefits payable in the future to Bank employees are based on the amounts that had been paid by the Bank in the past, and on estimates by Management (see extended discussion of this item in Section G(5) below).
- The amounts of the additional benefits payable in the future have been discounted to present value using an annual interest rate of 1.6% per annum, stemming from the adoption of the US accepted accounting principles and guidelines of Bank of Israel.
- The rate of increase in the average real-term payroll anticipated in the future, amounts to 2.5% per year.

The financial statements as of December 31, 2016, include provisions in respect of the liability of the Bank for severance compensation to its employees, computed on an actuarial basis, in accordance with rules prescribed by Bank of Israel. The outstanding balance of these provisions as of December 31, 2016 amounts to NIS 573 million (December 31, 2015 – NIS 537 million).

The following data presents the financial implications of possible changes in parameters and assumptions standing at the base of the actuarial computation, on the Bank's liability for payment of severance compensation as of balance sheet date:

	Increase in liabilities	
	31.12.2016	**31.12.2015**
Sensitivity test	**NIS millions**	
• Increase of 1% in rate of employee retirement	**31**	21
• Increase of 10% in rate of severance compensation	**9**	22
• Increase of 0.5% in the annual real-term payroll	**32**	32

(3) Long service ("Jubilee") awards and post-retirement benefits

Until December 31, 2015, employees of the Bank, were entitled to "Jubilee awards" comprising several monthly salary amounts and paid vacation days, after completing twenty, thirty and forty years of service with the Bank, based on labour agreements prevailing at the Bank in that period.

On December 28, 2016, the Bank signed an agreement with the Federation of Labour and the employees' representative committee, according to which, the parties agreed to remove the above mentioned liability, in consideration for a one-off payment to the employees, based on the actuarial provisions as of September 30, 2016, discounted to their present value at an annual interest rate of 3.5% (and not at the interest rate prevailing on September 30, 2016). The resulting gain to the Bank from the removal of this liability, amounted to NIS 19 million, and was recognized in profit and loss in the item "Payroll and related expenses" in the reported period.

The above agreement and the payment to employees, as stated, settle in full the Bank's liability in this respect, and accordingly, as from December 31, 2016, the Bank no longer carries on its books a liability for the payment of "Jubilee awards".

Employees of the Bank are also entitled to certain post-retirement benefits (employees of the Bank and a part of its retirees agreed in 2015 to forgo their entitlement to receive a daily newspaper after retirement in consideration for a one-off payment made to them in 2015).

In accordance with accepted accounting principles, the Bank has to include a provision covering its liability in respect of the said rights. Notwithstanding this, the provision is subject to uncertainties due to the fact that the realization of the said rights is conditional upon existence of certain basic conditions in the future, the actual realization of which is uncertain.

Accordingly, assessment of the provision in respect of such expected liability involves probability tests as to the possible intensity of certain parameters used in the computation, including:

- The number of employees who will retire from the Bank on their specified retirement date , and not at an earlier date;
- The number of employees who will enjoy the benefits granted to Bank retirees in the period based upon the average life expectancy.

In view of the uncertainty involved in the preparation of the accounting provision in respect of the said liabilities of the Bank, Bank of Israel instructed the banks to prepare the accounting provisions in respect of such future liabilities, on an actuarial basis, taking into consideration the probability of their realization, and to present them in the financial statements at their present value at date of preparation of the provisions.

The financial statements of the Bank as of December 31, 2016, include provisions in respect of the said liabilities made in accordance with the rules determined by Bank of Israel, which are based on US accepted accounting principles initially (see Note 1P to the financial statements). The balance of the provision in respect of these liabilities as of December 31, 2016, amounts to NIS 47 million (December 31, 2015 – NIS 44* million).

* The provisions as of December 31, 2015, included in addition the liability for the payment of "Jubilee awards" in the amount of NIS 78 million

The provisions had been prepared on the basis of actuarial computations prepared by an expert actuary and based upon various criteria and parameters, including:

- The average retirement rate of employees at different seniority levels.
- Anticipated life expectancy
- Retirement age
- Discounting the anticipated future cash flows at rates of between 1.6% and 2.2% p.a., (December 31, 2015 – 1.8%-2.5%).

The probability of the rights materializing, derived from the said actuarial evaluation, is based on parameters and statistical tools, which are in turn based on past experience and forecasts regarding the future. Accordingly, the provision for the liability of the Bank derived from the said actuarial evaluation is sensitive to possible changes in parameters or forecasts standing at its base, so that a possible change in these factors may materially affect the amount of the liability reflected in the financial statements of the Bank.

The following data presents the implications of possible changes in parameters and assumptions standing at the base of the actuarial computation, on the Bank's liability for payment of post-retirement benefits as of balance sheet date:

	Increase in liabilities	
	31.12.2016	**31.12.2015**
Sensitivity test	**NIS millions**	
• Reduction of 1% in rate of employee retirement	**1**	1
• Decrease of 1% in the in the discounting rate	**9**	9

D. Presentation of financial instruments according to fair value

In accordance with Bank of Israel instructions, certain financial instruments (principally, investments in securities in the "available-for-sale" and in the "trading" portfolios), as well as derivative instruments, are measured according to fair value.

Bank of Israel instructions define fair value as the "price that would have been received from the sale of an asset or the price that would have been paid on the transfer of a liability", and differentiates between two types of data that might serve in the determination of fair value, as follows:

- **"Observable data"** – data reflecting the assumptions that other market participants use in pricing an asset or liability, and based on market quotations obtained from independent sources.
- **"unobservable data"** – data reflecting the assessments of the banking corporation as regards assumptions of other participants in the market – based on the best available information in the hands of the banking corporation.

According to these instructions, banks were required to prepare a qualitative scale for all assets and liabilities measured according to fair value, on the basis of the differentiation between the data used in determining fair value ("observable data" and "unobservable data"), as follows:

(a) **High quality group (Level 1)** – to which belong assets or liabilities the determination of their fair value is based on quoted prices on active markets for identical assets or liabilities.

(b) **Medium quality group (Level 2)** – to which belong assets or liabilities the determination of their fair value is based upon direct or indirect observable data (but which are not prices quoted on active markets), including prices quoted on an active market for similar assets or liabilities.

(c) **Low quality group (Level 3)** – to which belong assets and liabilities the determination of their fair value is based on unobservable data (where relevant observable data is not available).

The criteria, on the basis of which the Bank classified assets and liabilities into the various quality levels, as stated above, included:

- The high quality group (Level 1) includes financial instruments and derivative financial instruments, traded on an active market (characterized by a large number of participants and high trading volumes), the market quotations thereof reflect actual market prices.
- The medium quality group (Level 2) includes financial instruments and derivative financial instruments, that are not traded on an active market and determination of their fair value is based upon active market quotations for similar instruments, or on quotations obtained from independent sources (hereinafter – instruments the fair value of which is determined by "pricing services").

  The financial instruments (including derivatives), the fair value of which is determined by pricing services, include:

  - Nonmarketable securities;
  - Derivative instruments traded over the counter (OTC) in the non-linked shekel segment and in the foreign currency segment as well as commodities contracts.

  The prices quoted by "pricing services" are obtained daily (in respect of derivative instruments), or quarterly (in respect of nonmarketable securities), from designated sources providing "quoted prices" to the Bank. The practice of the bank is to obtain quotations from one independent source for each type of instrument, and to rely thereon in computing the fair value (following a validation process – see discussion below). In general, no adjustments are being made to quotations obtained, except for adjustments stemming from matters revealed during the validation process.

  "Quoted prices" obtained from providers of "pricing services" (who are not related to the parties to the transactions), are generally based on prices of similar assets and liabilities traded on an active market, subject to adjustments that might be required in respect of the specific assets or liabilities for which "quoted prices" had been obtained, and therefore, do not constitute binding offers for transactions in such assets or liabilities.

- The low quality group (Level 3) includes financial instruments and derivative financial instruments, the fair value of which is based on quotation obtained from inactive markets, or on other models.

Validation of fair value – Banking corporations are required by Bank of Israel to perform a "validation process" in respect of financial instruments (including derivative financial instruments), the fair value of which is not based on prices quoted on an active market. The Bank performs a validation process in respect of assets and liabilities measured by the fair value method and which belong to levels 2 and 3 quality groups. The process includes:

(a) A sample test of data and computations;
(b) Tests validating interest rate graphs used in discounting future cash flows, as well as interest rates and standard deviations used in computing the fair value of options;
(c) Reasonableness tests of the results;
(d) Examination of the component of changes in fair value in comparison with prior reporting periods;
(e) Tests of quotations obtained in relation to market data of similar assets and liabilities.

The validation process is independent of the "quoting source" or of the factor computing the fair value.

Determination of the credit risk – the credit risk component (including the counterparty credit risk), comprises one of the parameters used in determining the fair value of assets and liabilities measured by the fair value method.

The methods used by the Bank for the purpose of evaluating credit risk, include:

- Use of credit ratings for determining the credit risk level;
- Use of credit contract quotations (CDO) for similar credit instruments;
- Use of quotations for similar credit instruments (traded on an active market), for the evaluation of credit risk of financial instruments (including derivatives) in respect of which credit risk is computed.

Following are details of financial instrument balances (including derivatives), reflected in the financial statements at their fair value, differentiating between balances based on observable data and balances based on unobservable data – and the income (expenses) recognized in profit and loss in their respect:

	Balance sheet data		**Profit and loss data**	
	Fair value balances at December 31,		**For the year ended December 31,**	
	2016	**2015**	**2016**	**2015**
	NIS millions			
1. Available-for-sale securities				
Observable data				
• Traded on an active market (Level 1)	**4,720**	(1) 2,512	**34**	76
• Other (Level 2)	**951**	(1) 586	**17**	10
Unobservable data (Level 3)	**13**	12	-	(2) 3
Total	**5,684**	3,110	**51**	89
2. Derivative instruments				
Observable data				
• Traded on an active market (Level 1)	**-**	-	**1**	(1) 2
• Other (Level 2)	**(4)**	(18)	**(24)**	(1) (30)
Unobservable data (Level 3)	**(47)**	(70)	**12**	(21)
Total	**(51)**	(88)	**(11)**	(49)

(1) Reclassified.
(2) Excluding a loss of NIS 9 million recognized last year in the item "loss on sale of available-for-sale shares", following the ruling of the Supreme Court.

The changes during the year 2016, in fair value of derivative financial instruments belonging to the lowest quality group (Level 3), stem from the following factors:

- The effect of the rise in the Consumer Price Index and the change in the exchange rate of the shekel as against foreign currencies increased the fair value of these instruments by NIS 4 million (in 2015 – a decrease of NIS 6 million);
- The effect of changes in the market interest rate prevailing in the various segments (non-linked shekel, CPI and foreign currency linked shekel), increased the fair value of these instruments by NIS 12 million (in 2015 – a decrease of NIS 9 million);
- Accrual of current interest, reduced the fair value of these instruments by NIS 3 million (in 2015 – NIS 7 million);
- The change in the "credit risk component" reduced the fair value of liabilities in respect of transactions in derivative instruments in by NIS 1 million (in 2015 – identical).

As stated above, determination of fair value of financial instruments, including derivatives, belonging to the 2 and 3 quality groups, is based on evaluations and assumptions (as detailed above), relying, among other things, on subjective judgment.

Accordingly, a possible change in such factors might materially change the fair value of the said instruments.

E. Capitalization of in-house software development costs

As stated in Note 1K (4) to the financial statements, the Bank capitalizes certain costs in respect of the in-house development of software, charging them to the "Fixed assets" item. These costs includes the Bank's proportionate share in payments made to the parent company for computer services, in respect of the in-house software development costs incurred by the parent company and capitalized by it to "Fixed assets".

Measurement of the cost of in-house software development, as well as the estimated period of use of such software, are based on significant assessments involving a considerable degree of uncertainty (including assessments as to the expected period of benefits obtained from use of such software), as well as subjective estimate (including as regards the amount of work invested in the development of the software).

Accordingly, changes in the said assessments and estimates may have a material effect on the scope of payroll expenses or computer expenses capitalized to fixed assets, and on the future depreciation expenses charged in their respect.

In view of the materiality of this issue and the wide range of discretion applied in this respect, and whereas audits performed by Bank of Israel at several banks disclosed deficiencies in the internal control over the capitalization process of software costs, Bank of Israel published on March 31, 2015 a letter, within the framework of which, the parent company was required to apply uniform rules comprising guidelines regarding the process of capitalization of in-house software development costs (and which, accordingly, apply to all member companies of the parent company's banking group, including the Bank), including:

- The member companies of the parent company's banking group, are required to determine a minimum "materiality threshold" for software development costs, which may be classified to fixed assts, in a range of between NIS 450 thousand and NIS 600 thousand. In-house investment in software development in amounts lower than the "materiality threshold", may not be capitalized but charged to profit and loss.
- The depreciation period of capitalized software costs shall not exceed five years.

- Payroll costs capitalized to fixed assets shall take into consideration "economic inefficiency" and possible deviations in the reporting of hours worked.
- Investment in in-house software development projects capitalized to fixed assets shall only include expenses in respect of those employees who devoted most of their time to the actual development of the software.

The Bank implemented the new guidelines and measurement rules on their effective date.

The principal information systems serving the Bank are based on the core systems of the parent company, which provides computer services to the Bank (including software development), in accordance with agreements in the matter signed by the Bank and the parent company. Accordingly, software costs reflected in assets in the books of the Bank include also the proportionate part of the Bank in amounts invested by the parent company in the in-house development of software, on its behalf and on behalf of the Bank.

F. Impairment of available-for-sale securities

Investment in securities classified to the "available-for-sale" portfolio (as defined by Bank of Israel), are stated at fair value (based on quoted market prices for such or similar assets).

As a general rule, the difference between the fair value of these securities and their amortized cost (comprising unrealized gains or losses inherent in such securities), are reflected in the item "Other comprehensive profit", being part of equity capital (subject to that stated below).

Notwithstanding the above, according to Bank of Israel instructions and to accepted accounting principles, the charging of unrealized losses to the "other comprehensive profit" item, is subject to such loss being classified as "loss of a temporary nature" (losses classified as of "a nature other than temporary" are charged to profit and loss).

Accordingly, securities contained in the available-for-sale portfolio, which include unrealized losses, as stated, are examined by Management of the Bank on a quarterly basis, in order to determine their nature.

This examination includes two stages, as follows:

- Compilation of a follow-up list of securities carrying unrealized losses, in accordance with criteria determined in advance (such as: class of issuer, rate of loss, period of loss accumulation).
- A specific examination of the losses accumulated in respect of the securities included in the follow-up list in order to determine their nature. In doing so, Management of the Bank takes into account relevant parameters and criteria determined in advance, including:

    - Rating of bonds, including changes made in ratings
    - The ratio of impairment of bonds to their cost (taking into consideration developments occurring in this respect subsequently to balance sheet date.
    - The period of time in which the fair value of the bonds was lower than their cost.
    - The return to maturity of the bonds in relation to the range of return to maturity prevailing in the sector.
    - Volatility in the fair value of the bonds.
    - The financial situation of the issuer and his ability to honor his obligations.
    - The intention and ability of the Bank to hold the bonds until maturity date.

- Classification (or the non-classification) of the bonds as a "troubled debt".
- Default events recorded in respect of the bonds.

Management of the Bank has determined criteria upon the realization of which, or in the absence of significant evidence to the contrary, the losses accumulated in respect of securities would be considered as "of a nature other than temporary", including:

- The lowering of at least four rating grades from the rating of bonds (in relation to the rating prevailing at date of investment therein), to a rating that is not included in "investment rating".
- An impairment exceeding 20% of the cost of the security within a period of at least six months.
- Bonds, the rate of return to maturity thereof at the examination date exceeds 20%.

Moreover, Management of the Bank has determined relevant criteria, upon the realization of which, losses accumulated in respect of securities, would in any case be classified as "losses of a nature other than temporary":

- The securities, including the loss accumulated in respect thereof, had been realized subsequently to balance sheet date.
- The securities have been classified as "troubled debts".
- A default occurred with respect to the security in respect of which losses had been accumulated.

The process of determining the nature of losses accumulated in respect of securities, as stated above, is based on significant assessments involving a considerable degree of uncertainty (including the repayment ability of the issuer and the correlation between the criteria determined by the Bank and the nature of the accumulated loss), and relies on subjective assessments, both as to the classification of the issuer of the security (either "performing" or "troubled"), and to the criteria used for the classification of the nature of the losses (including: the rating of the bonds, estimates as to the intention and ability of the Bank to hold the bonds to maturity). Accordingly, the process of determination of the nature of losses accumulated in respect of available-for-sale securities but not yet sold is sensitive to possible changes in parameters and estimates standing at its base, in a way that a possible change in these factors, may materially affect the amount of the loss, which has to be recognized in profit and loss.

As of December 31, 2016, the balance of unrealized losses included in the available-for-sale securities portfolio amounted to NIS 11 million (December 31, 2015 – NIS 4 million), comprising 0.2% of the cost of such securities (December 31, 2015 – 0.1%). Based on the above yardsticks, the Bank's Management is of the opinion that the said losses stem mainly from current changes in returns to maturity on the bond market, and therefore are considered as "losses of a temporary nature".

In view of the above, such losses are reflected in the item "other comprehensive profit" in shareholders' equity.

G. Changes in critical accounting assessments

The following contains information regarding changes in critical accounting assessments made during the last three years:

(1) Provisions for credit losses on a collective basis

- **Integration of a model determining the "adjustment component"**

  On December 31, 2015, the Bank integrated a structured model, based on characteristics determined by Bank of Israel, and used by the Bank for the determination of the "adjustment coefficient", as part of the process of estimating the provision for credit losses on a collective basis.

  Implementation of the new model increased the collective provision for credit losses as of December 31, 2015, by an amount of NIS 5 million.

- **Change in Bank of Israel guidelines**

  In the light of the experience gained by banking corporations in the computation of provisions for credit losses on a collective basis, including in the matter of the provision range" (comprising a component in computing these provisions), Bank of Israel published on December 11, 2016 a draft amendment to the public reporting instructions, whereby banking corporations are required to extend the period relating to the write-off data, used in the computation of the "provision range" in 2016 from five to six years (and to seven years as from January 1, 2017). The Bank applied the new guidelines on their effective date. Application of the new guidelines did not have a material impact on the balance of the provision for credit losses on a collective basis.

(2) Provision for credit losses on a specific basis

Until December 31, 2015, the customer population in respect of which provisions for credit losses had been measured on a specific basis, included borrowers, whose contractual balance of debt exceeded NIS 50 thousand.

Following the experience gained by the Bank in the implementation of the instruction and tests made by the Bank during the past period regarding the agreement of the criterion for determining the maximum amount for debts measured on a collective basis, with the composition of the credit portfolio of the Bank and the nature of its operations, which indicated insignificant expense differences between the two methods of provision, as described above (for credits in small and medium volumes), on the one hand – and in view of the high investment of resources required for examining debts on a specific basis (including the requirement for adhering to strict and detailed documentation rules in this method of examination), on the other hand – Management of the Bank decided to change as from January 1, 2016, the accounting policy in this respect, and to raise the maximum amount of debts that would be measured on a collective basis, from NIS 50 thousand to NIS 0.5 million.

The said change in accounting policy is applied by the Bank as from January 1, 2016, and the results thereof are included in the financial statements for the year 2016.

The change in the rules for the classification of troubled debts and for the determination of the provisions for credit losses stemming from the change in accounting policy, as stated, did not result in a material change in the expenses for credit losses of the Bank.

The comparative data for prior periods have not been restated due to the practical impossibility of the retroactive application of this change, and whereas the financial implications arising from the application of this change are not material.

(3) Application of US accepted accounting principles in the matter of employee rights

On April 9, 2014, and on January 11, 2015, Bank of Israel published an amendment to the public reporting instructions in the matter of "employee rights", which required banking corporations to implement the US accepted accounting principles in this respect.

Following are the principal implications stemming from the implementation of these rules, on the critical accounting assessments in this respect:

- **Changes in the discount rate**

  According to the new measurement rules, certain employee rights assessed on an actuarial basis, are discounted to their present value at a discount rate based on the rate of return on Israel Government bonds, with the addition of a spread stemming from the difference between the return on high quality corporate bonds traded in the US and the return on US government bonds.

  In accordance with the previous accounting standard in effect until December 31, 2014, these liabilities had been discounted to present value at a fixed discount rate of 4%.

  In the opinion of the Bank's Management, the discount rate derived from the methodology implemented within the framework of the adoption of these accounting principles, comprise a fair basis for the computation of the fair value of employee rights, assessed on an actuarial basis. As stated in Section C (1) above, these accounting principles were adopted by the Bank as from January 1, 2015, and the provisions for employee rights created in accordance therewith, are included in the financial statements of the Bank by way of retroactive application as from January 1, 2013.

  The change to the new measurement rules increased the provision of the Bank for employee rights at date of initial application (January 1, 2013) by an amount of NIS 98 million.

- **Forecasted return on the assets of the severance compensation plan**

  In accordance with the accounting principles and the guidelines of Bank of Israel regarding this issue, changes in the fair value of the assets of the "defined benefit plan" (hereinafter – "the plan") are reflected in the financial statements, as follows:

  - Current changes in fair value stemming from the time value and comprising "forecasted return" on the assets of the plan are recognized in the payroll expense item in profit and loss.
  - Other changes in fair value of the plan's assets – are reflected in the "other comprehensive profits" item in shareholders' equity and are amortized in future years to profit and loss by the "straight line" method over the average period of service of the relevant employees.

According to the previous accounting standard in effect until December 31, 2014, all changes in the fair value of the plan's assets had been reflected in profit and loss.

The "forecasted return" on the assets of the plan (as defined in the new accounting principles and the guidelines of Bank of Israel) comprises a forecast of the expected profitability rates in respect of such assets, stemming from the composition of the plan's assets and from assessments of Management regarding the future estimated profits in their respect.

According to Bank of Israel guidelines, the forecast for future profits, as stated, is to be based on the "multi-annual" rates of return observed in the past in respect of similar assets.

Management's assessment of the "forecasted return" rates, as stated, is based on significant assessments involving a considerable degree of uncertainty (including assessments relating to the historical rates of return and the correlation between these rates and the future profits forecast).

Accordingly, the process of assessment of the forecasted rates of return in respect of the assets of the plan is sensitive to possible changes in parameters and assumptions standing at its base, in a way that a possible change in such factors may materially change the forecasted rates of return.

In accordance with the transitional instructions published by Bank of Israel in this respect, the new measurement rules apply only to changes occurring in the fair value of assets of the defined benefit plan, as from January 1, 2015, and thereafter.

The implementation of the new measurement rules reduced the payroll expense of the Bank in 2016 by an amount of NIS 6 million (2015 - NIS 12 million).

(4) Capitalization of software costs

On March 31, Bank of Israel published guidelines in the matter of "capitalization of in-house software development costs" (see extended discussion in Section E. above), stating new criteria for the capitalization of software costs applying to banking corporations.

The implementation of these guidelines is based on significant assessments involving a considerable degree of uncertainty (including assessments as to the future period of use of the developed software), and relies on subjective estimates (including estimates regarding the "inefficiency coefficient" inherent in the cost required for the development of the software).

Accordingly, the process of determining the value of the in-house software development costs, which may be capitalized, is sensitive to possible changes in parameters and assumptions standing at its base, in a way that a possible change in such factors may materially change the value of assets stemming from the in-house development of software.

The guidelines determined by Bank of Israel have been adopted by the Bank as from April 1, 2015, and are applied in the financial statements by way of retroactive application.

The change the measurement rules, as stated, reduced the balance of assets in respect of the in-house software development as of January 1, 2015, by an amount of NIS 16 million.

(5) Liabilities for the payment of severance compensation

(a) Efficiency plan

The Board of Directors of the Bank approved on September 11, 2016, an efficiency plan formed by Management of the Bank, and which includes voluntary retirement plans for employees under beneficial terms.

Following the approval of the plan, which offers certain classes of employees retirement terms that are more beneficial than those prevailing at the Bank in past years (and which thereby may have implications also on the retirement terms that would apply in the future to other classes of employees), the Bank has updated its liabilities for the payment of severance compensation (see extended discussion below).

(b) Updating the actuarial assessments

The provisions made by the Bank for the payment of severance compensation are based on actuarial assessments stemming, inter alia, from past years' data regarding the retirement of employees and the amounts of severance compensation paid to them.

The provisions made by the Bank until December 31, 2015, in respect of these liabilities**,** derived from the said data observed by the actuary in the years 2004-2010.

In the reported period, the actuary has updated his assessments based on updated data for the years 2011-2016, as well as on Management' forecasts regarding rates of employee retirement and increased severance compensation, which the Bank may have to pay in the future to retiring employees.

In view of the changes described in (a) and (b) above, the Bank has increased its liabilities for the payment of severance compensation to employees as of December 31, 2016 by an amount of NIS 54 million. This amount was recognized in the item "other comprehensive profit" in shareholders' equity.

Moreover, in view of the increase in payments of severance compensation made to employees in 2016 (mostly due to the implementation of the efficiency plan, as stated), which comprise the settlement of a significant part of the Bank's liability in respect of severance compensation, the Bank reduced in 2016 the balance of "actuarial differences" included in shareholders equity by an amount of NIS 16 million. The reduction in the balance of the "actuarial differences" as stated was charged to the item "payroll expenses" in the statement of profit and loss.

(6) Liabilities for the payment of "Jubilee awards"

On December 28, 2016, the Bank signed an agreement with the Federation of Labour and the employees' representative committee, according to which, the parties agreed to remove the above mentioned liability, in consideration for a one-off payment of NIS 61 million to the employees, based on the actuarial provisions as of September 30, 2016, discounted to their present value at an annual interest rate of 3.5% (and not at the interest rate prevailing on September 30, 2016). The resulting gain to the Bank from the removal of this liability, amounted to NIS 19 million, and was recognized in the statement of profit and loss for 2016, in the item "Payroll and related expenses".

The above agreement and the payment to employees, as stated, settle in full the Bank's liability in this respect, and accordingly, as from December 31, 2016, the Bank no longer carries on its books a liability for the payment of "Jubilee awards".

H. Differences in the realization of the guidelines and the critical accounting assessments

As stated in the item G(6) above, the Bank signed on December 28, 2016, an agreement with the Federation of Labour and the employees' representative committee, according to which, the parties agreed to remove the liability of the Bank for the payment of "Jubilee awards" to the employees, in consideration for a one-off payment of NIS 61 million.

Fulfilment of the above mentioned agreement resulted in the removal of the said liability and in the cancellation of the provisions made in respect thereof until that date (which were classified by the Bank in the past as critical accounting assessments).

20. Disclosure regarding controls and procedures

A. Controls regarding disclosure in the financial statements

Proper Conduct of Banking Business Directive No. 309 deals with controls both as regards procedures regarding disclosure (Section 302 of the Sarbanes-Oxley Act – hereinafter SOX) and as regards internal control over financial reporting (Section SOX 404 - see B. hereunder). The Directive determines the following requirements with respect to controls and procedures regarding disclosure in periodic financial statements:

- A bank has to maintain controls and procedures regarding disclosure in financial statements.
- Management of a bank together with the General Manager and the Chief Accounting Officer shall evaluate the effectiveness of the controls and procedures regarding disclosure in financial statements, at end of each quarter.

In addition, the General Manager and Chief Accounting Officer of each bank are required to make personal statements in the financial statements (reproduced in these financial statements) with respect to the disclosure in the financial statements, based on a review of the financial statements, and an evaluation of the efficiency of the controls and the procedures relating to the information contained in these financial statements.

The existence of such controls and their validity are being reviewed in every quarter at the various units of the Bank. In addition, a “disclosure committee” has been established, headed by the General Manager of the Bank, in which all Management members participate. The committee meets once in every quarter and discusses various issues which came to light during the ordinary course of business of the Bank and which may have an impact on the disclosure required in the financial statements.

B. Internal control over financial reporting

Proper Conduct of Banking Business Directive No. 309 specifies the duties of the management of a bank with respect to internal control over financial reporting (Section

SOX 404). In everything relating to internal control over financial reporting, the Directive specifies the following:

- A bank has to maintain internal control over financial reporting.
- Management of a bank shall evaluate in each year the effectiveness of the internal control layout of the bank.

In parallel to the above directive, the Supervisor of Banks issued in December 2005, a directive entitled "Responsibility of Management for internal control with respect to financial reporting", which implements the reporting duties derived from SOX 404. In accordance with this directive, every annual financial report shall contain an internal control report which shall include:

- Certification of responsibility of Management for the existence and maintenance of a system of proper internal control procedures with respect to the financial reporting;

- Evaluation of the efficiency of the system of internal control procedures with respect to the financial reporting. The Bank’s evaluation will be assessed by the independent auditor in accordance with auditing standards adopted or publicized by the Public Company Accounting Oversight Board (PCAOB), and the auditor’s opinion will be appended to this assessment.

In 2016, the Bank, with the assistance of external consultants, performed sample test checks for the validation of the internal control over financial reporting layout. These tests included: updating of the existing documentation regarding business processes that have implications upon financial reporting, review of existing controls regarding these processes, review of new controls that were added during the reported period, updating of the documentation regarding the processes that were added or changed during the reported period, current reviews of existing controls and evaluation of their level of effectiveness.

In addition to the above, the internal control over financial reporting is based on criteria determined by the integrated framework of "COSO". At the end of 2014, the criteria standing at the base of the model were updated (these had been determined already in 2012), and accordingly, the "COSO" model was replaced by the "COSO-2013" model. In 2016, the Bank completed its preparations for the adoption of the new "COSO-2013" model. Within the framework of these preparations, the Bank tested the effectiveness of the updated controls in order to modify them to the new model. These tests indicated immaterial differences, which would be rectified in 2017.

The internal control over financial reporting layout had been examined by the Bank's independent auditors and found to be effective.

The opinion of the independent auditors on the internal control, in the format determined by Bank of Israel, appears in this Report before their opinion on the financial statements.

C. Evaluation of controls and procedures regarding disclosure

Based on an examination of the existing controls over the processes of production and transfer of the data related to financial reporting and based on the outcome of the discussions of the “disclosure committee”, Management, together with the General Manager and the Chief Accounting Officer, evaluated the efficiency of the controls and procedures in force during the period covered by this report, with respect to the disclosure provided by the Bank.

On the basis of this evaluation, the General Manager and the Chief Accounting Officer concluded that, as of the end of the reported period, the disclosure controls and procedures were satisfactory for the purposes of recording, processing, summarizing and reporting the information which the Bank is required to disclose in its annual financial statements in accordance with the public reporting instructions of the Supervisor of Banks and within the time schedule determined in the instructions.

In the course of the quarter ended on December 31, 2016, no changes occurred in the internal control over financial reporting, which materially affected, or which might reasonably be expected to affect the internal control of the Bank over financial reporting.

Part E. Additional information

21. Other matters

A. Efficiency

Bank of Israel published a letter on January 12, 2016, requiring banking corporations to outline "multi-annual efficiency programs" that would include a specific line of action for the coming five years as well as a long-term efficiency outline.

In addition, the letter included a number of incentives intended to facilitate the implementation by banking corporations of the required efficiency program, including:

- Deferral of the dates fixed in the past for attaining the capital adequacy goals (to the extent that the reduction in capital, in respect of which deferral is applied for, stems from the efficiency program);
- Permission to adopt mitigating interpretations of the actuarial assessments applied in the computation of the liability for the payment of severance compensation.

Further to the above mentioned letter of Bank of Israel and to the staff program formed by the Bank in this matter – the Board of Directors of the Bank approved on September 11. 2016, an efficiency program, which includes, inter alia, a voluntary retirement plan under beneficial terms for employees. This plan was implemented by the Bank in the last quarter of 2016, at a cost of NIS 43 million.

Moreover, during the reported period, the Bank updated the actuarial forecasts, basing them on updated data regarding the rates of employee retirement and the amounts of severance compensation paid to retirees in the years 2011-2016, as well as on Management's forecasts as to the rates of employee retirement expected in the future and the amounts of severance compensation that may be paid to such retirees.

In accordance with the above, the Bank has increased the provisions for its liabilities for the payment of severance compensation to employees as of December 31, 2016, in respect of the voluntary retirement plan and its related implications, as well as in respect of the updated actuarial forecasts, as stated, by an amount of NIS 54 million.

The increase in liabilities of the Bank for the payment of severance compensation to employees has been classified as an "actuarial difference" and recognized in the item "other comprehensive profit" in shareholders' equity (after deduction of a tax savings of NIS 19 million).

In addition, in view of the increase in volume of severance compensation paid to employees in 2016 (stemming mostly from the implementation of the efficiency program, as stated), comprising a significant settlement of the Bank's liability for the payment of severance compensation, the balance of the "actuarial differences" included as part of shareholders' equity, was reduced in 2016 by an amount of NIS 16 million. This reduction in the balance of "actuarial differences", as stated, was charged to "payroll expenses" in the statement of profit and loss (see Note 21D to the financial statements).

B. Legislation regarding compensation

(1) Compensation of Officers of Financial Corporations Act (Special approval and the non-deductibility tax wise of an expense regarding exceptional compensation), 2016

Following public criticism voiced in recent years with respect to the high level of salaries payable to a part of the officers employed in the financial sector, and further to legislation proceedings started already in 2014, The Knesset passed on April 12, 2016, the Compensation of Officers of Financial Corporations Act (Special approval and the non-deductibility tax wise of an expense regarding exceptional compensation), 2016 (hereinafter – "the Act").

The Act includes restrictions regarding the maximum amount of salary that may be paid to an employee in the financial sector and the amount of salary that may be deductible tax wise, as follows:

- Financial corporations shall not be permitted to engage in an employment agreement with an officer or another employee, the cost of the annual compensation stated therein exceeds NIS 2.5 million per annum (hereinafter – "the salary ceiling");
- Notwithstanding that stated above, a financial corporation may be permitted to engage in a wage agreement, the cost of which is higher than the salary ceiling, as stated, subject to approval of the Compensation Committee, the Board of Directors and the General Meeting of Shareholders of the financial corporation, on condition that the ratio between the cost of the agreement and the lowest level of compensation payable to an employee of such corporation, does not exceed 35.

The provisions of the Act relate to complex aspects of employer/employee relations and include guidelines regarding matters not yet discussed and in respect of which no clarifications have as yet been issued, including the extent of relevancy of the provisions of the Act with respect to employee rights that had been accumulated in the period prior to its enactment. Accordingly, it is difficult to assess the implications which the implementation of the Act might nave on the labor relations at the Bank and on its current operations.

In view of the possible implications stemming from the provisions of the Act, and in view of the vagueness existing with respect to the appropriate interpretation of certain of these provisions, Bank of Israel approached the banking corporations on April 7, 2016, proposing the holding of a discussion regarding the possible implications that may apply to them due to the implementation of the provisions of the Act, including:

- The possible resignation of key personnel at the various executive levels;
- The effect on the implementation of existing efficiency programs and on future initiatives for similar programs;
- Examination of the accounting aspects stemming from the provisions of the Act, including the need for the updating of the provisions for employee rights, where the subject is relevant.

In view of the difficulty to interpret certain provisions and aspects of the Act, and whereas, in the period since the publication of the Act, neither the legislator nor anyone authorized on his behalf, have presented an interpretation clarifying these aspects, The Union of Banks submitted on June 1, 2016, an appeal to the High Court of Justice against the Knesset, the Minister of Finance, Bank of Israel and the Supervisor of Banks, as regards certain items and aspects contained in the Act (including as to the possibility of imposing certain restrictions on rights that had accumulated prior to the passing of the Act). A similar appeal was submitted on June 6, 2016, by the Union of Insurance Companies.

Following an Interim Order issued by it on July 11. 2016, the Supreme Court issued on September 29, 2016, a final decision in the matter of the said appeals.

On the one hand, the Court dismissed the arguments of the Appellants on two principle issues:

- In the opinion of the Court, the salary ceiling determined by the Act (a maximum ratio of 1:35 between the lowest amount of compensation payable by the corporation and the maximum cost of the employment agreement existing in that corporation) was intended to promote an appropriate purpose, including the achievement of an equitable distribution (even though the Court recognizes a potential possible impairment to employment terms of certain employees, the Court is of the opinion that the advantage inherent in this item is larger than the expected impairment in this respect.
- In spite of the fact that the Court agrees in principle with the argument that inherent in the legislation arrangements is an impairment of different constitutional rights of employees, including the freedom of engagement (through the differentiation between salary agreements of financial corporations and salary agreements of other corporations), the Court decided that such differentiation is appropriate because a material difference exists between financial corporations and other corporations, in view of the central role that financial corporations have in the economy, including the management of public funds and being subject to strict regulation.

On the other hand, the Court admitted the arguments of the Appellants regarding the application of the provisions of the Act to rights accumulated by employees, to whom the Act applies, in the period prior to the effective date of the Act. In the opinion of the Court, the Act is intended to apply to compensation payable for future work, only, and does not apply to rights acquired in consideration for work performed by the employee prior to the effective date of the Act (October 12, 2016). In addition, the Court extended to January 1, 2017, the date fixed for the entry into effect of the provisions of the Act applying to employees wishing to terminate their employment.

In the opinion of the Bank, based on the ruling of the Court, as stated, and on a review of existing employment agreements, the restrictions stated in the Act are not expected to affect the employment agreements in force at the Bank. Accordingly, at this stage, the Bank is not required to revise the provisions made in respect of employee rights.

(2) Amendment of Proper Conduct of Banking Business Directive No. 301A in the matter of the compensation policy of a banking corporation

Following the passing of the Compensation of Officers of Financial Corporations Act (see Section (1) above), Bank of Israel published on September 29, 2016, an amendment to Proper Conduct of Banking Business Directive No. 301A in the matter of the compensation policy of a banking corporation.

The above Amendment mitigates certain guidelines included in the present Directive, including:

- The scope of the employee population defined as "central employees" is to be reduced in a way that it would not include employees who do not report directly to the President and CEO and other employees (including officers) the amount of the annual compensation paid to them in the pat two years does not exceed NIS 500,000, and the amount of the variable compensation paid to them in those years did not exceed 20% of the annual compensation.
- It is permitted to include in the criteria determined in advance an element of "discretion", on condition that the amount of compensation paid as a result thereof should not exceed an amount equal to three monthly salaries.
- As a general rule, the payment of variable compensation to central employees and officers is subject to minimum deferment arrangements as determined in the Directive. Notwithstanding the above, the Directive permits banking corporations not to apply deferment arrangements in respect of variable compensation payable to a central employee, whose salary matches the requirements of the Compensation Act, to the extent that the variable compensation does not exceed 40% of the total fixed compensation paid to that employee in that year.

The Bank applies the guidelines contained in the amended Directive as from their effective date (date of publication) and has integrated the new guidelines in the policy and compensation mechanism of the Bank.

Yair Avidan	Joshua Burstein
Chairman of the Board	General Manager

February 26, 2016

Appendix no.1 -Total credit risk classified by economic sectors on a consolidated basis

December 31, 2016

	Total Credit Risk[1]			Debts[2] and off-balance sheet Credit Risk (excluding Derivatives)[3]				Credit Losses[4]		
	Total	Credit Performance Rating[5]	Problematic	Total*	Of which: Debts[2]	Problematic[6]	Impaired	Periodic Credit Loss Expenses	Net Accounting Write-Offs Recognized during the Period	of Allowance for Credit Losses
Lending Activity in Israel: Public Commercial										
Agriculture	**397**	**386**	**4**	**396**	**353**	**4**	**2**	**(2)**	**(2)**	**9**
Mining & Quarrying	**97**	**96**	**-**	**97**	**89**	**-**	**-**	**-**	-	**1**
Industry	**2,319**	**2,205**	**46**	**2,026**	**2,391**	**46**	**17**	**(2)**	**(1)**	**41**
Construction and Real Estate – Construction [7]	**4,017**	**3,903**	**70**	**4,016**	**1,853**	**70**	**36**	**6**	**2**	**48**
Construction and Real Estate - Real Estate Activity	**2,134**	**2,045**	**71**	**2,134**	**2,034**	**71**	**62**	**3**	**(2)**	**11**
Electricity and Water	**322**	**319**	**-**	**129**	**112**	**-**	**-**	**-**	**1**	**1**
Commerce	**4,683**	**4,434**	**131**	**4,681**	**4,126**	**131**	**94**	**13**	**18**	**97**
Hotels, Hotel Services and Food	**291**	**272**	**5**	**287**	**244**	**5**	**2**	**2**	**2**	**2**
Transportation and Storage	**1,184**	**1,139**	**25**	**1,183**	**1,050**	**25**	**18**	**(1)**	**(2)**	**33**
Communication and Computer Services	**152**	**144**	**2**	**149**	**95**	**2**	**1**	**1**	**1**	**3**
Financial Services	**390**	**385**	**3**	**301**	**276**	**4**	**3**	**1**	**2**	**6**
Other Business Services	**1,522**	**1,421**	**57**	**1,522**	**1,235**	**57**	**49**	**8**	**2**	**28**
Public and Community Services	**1,058**	**1,027**	**13**	**1,058**	**856**	**13**	**2**	**1**	**-**	**5**
Total Commercial	**18,566**	**17,776**	**427**	**18,272**	**14,349**	**428**	**286**	**30**	**21**	**282**
Private Individuals - Housing Loans	**3,902**	**3,804**	**62**	**3,902**	**3,713**	**61**	**-**	**1**	**-**	**17**
Private Individuals - Other	**4,943**	**4,676**	**54**	**4,934**	**3,931**	**54**	**19**	**10**	**6**	**59**
Total Public	**27,411**	**26,256**	**543**	**27,108**	**21,993**	**543**	**305**	**41**	**27**	**361**
Banks in Israel	**347**	**347**	**-**	**334**	**334**	**-**	**-**	**(1)**	**-**	**-**
Israeli Government	**5,377**	**5,377**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total Landing Activity in Israel	**33,135**	**31,980**	**543**	**27,442**	**22,327**	**543**	**305**	**40**	**27**	**361**
Lending Activity Outside of Israel										
Industry	**209**	**192**	**18**	**207**	**188**	**18**	**2**	**-**	**-**	**2**
Construction and Real Estate - Construction	**127**	**127**	**-**	**123**	**16**	**-**	**-**	**(4)**	**-**	**-**
Commerce	**88**	**86**	**-**	**88**	**83**	**-**	**-**	**-**	**-**	**1**
Transportation and Storage	**21**	**2**	**18**	**7**	**7**	**5**	**5**	**-**	**-**	**-**
Private Individuals - Housing Loans	**36**	**33**	**1**	**36**	**31**	**1**	**-**	**-**	**-**	**-**
Private Individuals - Other	**8**	**8**	**-**	**8**	**3**	**-**	**-**	**-**	**-**	**-**
Other	**30**	**4**	**26**	**30**	**28**	**26**	**25**	**-**	**-**	**12**
Total Public	**519**	**452**	**63**	**499**	**356**	**50**	**32**	**(4)**	**-**	**15**
Banks	**342**	**342**	**-**	**333**	**312**	**-**	**-**	**-**	**-**	**-**
Governments	**314**	**314**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total Lending Activity Outside of Israel	**1,175**	**1,108**	**63**	**832**	**668**	**50**	**32**	**(4)**	**-**	**15**
Total	**34,310**	**33,088**	**606**	**28,274**	**22,995**	**593**	**337**	**36**	**27**	**376**

Footnotes:

(1) Balance Sheet and Off-Balance Sheet Credit Risk, including in respect of derivative instruments. Including: Debts[2], bonds, assets in respect of derivative instruments, and credit risk in respect of off-balance sheet financial instruments, as calculated for single borrower liability limitation, in an amount of NIS 22,995, 5,989 ,46, 5,280 million, respectively.

(2) Credit to the Public, Credit to Governments, deposits with banks and other debts, excluding investments in bonds.

(3) Credit risk in respect of off-balance sheet financial instruments, as calculated for single borrower liability limitation, excluding in respect of derivative instruments.

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

(5) Credit risk, the credit rating thereof at date of reporting matches the credit rating for the granting of new credit in accordance with the Bank's policy of the Bank.

(6) Balance sheet and off-balance sheet credit risk, which is impaired, substandard or under special mention, including in respect of housing loans, in respect of which an allowance is made according to the extent of arrears, and housing loans in respect of which no allowance is made according to the extent of arrears, and are in arrears of 90 days or more.

(7) Including balance sheet credit risk in respect of acquisition groups in an amount of NIS 88 millions and off – balance sheet credit risk in an amount of NIS 102 millions.

Appendix no.1 -Total credit risk classified by economic sectors on a consolidated basis (continued)

December 31, 2015

	Total Credit Risk[1]			Debts[2] and off-balance sheet Credit Risk (excluding Derivatives)[3]				Credit Losses[4]		
	Total	Credit Performance Rating[5]	Problematic	Total	Of which: Debts[2]	Problematic[6]	Impaired	Periodic Credit Loss Expenses	Net Accounting Write-Offs Recognized during the Period	of Allowance for Credit Losses
Lending Activity in Israel: Public Commercial										
Agriculture	**387**	**381**	**4**	**387**	**348**	**4**	**3**	**(1)**	**(2)**	**9**
Mining & Quarrying	**102**	**102**	**-**	**102**	**94**	**-**	**-**	**1**	-	**1**
Industry	**2,312**	**2,218**	**70**	**2,299**	**2,036**	**70**	**19**	**10**	**1**	**42**
Construction and Real Estate - Construction	**3,448**	**3,338**	**80**	**3,447**	**1,678**	**80**	**33**	**1**	**7**	**44**
Construction and Real Estate - Real Estate Activity	**1,944**	**1,899**	**43**	**1,936**	**1,878**	**43**	**36**	**(2)**	**1**	**6**
Electricity and Water	**315**	**314**	**-**	**105**	**89**	**-**	**-**	**1**	**-**	**2**
Commerce	**4,444**	**4,269**	**145**	**4,429**	**3,930**	**145**	**121**	**10**	**8**	**102**
Hotels, Hotel Services and Food	**261**	**242**	**10**	**257**	**221**	**10**	**6**	**2**	**1**	**2**
Transportation and Storage	**980**	**931**	**36**	**980**	**858**	**36**	**28**	**23**	**10**	**32**
Communication and Computer Services	**121**	**115**	**3**	**117**	**93**	**3**	**2**	**4**	**2**	**3**
Financial Services	**620**	**613**	**6**	**360**	**339**	**6**	**6**	**5**	**-**	**7**
Other Business Services	**1,419**	**1,343**	**42**	**1,418**	**1,151**	**42**	**33**	**2**	**1**	**22**
Public and Community Services	**983**	**968**	**6**	**983**	**789**	**6**	**3**	**-**	**1**	**4**
Total Commercial	**17,336**	**16,733**	**445**	**16,820**	**13,504**	**445**	**290**	**56**	**30**	**276**
Private Individuals - Housing Loans	**3,497**	**3,412**	**57**	**3,497**	**3,271**	**57**	**-**	**3**	**-**	**16**
Private Individuals - Other	**4,470**	**4,238**	**70**	**4,460**	**3,521**	**70**	**26**	**6**	**5**	**22**
Total Public	**25,303**	**24,383**	**572**	**24,777**	**20,296**	**572**	**316**	**65**	**35**	**347**
Banks in Israel	**157**	**157**	**-**	**106**	**106**	**-**	**-**	**-**	**-**	**1**
Israeli Government	**2,716**	**2,716**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total Landing Activity in Israel	**28,176**	**27,256**	**572**	**24,883**	**20,402**	**572**	**316**	**65**	**35**	**348**
Lending Activity Outside of Israel										
Industry	**273**	**250**	**-**	**240**	**220**	**-**	**-**	**(1)**	**-**	**2**
Construction and Real Estate - Construction	**193**	**130**	**63**	**188**	**82**	**63**	**-**	**4**	**-**	**4**
Commerce	**83**	**83**	**-**	**83**	**80**	**-**	**-**	**-**	**-**	**-**
Transportation and Storage	**18**	**-**	**18**	**6**	**5**	**6**	**6**	**-**	**-**	**-**
Private Individuals - Housing Loans	**40**	**40**	**-**	**40**	**39**	**-**	**-**	**-**	**-**	**-**
Private Individuals - Other	**8**	**8**	**-**	**8**	**4**	**-**	**-**	**-**	**-**	**-**
Other	**47**	**7**	**25**	**29**	**28**	**25**	**25**	**(1)**	**-**	**13**
Total Public	**662**	**518**	**106**	**594**	**458**	**94**	**31**	**2**	**-**	**19**
Banks	**348**	**348**	**-**	**334**	**310**	**-**	**-**	**-**	**-**	**-**
Governments	**97**	**97**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total Lending Activity Outside of Israel	**1,107**	**963**	**106**	**928**	**768**	**94**	**31**	**2**	**-**	**19**
Total	**29,283**	**28,219**	**678**	**25,811**	**21,170**	**666**	**347**	**67**	**35**	**367**

(1) Balance Sheet and Off-Balance Sheet Credit Risk, including in respect of derivative instruments. Including: Debts[2], bonds, assets in respect of derivative instruments, and credit risk in respect of off-balance sheet financial instruments, as calculated for single borrower liability limitation, guarantees and liabilities on account of clients in an amount of NIS 21,170,3,420,52, and 4,641 million, respectively.

(2) Credit to the Public, Credit to Governments, deposits with banks and other debts.

(3) Credit risk in respect of off-balance sheet financial instruments, as calculated for single borrower liability limitation, excluding in respect of derivative instruments.

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

(5) Credit risk, the credit rating thereof at date of reporting matches the credit rating for the granting of new credit in accordance with the Bank's policy of the Bank.

(6) Balance sheet and off-balance sheet credit risk, which is impaired, substandard or under special mention, including in respect of housing loans, in respect of which an allowance is made according to the extent of arrears, and housing loans in respect of which no allowance is made according to the extent of arrears, and are in arrears of 90 days or more.

(7) Including balance sheet credit risk in respect of acquisition groups in an amount of NIS 88 millions and off – balance sheet credit risk in an amount of NIS 140 millions.

Appendix no.2 –Exposure to Foreign Countries-Consolidated

A. Information Regarding The Exposure to Foreign Countries*

	Cross border balance sheet exposure[3]							Maturity of balance sheet exposure	
	To governments	To banks	To others	Total	Balance sheet problematic credit risk	Impaired debts	Total off-balance sheet exposure[2][3]	Due up to one year	Due over one year
	NIS millions								
Total exposure to foreign countries:									
December 31, 2016									
United States [1]	**274**	**128**	**95**	**497**	**-**	**-**	**6**	**164**	**333**
Other	**40**	**189**	**166**	**395**	**1**	**-**	**[4]881**	**225**	**170**
Total	**314**	**317**	**261**	**892**	**1**	**-**	**887**	**389**	**503**
Of which - Total exposure to LDC countries	**-**	**-**	**15**	**15**	**-**	**-**	**27**	**2**	**13**
December 31, 2015									
United States [1]	97	161	96	354	-	-	6	180	174
Other	-	160	205	365	-	-	55	187	178
Total	97	321	301	719	-		61	367	352
Of which - Total exposure to LDC countries	-	3	18	21	-	-	28	5	16

Notes:

(1) On the basis of the ultimate risk, net of guaranties and liquid collateral. This table presents detailed information regarding countries, the credit exposure of the Bank in respect of which exceeds 1% of total assets of the Bank.

(2) Credit risk of off-balance sheet financial instruments as computed for the purpose of borrower indebtedness limitations.

(3) Balance sheet and off-balance sheet credit risk, Problematic credit risk and impaired debts are presented before the impact of the allowance for credit losses and before the impact of collateral that are deductible for the purpose of a borrower or a group of borrowers liability.

(4) Including exposure to foreign reinsurers amounting to NIS 827 million, stemming from agreements signed with such reinsurers obligating them to indemnify the Bank in respect of realized credit losses on guarantees issued by the Bank under the Sale Act regarding certain apartments (see Chapter 8B(4) above).

B. Information regarding countries the amount of exposure in respect of each exceeds 0.75% of total consolidated assets of the Bank

As of December 31, 2016 the Bank had no credit exposure exceeding 0.75% of total assets of the Bank (but lower than 1%). (31.12.2015- Identical).

C. Information regarding balance-sheet exposure to foreign countries having liquidity problems.

The bank's exposure to foreign countries having liquidity problems as of December 31, 2016 amounts to NIS 3 millions (31.12.2015- NIS millions).

* The Bank's exposure as of December 31, 2016, to the countries of Portugal, Spain, Italy, Ireland and Cyprus that had been included in the bailout program instituted by the Central European Bank and the International Monetary Fund, amounted to NIS 6 million (December 31, 2015 – NIS 13 million). As of December 31, 2016, the Bank had no off-balance sheet credit exposure to these countries (December 31, 2015 – Identical).

Appendix no.3 –Exposure to changes in interest rates - consolidated

	31 December 2016												31 December 2015		
	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 3 years	Over 3 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	No fixed maturity date	Total fair value	Internal rate of return In %	Effective average maturity In years	Total fair value	Internal rate of return In %	Effective average maturity In years
					NIS millions						%	Years		%	Years
Non linked Israeli currency															
Financial assets and amounts receivable in respect of derivative instruments															
Financial assets*	**19,591**	**1,623**	**1,410**	**1,064**	**1,373**	**463**	**73**	**19**	**74**	**25,690**	**3.32**	**0.54**	24,878	3.07	0.46
Derivative financial instruments (except for options)	**220**	**52**	**151**	**5**	**-**	**-**	**-**	**-**	**-**	**428**		**0.29**	1,048		0.21
Options (in terms of base assets)	**-**	**6**	**14**	**26**	**7**	**-**	**-**	**-**	**-**	**53**		**-**	47		-
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**		**-**	-		-
Total fait value	**19,811**	**1,681**	**1,575**	**1,095**	**1,380**	**463**	**73**	**19**	**74**	**26,171**		****0.53**	25,973		**0.45
Financial liabilities and amounts payable in respect of derivative instruments															
Financial liabilities*	**18,427**	**1,106**	**1,879**	**1,145**	**353**	**507**	**73**	**-**	**-**	**23,490**	**0.20**	**0.45**	21,106	0.16	0.36
Derivative financial instruments (except for options)	**274**	**102**	**579**	**405**	**4**	**94**	**-**	**-**	**-**	**1,458**		**1.08**	3,256		0.56
Options (in terms of base assets)	**-**	**1**	**1**	**8**	**2**	**1**	**-**	**-**	**-**	**13**		**-**	19		-
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	-	-	-
Total fait value	**18,701**	**1,209**	**2,459**	**1,558**	**359**	**602**	**73**	**-**	**-**	**24,961**		****0.49**	24,381		**0.39
Financial instruments, net															
Exposure to changes in interest rates in the segment	**1,110**	**472**	**(884)**	**(463)**	**1,021**	**(139)**	**-**	**19**	**74**	**1,210**					
Total fait value	**1,110**	**1,582**	**698**	**235**	**1,256**	**1,117**	**1,117**	**1,136**	**1,210**				1,592		

Notes:

(1) Full data of the exposure to changes in interest rates in each segment according to the various balance sheet items, is available on request.

(2) Data by period in this table represent the present value of future cash flows for each financial instrument, discounted at such interest rate as to discount them to the fair value included in the financial instrument.

(3) The internal rate of return is the interest rate used to discount the expected cash flows from a financial instrument to its fair value.

(4) The average effective maturity of a group of financial instruments is an approximation of the change, in percentage, in fair value of said group of financial instruments resulting from a small change (0.1% increase) in the internal rate of return of each of the financial instruments.

* Not including balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

** Weighted average by fair value of average effective maturity.

Appendix no.3 –Exposure to changes in interest rates – consolidated (continued)

	31 December 2016												31 December 2015		
	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 3 years	Over 3 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	No fixed maturity date	Total fair value	Internal rate of return In %	Effective average maturity In years	Total fair value	Internal rate of return In %	Effective average maturity In years
	NIS millions										%	Years		%	Years
Non linked Israeli currency															
Financial assets and amounts receivable in respect of derivative instruments															
Financial assets*	**36**	**78**	**642**	**1,727**	**847**	**369**	**24**	**12**	**2**	**3,737**	**1.20**	**2.56**	2,951	1.44	2.76
Derivative financial instruments (except for options)	**-**	**-**	**100**	**403**	**2**	**25**	**2**	**-**	**-**	**532**		**1.8**	1,273		0.79
Options (in terms of base assets)	**-**	**1**	**1**	**8**	**2**	**1**	**-**	**-**	**-**	**13**		**-**	12		-
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**		**-**	-		-
Total fait value	**36**	**79**	**743**	**2,138**	**851**	**395**	**26**	**12**	**2**	**4,282**		****2.46**	4,236		**2.16
Financial liabilities and amounts payable in respect of derivative instruments															
Financial liabilities*	**35**	**158**	**645**	**931**	**799**	**791**	**30**	**-**	**-**	**3,389**	**0.38**	**3.24**	3,776	0.51	3.25
Derivative financial instruments (except for options)	**-**	**6**	**102**	**57**	**100**	**-**	**-**	**-**	**-**	**265**		**2.13**	171		3.86
Options (in terms of base assets)	**-**	**1**	**7**	**21**	**6**	**-**	**-**	**-**	**-**	**35**		**-**	24		-
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	-	-	-
Total fait value	**35**	**165**	**754**	**1,009**	**905**	**791**	**30**	**-**	**-**	**3,689**		****3.13**	3,971		**3.26
Financial instruments, net															
Exposure to changes in interest rates in the segment	**1**	**(86)**	**(11)**	**1,129**	**(54)**	**(396)**	**(4)**	**12**	**2**	**593**					
Total fait value	**1**	**(85)**	**(96)**	**1,033**	**979**	**583**	**579**	**591**	**593**				265		

Notes:

(1) Full data of the exposure to changes in interest rates in each segment according to the various balance sheet items, is available on request.

(2) Data by period in this table represent the present value of future cash flows for each financial instrument, discounted at such interest rate as to discount them to the fair value included in the financial instrument.

(3) The internal rate of return is the interest rate used to discount the expected cash flows from a financial instrument to its fair value.

(4) The average effective maturity of a group of financial instruments is an approximation of the change, in percentage, in fair value of said group of financial instruments resulting from a small change (0.1% increase) in the internal rate of return of each of the financial instruments.

* Not including balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

** Weighted average by fair value of average effective maturity.

Appendix no.3 –Exposure to changes in interest rates – consolidated (continued)

	31 December 2016												31 December 2015		
	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 3 years	Over 3 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	No fixed maturity date	Total fair value	Internal rate of return In %	Effective average maturity In years	Total fair value	Internal rate of return In %	Effective average maturity In years
						NIS millions					%	Years		%	Years
Non linked Israeli currency															
Financial assets and amounts receivable in respect of derivative instruments															
Financial assets*	**819**	**116**	**107**	**517**	**219**	**223**	**1**	**-**	**-**	**2,002**	**2.0**	**1.94**	1,807	2.18	1.14
Derivative financial instruments (except for options)	**664**	**546**	**626**	**33**	**64**	**10**	**-**	**-**	**-**	**1,943**		**0.43**	3,025		0.35
Options (in terms of base assets)	**-**	**1**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**1**		**-**	7		-
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**		**-**	-		-
Total fait value	**1,483**	**663**	**733**	**550**	**283**	**233**	**1**	**-**	**-**	**3,946**		****1.20**	4,839		**0.64
Financial liabilities and amounts payable in respect of derivative instruments															
Financial liabilities*	**1,999**	**282**	**394**	**22**	**6**	**14**	**3**	**-**	**-**	**2,720**	**0.69**	**0.17**	2,826	0.37	0.19
Derivative financial instruments (except for options)	**508**	**104**	**342**	**33**	**12**	**231**	**2**	**-**	**-**	**1,232**		**1.80**	2,009		1.65
Options (in terms of base assets)	**-**	**5**	**6**	**4**	**1**	**-**	**-**	**-**	**-**	**16**		**-**	22		-
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	-	-	-
Total fait value	**2,507**	**391**	**742**	**59**	**19**	**245**	**5**	**-**	**-**	**3,968**		****0.67**	4,857		**0.79
Financial instruments, net															
Exposure to changes in interest rates in the segment	**(1,024)**	**272**	**(9)**	**491**	**264**	**(12)**	**(4)**	**-**	**-**	**(22)**					
Total fait value	**(1,024)**	**(752)**	**(761)**	**(270)**	**(6)**	**(18)**	**(22)**	**(22)**	**(22)**				(18)		

Notes:

(1) Full data of the exposure to changes in interest rates in each segment according to the various balance sheet items, is available on request.

(2) Data by period in this table represent the present value of future cash flows for each financial instrument, discounted at such interest rate as to discount them to the fair value included in the financial instrument.

(3) The internal rate of return is the interest rate used to discount the expected cash flows from a financial instrument to its fair value.

(4) The average effective maturity of a group of financial instruments is an approximation of the change, in percentage, in fair value of said group of financial instruments resulting from a small change (0.1% increase) in the internal rate of return of each of the financial instruments.

Notes:

* Not including balance sheet balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

** Weighted average by fair value of average effective duration.

*** Including Israeli currency linked to foreign currency.

**** Including shares listed under "No fixed maturity".

***** Including share options presented in the column "No fixed maturity date"

****** Including nonfinancial liabilities presented in the column "No fixed maturity date"

Appendix no.3 –Exposure to changes in interest rates – consolidated (continued)

	31 December 2016												31 December 2015		
	On demand or within 1 month	Over 1 month and up to 3 months	Over 3 months and up to 1 year	Over 1 year and up to 3 years	Over 3 years and up to 5 years	Over 5 years and up to 10 years	Over 10 years and up to 20 years	Over 20 years	No fixed maturity date	Total fair value	Internal rate of return In %	Effective average maturity In years	Total fair value	Internal rate of return In %	Effective average maturity In years
					NIS millions						%	Years		%	Years
Non linked Israeli currency															
Financial assets and amounts receivable in respect of derivative instruments															
Financial assets*	20,446	1,817	2,159	3,308	2,439	1,055	98	31	89	31,442	2.98	0.87	29,648	2.85	0.73
Derivative financial instruments (except for options)	848	598	877	441	66	35	2	-	-	2,903		0.66	5,346		0.43
Options (in terms of base assets)	-	8	15	34	9	1	-	-	-	67		-	66		-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	-		-	-		-
Total fait value	21,330	2,423	3,051	3,783	2,514	1,091	100	31	89	34,412		**0.85	35,060		**0.68
Financial liabilities and amounts payable in respect of derivative instruments															
Financial liabilities*	20,461	1,546	2,918	2,098	1,158	1,312	106	-	-	29,599	0.27	0.74	27,708	0.23	0.74
Derivative financial instruments (except for options)	782	212	1,023	495	116	325	2	-	-	2,955		1.47	5,436		1.07
Options (in terms of base assets)	-	7	14	33	9	1	-	-	-	64		-	65		-
Off-balance sheet financial instruments	-	-	-	-	-	-	-	-	-	19	-	-	16	-	-
Total fait value	21,243	1,765	3,955	2,626	1,283	1,638	108	-	19	32,637		**0.81	33,225		**0.79
Financial instruments, net															
Exposure to changes in interest rates in the segment	87	658	(904)	1,157	1,231	(547)	(8)	31	70	1,755					
Total fait value	87	745	(159)	998	2,229	1,682	1,674	1,705	1,755				1,835		

Notes:

(1) Full data of the exposure to changes in interest rates in each segment according to the various balance sheet items, is available on request.

(2) Data by period in this table represent the present value of future cash flows for each financial instrument, discounted at such interest rate as to discount them to the fair value included in the financial instrument.

(3) The internal rate of return is the interest rate used to discount the expected cash flows from a financial instrument to its fair value.

(4) The average effective maturity of a group of financial instruments is an approximation of the change, in percentage, in fair value of said group of financial instruments resulting from a small change (0.1% increase) in the internal rate of return of each of the financial instruments.

Notes:

* Not including balance sheet balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

** Weighted average by fair value of average effective duration.

*** Including Israeli currency linked to foreign currency.

**** Including shares listed under "No fixed maturity".

***** Including share options presented in the column "No fixed maturity date"

****** Including nonfinancial liabilities presented in the column "No fixed maturity date"

Certification

I, Joshua Burstein, hereby certify as follows:

1. I have reviewed the annual report of Mercantile Discount Bank Ltd. (hereinafter: “the Bank”) for the year 2016 (hereinafter: “the Report”):
2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the Report;
3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations, changes in shareholders’ equity and cash flows of the Bank as of, and for, the periods presented in this report;
4. I and other officers of the Bank providing this certification are responsible for establishing and maintaining disclosure controls and procedures[2] and the internal control of the Bank over financial reporting[1], and have:
   (a) Established such controls and procedures, or caused such controls and procedures to be established under our supervision, intended to ensure that material information relating to the Bank, including its consolidated subsidiaries, is made known to us by others within the Bank and those entities, particularly during the period of preparing this Report;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accepted accounting principles and directives and guidelines of the Supervisor of Banks;
   (c) Evaluated the effectiveness of the Bank’s disclosure controls and procedures and presented in the Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report based on such evaluation; and
   (d) Disclosed in the Report any change in the Bank’s internal control over financial reporting that occurred in the fourth quarter that has materially affected, or is reasonably likely to materially affect, the Bank’s internal control over financial reporting.

[2] As defined in the Public Reporting Directives regarding "Directors and Management Report".

5. I and the other officers of the Bank providing this certification have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's Auditors, to the Board of Directors and to the Audit Committee of the Board of Directors:

   (a) All significant deficiencies and material weaknesses relating to the establishment or operation of internal control over financial reporting, which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves Management or other employees who have a significant role in the Bank's internal control over financial reporting.

Nothing in that stated above derogates my responsibility or the responsibility of any other person under any law.

Joshua Burstein
General Manager

February 26, 2017.

Certification

I, Avi Rishpan, hereby certify as follows:

1. I have reviewed the annual report of Mercantile Discount Bank Ltd. (hereinafter: “the Bank”) for the year 2016 (hereinafter: “the Report”):
2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the Report;
3. Based on my knowledge, the financial statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations, changes in shareholders’ equity and cash flows of the Bank as of, and for, the periods presented in this report;
4. I and other officers of the Bank providing this certification are responsible for establishing and maintaining disclosure controls and procedures[1] and the internal control of the Bank over financial reporting[1], and have:
   (a) Established such controls and procedures, or caused such controls and procedures to be established under our supervision, intended to ensure that material information relating to the Bank, including its consolidated subsidiaries, is made known to us by others within the Bank and those entities, particularly during the period of preparing this Report;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accepted accounting principles and directives and guidelines of the Supervisor of Banks;
   (c) Evaluated the effectiveness of the Bank’s disclosure controls and procedures and presented in the Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report based on such evaluation; and
   (d) Disclosed in the Report any change in the Bank’s internal control over financial reporting that occurred in the fourth quarter that has materially affected, or is reasonably likely to materially affect, the Bank’s internal control over financial reporting.

[1] As defined in the Public Reporting Directives regarding "Directors and Management Report".

5. I and the other officers of the Bank providing this certification have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's Auditors, to the Board of Directors and to the Audit Committee of the Board of Directors:

   (a) All significant deficiencies and material weaknesses relating to the establishment or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves Management or other employees who have a significant role in the Bank's internal control over financial reporting.

Nothing in that stated above derogates my responsibility or the responsibility of any other person under any law.

Avi Rishpan
Deputy General Manager and
Chief Accounting Officer

February 26, 2017.

Report of the Directors and Management on Internal Control over Financial Reporting

The Board of Directors and Management of Mercantile Discount Bank Ltd. (hereinafter – “the Bank”) are responsible for establishing and maintaining effective internal control over financial reporting (as defined in the public reporting instructions regarding “Directors and Management Report”).

The internal control system of the Bank has been designed to provide reasonable assurance to the Board of Directors and Management regarding the preparation and the fair presentation of financial statements published in accordance with accepted accounting principles and directives and guidelines of the Supervisor of Banks.

Regardless of the quality of their level of design, all internal control systems have inherent limitations. Therefore, even if these systems are determined effective, they can provide only a reasonable degree of assurance regarding the preparation and presentation of the financial report.

Management, under the supervision of the Board of Directors, maintains a comprehensive system of controls intended to ensure that transactions are made in accordance with authorization of Management, assets are protected and the accounting records are reliable. In addition, Management, under the supervision of the Board of Directors, takes the necessary actions to ensure that communication and information channels are effective and monitor performance, including performance of internal control procedures.

Management, under the supervision of the Board of Directors, assessed the effectiveness of the Bank’s internal control over financial reporting as of December 31, 2016, based on criteria set forth in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO - 1992). Based on that assessment, Management believes that as of December 31, 2016, the Bank’s internal control over financial reporting is effective.

The effectiveness of the Bank’s internal control over financial reporting as of December 31, 2016 has been audited by the independent auditors of the Bank, Messrs. Somekh Chaikin and Ziv Haft, Certified Public Accountants, as stated in their report presented on page ___, which includes an unqualified opinion regarding the effectiveness of the Bank’s internal control over financial reporting as of December 31, 2016.

Yair Avidan	Joshua Burstein	Avi Rishpan
Chairman of the Board of Directors	General Manager	Deputy General Manager and Chief Accounting Officer

February 26, 2017.

KPMG
Somekh Chaikin

BDO
Ziv Haft

Tel Aviv, February 26, 2017

Report of Independent Auditors to the shareholders of
Mercantile Discount Bank Ltd.

In accordance with the Public Reporting Directives of the Supervisor of Banks regarding internal control over financial reporting

We have audited the internal control over financial reporting of Mercantile Discount Bank Limited (hereinafter – "the Bank") as of December 31, 201**5**, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (hereinafter – "COSO - 1992"). The Bank's Board of Directors and Management are responsible for maintaining effective internal control over financial reporting and for their assessment of the effectiveness of internal control over financial reporting, included in the accompanying Directors' and Management's reports on internal control over financial reporting. Our responsibility is to express an opinion on the Bank's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the United States Public Company Accounting Oversight Board (PCAOB) regarding the audit of internal control over financial reporting, as adopted by the Institute of Certified Public Accountants in Israel. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

The internal control of a bank over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in Israel (Israeli GAAP) and directives and guidelines of the Supervisor of Banks. The internal control of a bank over financial reporting includes those policies and procedures that:
(1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets of the bank (including disposals thereof);
(2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with Israeli GAAP and directives and guidelines of the Supervisor of Banks, and that receipts and expenditure of the bank are being made only in accordance with authorizations of Management and Directors of the bank;
(3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition (including disposal) of the bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Bank maintained, in all material respects, effective material control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework issued by COSO.

We also have audited, in accordance with accepted auditing standards in Israel and certain auditing standards applied in the audit of banking corporations as determined by directives and guidelines of the Supervisor of Banks, the accompanying consolidated balance sheets of the Bank as of December 31, 2016 and 2015 and the consolidated statements of profit and loss, the statements of comprehensive profit, the statement of changes in shareholders' equity and the statements of cash flows of the Bank - for each of the years in the three-year period ended on December 31, 2016, and our report dated February 26, 2017, expressed an unqualified opinion on the said financial statements.

Somekh Chaikin	Ziv Haft
Certified Public Accountants (Isr.)	Certified Public Accountants (Isr.)

KPMG **BDO**
Somekh Chaikin **Ziv Haft**

Tel Aviv, February 26, 2017

Auditors' Report to the Shareholders of
Mercantile Discount Bank Limited – Annual Financial Statements

We have audited the accompanying consolidated balance sheets of Mercantile Discount Bank Limited and its consolidated subsidiaries (hereinafter – "the Bank") as of December 31, 2016 and 2015, and the related consolidated statements of profit and loss, statements of comprehensive profit, statements of changes in shareholders' equity and statements of cash flows of the for each of the years in the three-year period ended on December 31, 2016. These financial statements are the responsibility of the Bank's Board of Directors and Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards, including standards prescribed by the Auditors' Regulations (Auditor's Mode of Performance), 1973, and certain auditing standards applied in the audit of banking corporations as determined by directives and guidelines of the Supervisor of Banks. Such standards require that we plan and perform our audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank's Board of Directors and Management, as well as evaluating the overall financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank and of its consolidated subsidiaries as at December 31, 2016 and 2015, and the results of operations, changes in shareholders' equity and cash flows of the Bank and of its consolidated subsidiaries for each of the years in the three-year period ended on December 31, 2016, in conformity with generally accepted accounting principles in Israel (Israeli GAAP). Furthermore, in our opinion, the financial statements have been prepared in accordance with the directives and guidelines of the Supervisor of Banks.

We have also audited in accordance with standards prescribed by the United States Public Company Accounting Oversight Board (PCAOB), as adopted by the Institute of Certified Public Accountants in Israel, the internal control of the Bank over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO - 1992), and our report dated February 26, 2017, expressed an unqualified opinion on the maintenance of an effective internal control over the financial reporting of the Bank.

Somekh Chaikin Ziv Haft
Certified Public Accountants (Isr.) Certified Public Accountants (Isr.)

Consolidated Statements of Profit and Loss for the Years Ended December 31

Reported amounts (NIS millions)

	Note	2016	2015	2014
Interest income	2	**1,058**	**974**	1,011
Interest expenses	2	**124**	**102**	211
Net interest income		**934**	**872**	800
Provision for credit losses	13,29	**36**	**67**	15
Net interest income after provision for credit debts		**898**	**805**	785
Non-interest income				
Non-interest financing income (expenses)	3	**36**	**37**	42
Fees	4	**304**	**310**	313
Other income (expenses)	5	**9**	**33**	1
Total non-interest income		**349**	**380**	356
Operating and other expenses				
Salaries and related expenses	6	**581**	518	585
Maintenance and depreciation of buildings and equipment	15	**154**	152	150
Other expenses	7	**175**	171	167
Total operating and other expenses		**910**	841	902
Profit before taxes		**337**	344	239
Provision for taxes on profit	8	**146**	136	94
Profit after taxes		**191**	208	145
Banks net share in the results of investee companies, after taxes	14	**2**	2	2
Net profit		**193**	210	147
Earnings per share (in NIS thousands)	9			
Stock per share of NIS 0.1		**1.55**	1.69	1.18
Stock per share of NIS 0.01		**0.15**	0.17	0.12

The notes to the financial statements are an integral part thereof.

Yair Avidan
Chairperson of the Board of Directors

Joshua Burstein
General Manager

Avi Rishpan
Senior Vice General Manager and
Chief Accounting Officer

Date of approval of the financial statements: February 26, 2017

Consolidated Statement of Comprehensive Profit

Reported amounts (NIS millions)

	Year ended December 31,		
	2016	**2015**	**2014**
Net profit	193	210	147
Other comprehensive profit (loss) before taxes**:**			
Adjustments in respect of presentation of available-for-sale securities at fair value, net	**(37)**	(49)	(27)
Adjustment of liabilities in respect of employee rights (1)	**(40)**	13	(41)
Other comprehensive loss before taxes	**(77)**	(36)	(68)
Related tax effect	**25**	13	25
Other comprehensive loss after taxes	**(52)**	(23)	(43)
Total comprehensive profit	**141**	187	104

The notes to the financial statements are an integral part thereof.

(1) Comprises mainly adjustments of actuarial assessments relating to severance compensation and to post-retirement benefits, as well as amortization of amounts recorded in prior years in other comprehensive profit.

Consolidated Balance Sheets as at December 31

Reported amounts (NIS millions)

	Note	2016	2015
Assets			
Cash and deposits with banks	11	**3,422**	5,502
Securities [(1),(2)]	12	**6,002**	3,432
Credit to the public	13, 29	**22,439**	20,754
Allowance to the credit losses	13, 29	**(348)**	(337)
Credit to the public, net		**22,001**	20,417
Investments in investee companies	14	**9**	7
Buildings and equipment	15	**358**	346
Assets in respect of derivative instruments	26	**26**	31
Other assets	16	**346**	341
Total assets		**32,164**	30,076
Liabilities and shareholders' equity			
Deposits from the public	17	**27,199**	25,388
Deposits from banks	18	**259**	459
Deposits from the Government		**149**	151
Subordinated capital notes	19	**926**	672
Liabilities in respect of derivative instruments	26	**79**	122
Other liabilities [(3)]	20	**1,308**	1,181
Total liabilities		**29,920**	27,973
Shareholders' equity	22	**2,244**	2,103
Total liabilities and shareholders' equity		**32,164**	30,076

The notes to the financial statements are an integral part thereof.

(1) The balance includes securities pledged to lenders in the amount of NIS 369 million (2015 - NIS 384 million).
(2) The balance includes securities presented at fair value in the amount of NIS 5,693 million (2015- NIS 3,120 million).
(3) The balance includes provision for credit losses in respect of off-balance sheet credit instruments in the amount of NIS 28 million (2015- NIS 29 million).

Statement of Changes in Shareholders' Equity

Reported amounts (NIS millions)

	Paid-up share capital	Capital reserves	Total capital and capital reserves	Cumulative other comprehensive Profit	Retained earnings	Total shareholders' equity
Balance as at January 1, 2014	51	152	203	21	1,633	1,857
Other comprehensive loss, net after tax effect	-	-	-	(43)	-	(43)
Dividend paid	-	-	-	-	(45)	(45)
Net profit for the year	-	-	-	-	147	147
Balance as at December 31, 2014	51	152	203	(22)	1,735	1,916
Other comprehensive loss, net after tax effect	-	-	-	(23)	-	(23)
Net profit for the year	-	-	-	-	210	210
Balance as at December 31, 2015	51	152	203	(45)	1,945	2,103
Other comprehensive loss, net after tax effect	**-**	**-**	**-**	**(52)**	**-**	**(52)**
Net profit for the year	**-**	**-**	**-**	**-**	**193**	**193**
Balance as at December 31, 2016	**51**	**152**	**203**	**(97)**	**2,138**	**2,244**

The notes to the financial statements are an integral part thereof.

Consolidated Statements of Cash Flows for the Years Ended December 31

Reported amounts (NIS millions)

	2016	2015	2014
Cash flows generated by operating activities			
Net profit for the year	**193**	210	147
Adjustments to reconcile net profit to net cash flows generated by operating activities (Appendix A)	**270**	259	235
Net cash inflow generated by operating activities	**463**	469	382
Change in asset activities, net:			
Deposits with banks, net	**254**	(294)	134
Credit to the public	**(1,660)**	(1,658)	(1,400)
Assets regarding derivatives	**5**	(1)	(6)
Securities held for trading, net	**-**	(5)	15
Other assets	**2**	34	(29)
Total change in asset activities	**(1,399)**	(1,924)	(1,286)
Change in liability activities, net:			
Deposits from the public	**1,811**	1,328	96
Deposits from banks	**(200)**	(33)	5
Deposits from the Government	**(2)**	12	(29)
Liabilities regarding derivatives	**(43)**	13	(31)
Other liabilities	**44**	7	20
Total change in liabilities activities	**1,610**	1,327	61
Net cash from (for) operating activities:	**674**	(128)	(843)
Cash flows generated by investing activities:			
Proceeds from sale of investee company activities	**-**	-	1
Purchase of securities available for sale	**(4,980)**	(2,748)	(1,399)
Purchase of bonds held to maturity	**-**	-	(19)
Proceeds from sale of securities available for sale	**1,330**	2,560	1,512
Proceeds from redemption of securities available for sale	**761**	848	2,284
Acquisition of buildings, equipment	**(80)**	(59)	(46)
Proceeds from sale of buildings and equipment	**17**	81	-
Dividend received from an affiliated company	**-**	6	-
Cash net, from (used for)investing activities	**(2,952)**	688	2,331
Cash flows generated by financing activities:			
Dividend paid to shareholders	**-**	-	(45)
Bonds issuing	**253**	-	-
Repayment of subordinated capital notes	**(26)**	(28)	(170)
Cash net, used for financing activities	**227**	(28)	(215)
Increase (decrease) in cash	**(2,051)**	532	1,275
Effect of exchange rate changes on cash	**(18)**	(6)	54
Balance of cash at beginning of year	**5,407**	4,881	3,552
Balance of cash at end of year	**3,338**	5,407	4,881

The notes to the financial statements are an integral part thereof.

Appendices to the Consolidated Statements of Cash Flows for the Years Ended December 31

Reported amounts (NIS millions)

	2016	2015	2014
Appendix A - Adjustments to reconcile net profit to net cash flows generated by operating activities			
The Bank's share in net gains of investee companies	**(2)**	(2)	(2)
Depreciation and other amortizations	**56**	57	59
Credit loss expenses	**74**	169	120
Net gain on sale of securities available-for-sale and held to redemption	**40**	8	20
Provision for impairment of securities available for sale	**-**	(1)	(2)
Realized and unrealized, losses (gains) on adjustments to fair value of securities held for trading	**-**	1	(1)
Loss (gain) on sale of buildings and equipment	**(8)**	(33)	-
Deferred taxes, net	**18**	36	(3)
Increase (decrease) in provisions for severance compensation, net	**47**	(1)	70
Adjustment in value of subordinated capital notes	**27**	19	28
Exchange rate differences on cash	**18**	6	(54)
Total adjustments to cash generated by operating activities	**270**	259	235
Appendix B - Non-cash activities			
Acquisition of buildings and equipment	**4**	7	6
Lending of securities (return of securities on loan)	**242**	(313)	(114)
Appendix C – Information regarding interest and taxes received (paid)			
Interest received	**1,121**	1,146	1,118
Dividends received	**-**	-	-
Interest paid	**(114)**	(371)	(409)
Taxes on income paid	**(151)**	(117)	(82)
Taxes on income received	**19**		

Notes to the financial statements as of December 31, 2016

Note 1 – Significant Accounting and Reporting Policies

A. General

(1) Mercantile Discount Bank Ltd. (hereinafter – "the Bank") is a banking corporation. The consolidated financial statements as of December 31, 2016, include those of the Bank and of companies held by the Bank (hereinafter – "the Group" or "consolidated"). The financial statements are prepared in accordance with accounting principles generally accepted in Israel (Israeli GAAP) and in accordance with directives and guidelines of the Supervisor of Banks.

(2) Since there are no significant differences between the consolidated data and the data for the Bank, the financial statements and the notes thereto are presented on a consolidated basis only. Information relating to the financial statements of the Bank is presented in Note 34.

(3) The Board of Directors of the Bank approved the financial statements for publication on February 26, 2017.

(4) Definitions –

In these financial statements

(a) **Consolidated subsidiaries -** Companies the financial statements of which are fully consolidated, directly or indirectly, with those of the Bank.

(b) **Affiliated companies -** Companies, other than consolidated subsidiaries, the investment in which is included in the financial statements of the Bank, directly or indirectly, on equity basis.

(c) **Investee companies -** Consolidated subsidiaries and affiliated companies.

(d) **Functional currency –** The currency of the principal economic environment in which the Bank operates; generally this is the currency of the environment in which the Bank generates and spends most of the cash. The functional currency of the Bank is the New Israel Shekel (NIS).

(e) **Reporting currency –** The currency in which the financial statements are presented.

(f) **Related parties –** As defined in Directives of the Supervisor of Banks.

(g) **Interested parties –** As defined in paragraph 1 of the "Interested party in a corporation" definition, in Section 1 of the Securities Act, 1968.

(h) **CPI –** The consumer price index in Israel published by the Central Bureau of Statistics.

(i) **Adjusted amount –** An amount in nominal historical terms adjusted to the CPI for December 2003, in accordance with Opinions Nos. 23 and 36 of the Institute of Certified Public Accountants in Israel.

Note 1 - Significant Accounting and Reporting Policies (cont'd)

A. General (cont'd)

(j) **Reported amount –** Adjusted amount to date of transition (December 31, 2003), together with nominal amounts which were added subsequent to the date of transition, and less amounts which were deducted after that date.

(k) **Fair value –** The price that would have been received on the sale of an asset or the price that would have been paid upon the transfer of a liability in a regular transaction between participants in the market on date of measurement.

(l) **Cost –** Cost in reported amounts.

(m) **Nominal financial reporting –** Financial reporting based on reported amounts.

(n) **International Financial Reporting Standards** – Standards and interpretations adopted by the Accounting Standards Board (IASB), which include international financial reporting standards (IFRS), and international accounting standards (IAS), as well as interpretations of these standards promulgated by the International Financial Reporting Interpretation Committee (IFRIC) or interpretations issued by the Standing Interpretation Committee (SIC).

(o) **Accounting principles accepted by US banks** – Accounting principles, which US banks are required to implement, promulgated by the bank supervisory authorities in the US, the US Securities and Exchange Commission, the US Accounting Standards Board and additional bodies, and which are applied according to the reporting hierarchy determined in the codification of accounting standards published by the US Accounting Standards Board (FAS 168).

B. Basis for the preparation of the financial statements

(1) Principles of financial reporting

The financial statements have been prepared according to the following financial reporting standards scale:

- As a general rule, the financial statements are prepared according accepted accounting principles in Israel (Israeli GAAP) and in accordance with the principles determined in the public reporting directives and guidelines of the Supervisor of Banks (hereinafter – "Supervisor's directives").
- As regards principal issues, the Supervisor's directives are based on accounting principles accepted by US banks. In other matters (that are less material) the Supervisor's directives are based on international financial reporting standards (IFRS) and on accounting principles accepted in Israel (Israeli GAAP).
- Where international financial reporting standards (IFRS) offer several alternatives or do not refer specifically to a given situation, the Supervisor's directives include specific application guidelines, mostly based on US accepted accounting principles.

Note 1 - Significant Accounting and Reporting Policies (cont'd)

B. Basis for the preparation of the financial statements (cont'd)

(2) Basis of presentation of the financial data

The data is presented in the financial statements as follows:

(a) Balance Sheet Data

- Monetary items are stated in nominal historical values.
- Non-monetary items are stated in reported amounts.

(b) Operating Data

- Income and expenses deriving from monetary items are stated in nominal values.
- Income and expenses deriving from non-monetary items (such as: depreciation and amortization and prepaid income and expenses) are derived from changes in the relevant non-monetary balance sheet item.

(3) Functional currency and reporting currency

The NIS is the currency which represents the principal economic environment in which the Bank operates.

(4) Basis of measurement

The financial statements have been prepared on the historical cost basis, excluding assets and liabilities as detailed below:

- Derivative financial instruments and other financial instruments measured by the fair value method (investment in securities, credit deriving from the lending of securities and deposits relating to employee rights).
- Assets and liabilities deriving from provisions (such as: income receivable and expenses payable, deferred tax provisions and liabilities in respect of employee rights).
- Investment in affiliates treated by the equity method of accounting.

(5) Use of Estimates

(a) General

The preparation of financial statements in accordance with generally accepted accounting principles in Israel (Israeli GAAP) and directives and guidelines of the Supervisor of Banks, involves judgment, assumptions and use of estimates which affect the reported amounts of asset and liabilities, the disclosure relating to contingent assets and liabilities as well as amounts of income and expenses for the reported period. The assessments are based on assumptions made by Management of the Bank, which involve uncertainty or are sensitive to various variables. Management's assessments are based on past experience, observable data, and reasonable assumptions adjusted to the circumstances of each assessment. The assessments and assumptions on which they are based are updated on a current basis, and their results are reflected in the financial statements for the period in respect of which the update has been made.

It is clarified, however, that the future realization of such assessments and estimates may differ from the estimates included in the financial statements. For additional information regarding changes in estimates in respect of the Bank's liability for the payment of severance compensation to employees, see item (b) below. Moreover, different estimates have been revised following the application of new accounting principles and reporting instructions, as discussed in Section D. below.

(b) Liability for the payment of severance compensation to employees

Section P. below, contains information regarding accounting principles applied by the Bank in the calculation of its liability in respect of "employee rights", including estimates involved in the computation of allowances in respect of the liabilities for the payment of severance compensation to Bank employees.

The Board of Directors approved on September 11, 2016, an efficiency program formed by Management of the Bank, which includes a voluntary retirement plan for employees under beneficial terms (see also Note 21D. below).

Furthermore, during the reported period, the Bank updated the actuarial assessments used in the computation of allowances made in respect of the Bank's liability for the payment of severance compensation to its employees, based on updated data regarding the rates of employee retirement and the enlarged amounts of severance compensation paid to retiring employees, and in accordance with forecasts by the Bank as to the enlarged amounts of compensation which the Bank may have to pay in the future.

Following the approval of the plan, which includes higher retirement benefits than those in practice at the Bank in the past, and following the updating of the actuarial assessments, as stated, the Bank increased in 2016 the allowances in respect of liabilities for the payment of severance compensation by an amount of NIS 54 million.

Note 1 - Significant Accounting and Reporting Policies (cont'd)

C. Information regarding the impact of new accounting standards and directives of the Supervisor of Banks in the period prior to their implementation

(1) Adoption of international financial reporting standards (IFRS)

Following the publication of Accounting Standard No. 29 which applies the International Financial Reporting Standards (IFRS) to entities that are subject to the Securities Law – 1968 (but which does not apply to banking corporations, the financial statements of which are prepared according to directives and guidelines of the Supervisor of Bank), Bank of Israel published on June 7, 2009 a document, which includes an outline for the adoption of the international financial reporting standards in financial reporting by banking corporations in Israel. The outline establishes a differentiation between reporting standards relating to issues constituting the essence of banking business and reporting standards relating to other matters, as follows:

(a) International Financial Reporting Standards, which do not apply to matters relating to the essence of banking business were to be adopted gradually in the years 2011-2012 (most of the said Standards have indeed been adopted in the years 2011-2013). For additional details regarding the decision of Bank of Israel to adopt US accepted accounting principles in this matter – see item 2 below.

(b) The target date for the implementation of the international reporting standard relating to issues constituting the essence of banking business should have been determined by Bank of Israel in accordance with the progress made in the "convergence process" conducted between the International Standards Board and the US Standards Board.

Information received by Bank of Israel in the reported period shows that the "convergence process" has been discontinued at this stage, and a date for the adoption by the US of the international standards, if at all, has not yet been fixed.

In view of the above and in the light of the significant advantages which Bank of Israel attributes to the adoption of US accounting standards, Bank of Israel issued on January 27, 2014, a draft memorandum for discussion, which includes an outline for the adoption by banking corporations in Israel of US accepted accounting principles.

To date, no binding instruction in this matter has been published and no date has been fixed for the implementation of this outline.

(2) Adoption of certain US accounting standards

Following the outline published by Bank of Israel on January 24, 2014 (see Section 1B. above), Bank of Israel published on October 13, 2016, an amendment to the public reporting instructions, within the framework of which, banking corporations are required to adopt the US accepted accounting principles regarding the following matters:

- Taxes on income
- Noncurrent assets held for sale and discontinued operations
- Fixed assets and impairment of fixed assets, investment property
- Per share earnings
- Cash flow
- Interim period reporting
- Capitalization of interest costs
- Measurement and disclosure of guarantees

The measurement and disclosure guidelines regarding the matters contained in the amendment to the instructions (excluding the item "taxes on income"), take effect on January 1, 2018. The guidelines regarding "taxes on income" took effect on January 1, 2017.

Set below is additional information regarding US accepted accounting principles included in the amendment to the instructions, as stated above, the application of which, might have material implications on measurement and financial reporting:

(a) Amendment of the public reporting instructions regarding reporting in accordance with US accepted accounting principles in the matter of "taxes on income"

The amendment to the public reporting instructions regarding this matter was published by bank of Israel on October 22, 2015. The guidelines contained in the amendment to the instructions require banking corporations to apply, as from January 1, 2017, the accounting principles accepted by US banks regarding this matter, including the measurement and disclosure rules contained in the US accounting and reporting standards.

An update of the instructions contained several changes including:

- Interest income and expenses relating to taxes on income shall be classified to the item "taxes on income";
- Penalties imposed by the Tax Authorities shall be classified to the item "taxes on income";
- The effect of changes in the tax rates on deferred tax balances shall be recognized in profit and loss – also in respect of timing differences recognized outside profit and loss;
- Temporary differences in respect of periods prior to the effective date of the guidelines (January 1, 2017) shall be treated in accordance with the rules in effect until December 31, 2016.

The new guidelines have been initially applied in accordance with transitional instructions determined in the matter, including a retroactive amendment of the comparative data. Management of the Bank estimates that the application of the new accounting rules will not have a material effect on the financial statements, except for implications stemming from disclosure aspects included in the amendment to the instructions.

Note 1 - Significant Accounting and Reporting Policies (cont’d)

C. Information regarding the impact of new accounting standards and directives of the Supervisor of Banks in the period prior to their implementation (cont’d)

(2) Adoption of certain US accounting standards (cont'd)

(b) Amendment of the public reporting instructions regarding reporting in accordance with US accepted accounting principles in the matter of "foreign currency"

The amendment to the public reporting instructions regarding this matter was published by bank of Israel on March 21, 2016. The guidelines contained in the amendment to the instructions require banking corporations to apply, as from January 1, 2017, the accounting principles accepted by US banks in this respect, including the measurement and disclosure rules prescribed by the US accounting and reporting standards, subject to transitional instructions set in the amendment to the instructions, as detailed below:
According to the measurement rules in practice in the US, exchange differences In respect of available-for-sale securities in foreign currency, are recognized in other comprehensive profits (and not in profit and loss, as required by the present guidelines of the Supervisor of Banks).
In order to enable banks to study the implications stemming from the changes in the measurement rules, as stated, and to prepare for their application, Bank of Israel has decided to postpone the effective date of this component of the new measurement rules to January 1, 2019 (hereinafter – "the interim period"). Accordingly, as from the date set for the entry into effect of the new guidelines (January 1, 2017) and until the end of the interim period, banks shall continue to recognize in profit and loss exchange rate differences in respect of available-for-sale securities.
The Bank is preparing to apply the new measurement rules, including the mitigated rules for the interim period, as from their effective date.
Management of the Bank estimates that the application of the new accounting rules will not have a material effect on the financial statements for the interim period.

(c) Amendment to Proper Conduct of Banking Business Directive in the matter of "capital requirements in respect of exposure to central counterparties"

Following an update of the recommendations of the Basel Committee in the matter of capital requirements in respect of exposure to central counterparties, published in July 2012, Bank of Israel published on October 22, 2015, an amendment to Proper Conduct of Banking Business Directive Nos. 203 and 204, in which are contained new guidelines regarding the definition of "central counterparties" and the weight of risk to be allotted to them, as follows:

- "a qualified counterparty" is defined as an entity having permission to act as a central counterparty by a regulator (or supervisor) in respect of specific products offered by him;
- Exposure to "qualified central counterparties", shall be averaged at 2% (instead of the present 0%);
- Exposure to amounts transferred to a "risk fund" of unqualified central parties, shall be averaged at the rate of 1250% (but not in excess of 20% of the amount of exposure to the "central counterparty".

The guidelines contained in the amendment to the Directive should have become effective on July 1, 2016. However, in order to allow the banking corporations to prepare for the implementation of all aspects deriving from the new guidelines, Bank of Israel published on June 1, 2016, an amendment to the Directive which defers the effective date for its application to January 1, 2017. In addition, as part of the transitional instructions contained in the Directive, the Tel Aviv Stock

Exchange will be classified in the first stage, as from date of application of the instruction and until June 30, 2017, as a "qualified central counterparty".

In addition, on December 28, 2016, Bank of Israel issued a guideline permitting the Bank to compute the amount of exposure in respect of the MAOF market activity of customers by the "scenario approach".

The Bank is preparing for the implementation of the guidelines contained in the Directive (including the mitigated guidelines relating to the transitional period) on the amended effective date.

Management of the Bank estimates that application of the guidelines contained in the Directive is not expected to materially reduce the equity capital ratio of the Bank.

D. Information regarding new accounting standards and directives of the Supervisor of Banks initially applied in the reported period

1. Amendment to the public reporting instructions in the matter of "the restructuring of a troubled debt"

As part of the process for the adoption of US accepted accounting standards, as stated, Bank of Israel published on May 22, 2016, an amendment to the public reporting instructions in the matter of "the restructuring of troubled debts".
The amendment to the instructions changes the definitions existing in this matter and states new definitions, including:

- **New criteria for the classification of troubled debts as "restructured debts"**
  In accordance with the guidelines contained in the amended instruction, "inferior debts" are to be classified as "restructured troubled debts", when:
  - Upon renewal of credit classified as an "inferior debt", an updated underwriting process reflecting changes in the risk level of the debt had not been made
  - The underwriting process made in respect of the debt did not involve an updated pricing of the debt (reflecting adjustment to the increase in the risk level of the debt), or alternatively, other measures that would reduce the risk level of the debt (such as: providing additional collateral or guarantors).

- **Mitigated criteria for the classification of "restructured troubled debts"**
  In certain cases, where changes had been made to the original terms of the debt, it may be possible to avoid its classification of as a "restructured troubled debt", such as:
  - The new debt arrangements resulted in only a "negligible delay" (as defined in the amended instruction) in repayments by the debtor.
  - The debt arrangement made with the borrower included an updated underwriting of the borrower's indebtedness (such as: additional collateral) leading to a reduction in the borrower's risk level to its original state.

- **"Following restructure"**
  This classification of a debt is defined as an additional debt arrangement made during the period of a prior debt arrangement (where the debt was classified as a "restructure of a troubled debt"). The guidelines contained in the amended instruction state that it may be possible not to classify the new debt arrangement (the "following restructure") as a "restructured troubled debt", subject to the following conditions:
  - The borrower is no longer in "financial difficulties" (as defined in the amended instruction).

- The new debt arrangement does not include a "waiver" (as defined in the amended instruction).

In addition, the instruction contains new guidelines and new documentation requirements, including:

- At date of the debt arrangement classified as a "restructure of a troubled debt", banking corporations are required to maintain a minimal provision for credit loss, based on the economic sector in which the borrower operates and on the rate of the collective provision for credit losses in respect of "troubled debts" determined for that economic sector.
- A requirement for detailed documentation of the processes relating to the implementation of the guidelines contained in the instructions, including:
  - An analysis of the facts and circumstances related to the debt arrangement and to the market conditions prevailing at date of the arrangement.
  - Documentation of the correlation between the rate of interest fixed in the new debt arrangement and the updated risk level of the borrower, including: Analysis of the financial condition of the borrower, comparison between the interest rate fixed in the new debt arrangement and the interest rates prevailing at the bank in respect of customers having similar financial characteristics and risk levels, analysis of the borrower's credit history as well as the present repayment ability of the borrower.

The guidelines contained in the amended instruction apply to all debts arrangements made as from December 31, 2016 and thereafter, as well as to existing arrangements renewed as from that date. The Bank implements the guidelines contained in the amended instruction as from their effective date.

2. Amendment to Proper Conduct of Banking Business Directive No. 312 in the matter of "related parties"

The rules promulgated by Bank of Israel in the past defined a "related party", inter alia, as anyone holding over 5% of any class of means of control.
On June 16, 2016, Bank of Israel published a letter permitting institutional bodies to hold in investment portfolios managed by them on behalf of customers, means of control in banking corporations at a rate not exceeding 7.5% of the capital of such corporations, without having to obtain a control permit from Bank of Israel prior to making such an investment (instead of the rate of 5% of the capital as determined by the previous policy of Bank of Israel).

Following this mitigating instruction, Bank of Israel published on September 29, 2016 an amendment to Proper Conduct of Banking Business Directive No. 312 in the matter of "related parties", which excludes from the definition of a "related party" investments made by institutional bodies complying with the new restrictions determined by Bank of Israel, as stated.

The new guidelines became effective on date of publication of the amendment to the Directive. The Bank applies the new guidelines as from their effective date.

Application of the new guidelines does not have a material effect in the financial reporting save for disclosure aspects.

3. Amendment to the public reporting instructions in the matter of "reporting segments of operation"

On November 3, 2014, Bank of Israel published an amendment to the public reporting instructions in the matter of "reporting segments of operation", within the framework of which, banking corporations are required to include in their financial statements additional information regarding their results of operation by "regulatory segments of operation" (as detailed in the amendment to the instruction – see also Note 27 below), in a format that connects on a uniform and singular basis, the different customers of the banking sector as a whole and these regulatory segments of operation.

The disclosure format contained in the amended instruction took effect gradually, as follows:

- The disclosure relating to balance sheet data by "regulatory segments of operation" entered into effect on December 31, 2015, and was included in the financial statements of the Bank as of that date.
- The detailed disclosure regarding the operating results of the "financial management" segment takes effect on January 1, 2017.
- The remaining disclosure requirements included in the amended instruction took effect on January 1, 2016.

The Bank applied the disclosure requirements that took effect on January 1, 2016, and included them in these financial statements (see Note 27 below). Whereas the organizational structure of the Bank does not coincide with the distribution of activity according to the "regulatory segments of operation", the reporting of a part of the data included in the Note is based on various assumptions and estimates (mainly with respect to the allocation of expenses), derived from the distribution of costs by segments of operation in accordance with Management's approach (which agrees with the organizational structure of the Bank) and its adjustment to the "regulatory" distribution of operations, by using the "income distribution" key.

4. Adoption of US accepted accounting principles in the matter of "intangible assets)

In continuation of the draft memorandum in the matter of "adoption of US accounting standards", published by Bank of Israel on January 27, 2014 (see Section C (1)(b) above), which includes an outline for the adoption of the US accepted accounting principles by the banking sector in Israel, Bank of Israel issued on October 22, 2015, an amendment to the public reporting instructions, which adopts the US accepted accounting principles regarding "intangible assets". The guidelines contained in the said amendment require banking corporations to apply as from January 1, 2016, the accounting principles accepted by US banks in the matter of "intangible assets", including presentation, measurement and disclosure rules contained in the US accounting and reporting standards.

The new guidelines were applied by the Bank on their effective date, in accordance with transitional instructions issued in this matter. The application of the new accounting rules did not have implications on the financial statements.

5. Changes in the rules applying to the computation of the "provision for credit losses on a collective basis"

(a) Computing the "average loss rates"

Section J(7) below, contains information regarding the rules determined by Bank of Israel in the matter of "provisions for credit losses on a collective basis", including rules for the measurement of the "provision range" component (as defined in Bank of Israel instructions published on January 19, 2015).

In accordance with these rules, the "provision range" component had been computed in the past on the basis of data regarding write-offs reported by the Bank during the past five years preceding the date of computation.

On December 11, 2016, Bank of Israel published a draft amendment to the public reporting instructions, in which banking corporations are required as from the year 2016, to compute the provision range on the basis of write-offs reported in the past six years preceding the computation date (instead of five years, as determined in the public reporting instructions).

As from January 1, 2017, the write-offs data period used for the computation of the provision range, would be extended to seven years.

The Bank applies the new guidelines determined by bank of Israel as from their effective date.

Application of the guidelines had no material effect on the balance of the provision for credit losses assessed on a collective basis.

(b) Computation of the "supplementary provision for doubtful debts"

The instructions in the matter of "provisions for credit losses on a collective basis", issued by bank of Israel on January 19, 2015, require banking corporations to maintain a minimal provision for credit losses on a group basis in an amount of not less than the amount of the general and supplementary provisions for credit losses, as defined in Proper Conduct of Banking Business Directive No. 315, which, inter alia, includes guidelines for the computation of the supplementary provision in respect of deviation from segment indebtedness concentration.

Following agreements signed between a number of banking corporations and re-insurers, whereby these banking corporations purchased insurance cover in respect of credit exposure stemming from guarantees issued by them under the Housing Sale Act, and whereas the agreement with the re-insurers was recognized by Bank of Israel as qualified for the purpose of reducing the credit risk pertaining to those banking corporations – Bank of Israel issued on September 29, 2016, and amendment to Proper Conduct of Banking Business Directive No. 315, which includes mitigating rules as to the computation of the "supplementary provision" in respect of the deviation from segment concentration restrictions.

The amendment to the instruction also permitted banking corporations, which had purchased insurance cover for credit in respect of guarantees issued under the Housing Sale Act, as stated, to change (for the purpose of computing the supplementary provision for doubtful debts component in respect of deviation from the restriction on concentration of credit in the real estate sector) the segment classification of 70% of the Housing Sale Act guarantees, in respect of which re-insurers had provided commitments for indemnification of credit losses, as stated, from the real estate segment to the financial services segment (being the segment of operation for re-insurers).

As stated in Note 23A(4) below, in April 2016, the Bank purchased from re-insurers insurance cover for credit in respect of guarantees issued by it under the Housing Sale Act.

The change in the rules for the computation of the deviation from restrictions on segment indebtedness concentration, as stated, reduced the exposure rate of the Bank to the real estate sector (as defined in Proper Conduct of Banking Business Directive No. 315) as of December 31, 2016, by approximately 1.0 percentage points.

E. Reclassification

Note 28 presents information regarding the distribution of the financial results of the Bank by segments of operation in accordance with "Management approach". Determination of the characteristics for the different segments of operation is based upon the business organizational structure of the Bank, excluding the characteristics determining the household segment and the private banking segment, which are subject to the Retail Division (for which no separate organizational units had been allocated), that were defined as follows:

- **"Households" –** private customers, the nature of operations of whom is typical to that of households, including credit in amounts not exceeding NIS 300 thousand and deposits in amounts not exceeding NIS 500 thousand, as well as activity in the housing loan field.
- **"Private banking" –** customers (both individuals and corporations) having a medium and over financial wealth (generally, customers the volume of their savings and investments exceeds NIS 500 thousand).

Following the publication of the amendment to the public reporting instructions in the matter of "regulatory segments of operation", within the framework of which Bank of Israel stated specific definitions for activities included in the household segment and in the private banking segment, which differ from those that had been determined in the past by the Bank, and whereas the previous definitions determined for these segments by the Bank, as stated, were, in any case, not based upon the organizational structure of the Bank, Management of the Bank decided during the reported period, to change the characteristics determined by Bank of Israel for the "regulatory segments of operation" (excluding deposit activity of "business individuals", which remained in the "commercial banking" segment).

Following the change in definition of these segments of operation, as stated, the balance sheet comparative data regarding credit and deposit balances and the profit and loss comparative data regarding interest and commission income and operating expenses, relating to the household, private banking and small businesses segments, were reclassified in the reported period in order to adjust them to the updated classification prescribed by the new definitions.

F. Consolidation of the financial statements

(1) The consolidated financial statements include the financial statements of the Bank and of its consolidated subsidiaries. Intercompany balances and transactions have been eliminated upon consolidation.

(2) The financial statements of the Bank include the financial statements of Mercantile Issuers Ltd., which is a "service company" as defined in the directives of Bank of Israel.

G. Investments in Investee Companies

The investment in investee companies is stated by the equity method, based on their audited financial statements.

H. Foreign Currency and Linkage

(1) Monetary items denominated in foreign currency or linked thereto or which are linked to the Consumer Price Index (CPI), are stated in the financial statements as follows:

- Those in foreign currency or linked thereto are stated according to the representative rates of exchange published by Bank of Israel as at balance sheet date, or as of another date, according to the terms of the transaction.

- Those fully linked to the CPI are stated on the basis of either the latest known index as at balance sheet date or the index in respect of the last month of the year, depending on their contractual terms.

(2) Income and expenses in foreign currency are included in the Statement of Profit and Loss according to the representative exchange rates prevailing on their accrual dates.

(3) Exchange rate and linkage differences deriving from the adjustment of assets or liabilities in foreign currency or linked thereto or linked to the Consumer Price Index are included in the Statement of Profit and Loss in the appropriate items.

(4) Details of representative exchange rates and the Consumer Price Index:

	December 31				Percentage of change		
	2016	2015	2014	2013	2016	2015	2014
Consumer Price Index "in respect of" the month of December – points	**106.1**	106.3	107.4	107.6	**(0.2)**	(1.0)	(0.2)
"Latest known" Consumer Price Index in the month of December – points	**106.1**	106.4	107.4	107.5	**(0.3)**	(0.9)	(0.1)
Exchange rate of the U.S. dollar – in NIS	**3.845**	3.902	3.889	3.471	**(1.5)**	0.3	12.0

I. Securities

(1) Securities held by the Bank

a. In accordance with the directives of the Supervisor of Banks, the securities portfolio held by the Bank is classified according to three categories:

- **Bonds held to maturity** – These are bonds in respect of which the Bank has the intention and the ability to hold until maturity. The bonds are stated at cost together with accrued CPI or exchange differences and interest as well as the discount or premium component created at purchase date and not yet amortized, and after deduction of a provision for impairment, which is not of a temporary nature.
  Interest income in respect of these bonds is recognized on the accrual basis and is reflected in the Statement of Profit and Loss.

- **Securities held for trading** – Securities, which were purchased and are held for the purpose of being sold in the short term. These are stated at their fair value as at balance sheet date. Gains or losses stemming from their adjustment to market value are reflected in the Statement of Profit and Loss.

- **Available-for-sale securities** – Securities which are not included in the previous category. These are stated at their fair value as at balance sheet date, except for shares the fair value of which is not readily determinable, and are stated at cost net of a provision for impairment, if required. The difference between the written-down cost of such securities and their fair value, net of tax effect, is stated as a separate item in the Statement of Comprehensive Profit.
  Differences between the cost of securities and their written down cost are stated in the Statement of Profit and Loss on the accrual basis.

b. The cost of securities sold is reflected in the Statement of Profit and Loss on the "moving average" basis.

c. Regarding the accounting treatment of impairment of securities – see item N. below.

(2) Securities held by others

Available-for-sale securities on loan by the Bank to other parties – are stated at their fair value under "Credit granted to the public" or under "Deposits with banks" as the case may be. The changes in the value of such securities, on the accrual basis, are reflected in the Statement of Profit and Loss under "Interest income ". The difference between the market value of such securities and their written-down cost is reflected in the statement of changes in shareholders' equity in the item "other comprehensive profit".

J. Credit to the public, impaired debts and credit risk, and provision for credit losses

(1) Credit to the public

Credit to the public and other debt balances, in respect of which specific presentation principles have not been determined (such as: deposits with banks) are presented at the "stated balance of the debt", which is defined as the "outstanding balance of the debt (including interest, linkage increments and exchange differences accrued on the debt) net of accounting write-offs", but before provision for credit losses.

(2) Debts the provision for credit losses in respect of which is assessed on a collective basis

The provision for credit losses in respect of small and homogeneous debts is assessed on a collective basis. Included in such borrower population are all housing loans granted by the Bank (the provision for credit losses in their respect is computed by the "extent of default" method), and other debts, the contractual balance thereof is lower than NIS 500 thousand (until December 31, 2015 – NIS 50 thousand) – see extended discussion in item 4 below.

(3) Debts the provision for credit losses in respect of which is assessed on a specific basis

These include debts the contractual balance of which exceeds NIS 500 thousand (until December 31, 2015 – NIS 50 thousand) – see extended discussion in item 4 below (excluding housing loans the provision for credit loss in their respect is computed by the "extent of default" method), as well as "restructured troubled debts".

(4) Change in accounting policy in the matter of "classification of troubled debts and provisions for credit losses"

The public reporting instructions in the matter of "measurement and disclosure of impaired debts, credit risk and provisions for credit losses" (hereinafter – "the instruction"), published by Bank of Israel on February 18, 2010, require banking corporations to form an accounting policy with respect to the implementation of the guidelines contained in the instruction, which, inter alia, include reference to the different methods used for assessing the provisions for credit losses, as follows:

- **Provision for credit losses on a specific basis** – applied in respect of troubled debts the contractual balance of which exceeds NIS 1 million, and in respect of other identified troubled debts (the provision for credit loss in their respect is not measured on a collective basis).

- **Provision for credit losses assessed on a collective basis** – applied in respect of homogenous groups of credit composed of credit in relatively small amounts (such as: credit card charges, housing loans, instalment consumer credit, etc.) on condition that their contractual debt balance does not exceed NIS 1 million.

As required, the Bank has formed an accounting policy in this matter, within the framework of which a minimal amount of NIS 50 thousand was determined for "homogenous credit groups", as above, namely, debts the balance of which exceeds the said amount are examined by the Bank on a specific basis. This criterion served the Bank in the implementation of the accounting policy in the matter of "classification of troubled debts and assessment of provisions for credit losses", as from the effective date of the instruction (January 1, 2011) and until December 31, 2015.

In the wake of the experience gained by the Bank in the implementation of the instruction, and examinations made by Management of the Bank during the said period, as to the compatibility of the criterion for the determination of the minimal amount of debts tested on a collective basis, with the composition of credit at the Bank and the nature of its operations, which did not indicate significant differences in results produced by the two methods of assessing provisions, as described above, (in respect of small and medium amounts of credit), on the one hand – and in view of the high investment of resources required for the testing of credit on a specific basis (including the requirement for adherence to strict and detailed documentation rules regarding this method of assessment) on the other hand - Management of the Bank decided to change as from January 1, 2016, the accounting policy on this subject and to raise the criteria for the minimal amount of credit tested specifically from NIS 50 thousand to NIS 500 thousand. This change in the accounting policy is being applied as from the above date, and the results thereof are reflected in these financial statements.

The change in the rules for the classification of troubled debts and for the determination of the provisions for credit losses derived from the change in the accounting policy, as above, did not result in a significant change in expenses of the Bank in respect of credit losses in 2016.

The comparative data for prior years has not been restated, due to the absence of practical possibility for the retroactive application of the new measurement and classification rules stemming from the change in policy to the different credit segments, and whereas the implications on the financial results stemming from the application of the change, as stated, are not significant.

(5) Impaired debts

- **Classification:**

  Debts classified as" impaired" include the following classes of troubled debts:

  - All restructured troubled debts.
  - Debts examined on a specific basis, which are past ninety days due (excluding "well secured debts in the process of collection", as defined in the directive); debts, where no deposits in amounts that are not lower than their average balance, had been deposited in their related current account during a given period; debts, which constantly exceed their approved credit facility during a ninety days period, as well as debts under legal proceedings (including stay of proceedings, receivership and liquidation).
  - Any other debt examined on a specific basis and which in the opinion of the Bank, the full amount due under the contractual terms of the debt would not be collected.

- **Reversal of the "impaired debt" classification**

  The classification of a debt as "impaired" is reversed in the following cases:

  - No "default components" exist in respect of the debt (the Bank believes that the balance of the debt will be paid in full).
  - The debt is well secured and is in the process of collection.

- **Accrual of interest**

The rules applied by the Bank in the matter of accrual of interest in respect of "impaired debts" include:

- Discontinuation of accrual of interest income in respect of impaired debts from date of classification of the debt as "impaired".
- Interest on a debt classified as impaired, accrued to date of such classification and not collected is cancelled.
- Notwithstanding the above, the Bank continues to accrue interest in respect of "restructured troubled debts", where anticipation for the repayment of the debt is supported by a reliable credit assessment.

- **Recognition of interest income**

Interest income in respect of impaired debts will be recognized if the following conditions exist:

- Upon reversal of the "impaired" classification of the debt, interest income is recognized as follows:

  (1) Current interest in respect of the stated amount of the debt will be recognized in profit and loss on an accrual basis.
  (2) Interest written-off in the past and not recognized in profit and loss – shall be recognized as periodic income over the remaining period of the debt, by the "effective interest" method.

- Upon collection of an impaired debt (where the collection of the stated balance of the debt is secured) – current interest income in respect of the stated balance of the debt will be recognized (according to the contractual interest rate). The non-recognized balance of interest, as stated, will be recognized in profit and loss after the stated amount of the debt had been collected in full.

(6) Accounting write-offs

According to guidelines included in the directive, the Bank differentiates between two types of accounting write-offs, as follows:

- **Write-off of debts classified as "impaired"**

Impaired debts considered uncollectible, or of a very low value the maintenance of which as an asset is not justified or involves lengthy efforts, are to be written-off accounting wise. In this respect principles have been determined for the write-off of impaired debts according to the following characteristics:

- Impaired debt the collection of which is conditional upon collateral – that part of the debt exceeding the fair value of the collateral shall be written-off accounting wise.
- Restructured troubled debt – the amount of the "conditional waiver" included in the debt arrangement shall be written-off accounting wise.
- Any other impaired debt – the amount of the debt that is in excess of the amounts expected to be collected from the borrower shall be written-off accounting wise, unless the Bank has evidence that additional collections are expected, on condition that certainty exists as to the amount of the loss to be sustained by the Bank. As a general rule, no deferral of an accounting write-off is permitted in respect of uncertainty as to the amount of loss to be sustained by the Bank after the passing of two years since the classification of the debt as impaired.

- Debts, the restructure of which has failed, are written-off accounting wise following sixty days from the date of default.

- **Write-off of debts the provision for credit losses in respect of which is assessed on a collective basis**

  The write-off of such debts is made on the basis of the following rules and characteristics:

  - Debt collateralized by a residential unit – the excess of the amount of the debt over the fair value of the residential unit shall be written-off following 180 days since the beginning of the default period.
  - Debts of individuals or corporations in bankruptcy, liquidation or in receiverships – that part of the debt exceeding the value of the collateral held by the Bank (on condition that collection of the value of the collateral is expected) shall be written-off following 60 days from date of the Receivership Order or of the Liquidation Order, as the case may be.
  - A debt fraudulently created – shall be written-off accounting wise following 90 days from date of discovery of the fraud.
  - Other debts – that part of the debt exceeding the value of the collateral held by the Bank (on condition that attachment of the collateral has begun and is assured) shall be written-off accounting wise following 150 days since the beginning of the default period.

(7) Provisions for credit losses

The provision for credit losses reflects the estimates of the Bank regarding credit losses inherent in its asset portfolio. According to the guidelines included in the directive, the measurement principles for the provisions for credit losses are divided into too groups, as follows:

- **Debts the provision for credit losses in respect of which is computed on a specific basis:**

  The provisions for credit losses in respect of such debts are computed using one of the following methods:

  - In respect of collateralized impaired debts – the provision for credit losses comprises the difference between the stated balance of the impaired debt and the fair value of the collateral.
  - In respect of other impaired debts - the provision for credit losses comprises the difference between the stated balance of the impaired debt and the value of the anticipated receipts from the borrower, discounted to present value using the contractual interest rate of the impaired debt.

- **Debts the provision for credit losses in respect of which is assessed on a collective basis**

  The provision for credit losses on a collective basis is computed according to the following rules:

  - Debts not classified as housing loans:
    In accordance with the amendment to the public reporting instructions, banking corporations are required to include provisions for credit losses assessed on a collective basis in respect of all credit instruments of a bank (excluding debts classified as

impaired and housing loans in respect of which the provision for loan losses is based on the extent of the default period), as stated below:

The provision on a collective basis in respect of these debts is computed as the multiplication of the stated debt balances of the credits to which the amended instruction applies (divided into economic sectors) by the "provision for credit loss coefficient" as detailed below, for each of the economic sectors, as stated, while differentiating between "troubled commercial credit", "troubled credit to individuals " and other credit.

The "provision for credit loss coefficient" has been defined in these guidelines as a combination of the following two components:

- **"Decision coefficient"** – comprising an assessment of the provisions included in the credit portfolio of a bank, based on losses recognized in the past by the bank.
- **"Adjustment coefficient" -** defined as the required addition to the provisions for credit losses in respect of "environmental factors" not taken into consideration in determining the "decision coefficient", and inter alia, reflects trends in the scope of credit in each economic sector, expected implications in respect of macro-economic changes, and in respect of other changes, such as: the quality of credit in each sector, trend of troubled debts in each sector, credit concentration, etc.

In view of the above, the Bank has prepared an assessment of the "decision coefficient" for each of the economic sectors, and for each of the sub-groups, as stated above, based on the "provision range", computed on the basis of write-off data reported by the Bank during the period of five years preceding the date of computation (for additional information regarding the change in Bank of Israel guidelines on the subject, see item D(5)(a) above).

The Bank believes that the "decision coefficient" determined for the purpose of estimating the provision for credit losses computed on a collective basis, as stated, constitute the best possible estimate (within the provision range), with respect to unidentified loss rates inherent in the credit portfolio for each of the classes detailed above.

The Bank also computes the "adjustment coefficient" in respect of environmental factors, as stated above using a structured model based on parameters determined in instructions published by bank of Israel in this respect.

- Housing loans the provision in their respect is computed by the extent of default period method.

  The provisions for credit losses in respect of such debts are computed on the basis of the rates determined in Proper Conduct of Banking Business Directive No. 314, derived from the extent of default period relating to each loan.

- In accordance with instructions of the Supervisor of Banks, the rate of qualitative adjustments in respect of private individuals is not below 0.75%.

- Off-balance sheet credit instruments (not classified as impaired):

  The provisions for credit losses in respect of this credit risk are computed by multiplying the stated debt balance of the credit risk by the "provision for credit loss coefficient" determined by the Bank (after conversion to a "credit equivalent" – in accordance with CCF coefficients determined in the Basel rules or according to another business model).

According to the rules determined in the amended instruction, the provisions for credit losses do not include certain provisions for credit losses, which banks had been required to maintain in the past, such as: the general and the supplemental provisions for doubtful debts (required to be maintained according to the instructions in effect until December 31, 2010).

Notwithstanding, the Bank continues to compute in each reporting period the amount of the supplemental provision for doubtful debts, in accordance with the updated rules of Proper Conduct of Banking Business Directive No. 315, in order to verify that the balance of the provision for credit losses on a collective basis does not fall below the amounts of the general and supplemental provisions for doubtful debts, as required by the amended instruction.

K. Fixed Assets

(1) Fixed assets are stated at cost net of accumulated depreciation and provisions for impairment. Cost includes identifiable expenditure that may be directly attributed to the acquisition of the asset and any additional expenditure that may be directly attributable to bringing the asset to the location and condition required for its intended use.

(2) Identified components included in a fixed asset, the useful life of which is different from the life of the main asset, have been separated and treated separately.

(3) Depreciation is calculated by the "straight line" method based on the estimated useful life of each of the components of the assets, as stated below:

Type of asset	Years
Buildings	25 – 30
Furniture and equipment	6 – 17
Computers	5
Software costs	5
Leasehold improvements	10

The depreciation period of leasehold improvements is determined in accordance with the period of expected benefits from these improvements, or the lease period, whichever is shorter.

(4) Certain costs in respect of in-house development of computer software have been capitalized to investment in equipment. These costs are depreciated by the straight line method, as from the beginning of the use of the software over the period of the economic benefit derived there from, but not more than five years.
In accordance with guidelines published by Bank of Israel, the Bank capitalizes in-house software development costs, subject to the following restrictions:

- Software development in amounts not exceeding NIS 500 thousand, are recognized as an expense and not as a fixed asset.
- Payroll costs, which are capitalized to fixed assets, take into account "economic inefficiency" and possible deviations in reporting hours worked by employees on software development.

- Investment in projects for the in-house development of software capitalized to fixed assets include only payroll expenses in respect of employees who spend most of their time on the actual development of software.

(5) Leased assets, in respect of which the Bank significantly bears (according to the rates determined by accounting standards) the risk and enjoys the benefits deriving from the asset, are classified as financial leases and are included in the item "Buildings and equipment". Cost of the leased assets is determined on the basis of the minimum lease fees or their fair value, whichever is lower.

(6) Assets designated for sale are stated at cost less depreciation or at fair value - whichever is lower.

L. Investment property

Investment property comprises land or buildings (a part thereof or both) held by the Bank as a rental income producing asset or for future use, or for a capital appreciation in value, excluding property used for:

- Service to customers or for administrative purpose services
- Sale in the ordinary course of business.

Investment property is initially measured at acquisition cost together with the transaction costs, and in following periods is measured at cost less accumulated depreciation and impairment losses.

M. Issuance Expenses

The expenses involved in the issue of bonds and subordinate debt notes are amortized annually proportionate to the outstanding balance of such instruments.

N. Impairment of Securities

The Bank examines at each reporting date the need to classify impairment of the fair value of securities in the available-for-sale portfolio as "impairment of a nature other than temporary".

The decision to classify impairment as being of a nature other than temporary is based on the following tests:

(1) The rate of loss in relation to the cost of the security.
(2) The length of the period in which the fair value of the security is lower than its cost.
(3) Deterioration in the financial condition of the issuer or of the market in general.
(4) The intention and ability of the Bank to continue holding the security for a long enough period that would allow recovery of its fair value, or until its maturity.
(5) The rate of return to maturity of the bond in relation to the period to maturity and accepted returns in the industry.
(6) The economic condition of the issuer of the security and his ability to honour his obligations.

Impairment shall be classified as being of a "nature other than temporary" in each of the following cases:

(1) The security in respect of which impairment had been recognized, was sold subsequent to balance sheet date, or is intended to be sold within a short period of time.
(2) The rating of the bond in respect of which impairment had been recognized, was reduced significantly in comparison with its rating at date of purchase.
(3) The bond in respect of which impairment had been recognized was classified by the Bank as "troubled indebtedness".
(4) There was a default in a payment on the bond in respect of which impairment has been recognized.

(5) A significant impairment was recognized in the fair value of the security, in respect of which impairment had been recorded, in relation to its cost, and the Bank does not have objective evidence, including economic and business analysis, proving at a high level of assurance that impairment is of a temporary nature.

In cases where impairment was classified as being of a nature other than temporary, and the loss reflected in the Statement of Profit and Loss, the cost of the security is to be reduced in parallel to its fair value, which will serve as the new cost basis. Any increase in value in following periods shall be reflected as a separate item in shareholders' equity, within the framework of "Other cumulative comprehensive profit" and not in the Statement of Profit and Loss. Interest income in respect of bonds the cost of which had been depreciated in the past, is recognized on the basis of the new cost.

O. Impairment of Non-Financial Assets

The Bank implements the principles determined by International Accounting Standard No.36 regarding assets to which the Standard applies (mainly buildings), the cost of which exceeds their recoverable value. The provision for impairment is examined separately in respect of each building. The recoverable amounts are determined as follows:

- Building used as premises for the branches of the Bank – according to the discounted future cash flows anticipated from the branch.
- Other buildings – according to periodic assessments by an assessor.

P. Employee Benefits

The liabilities of the Bank and of its consolidated subsidiaries stemming from employer/employee relations under the law and prevailing practices - are covered by appropriate provisions based on US accepted accounting principles that had been adopted by the Supervisor of Banks within the framework of the amendment to the public reporting instructions which became effective on January 1, 2015.

The Bank applies the measurement rules prescribed by the amended instructions as from their effective date.

In accordance with the guidelines contained in the amended instructions, the Bank computes the provisions in respect of employee rights, as follows:

1. Provisions in respect of liabilities for the payment of employee rights stemming from a "defined benefit plan" (such as: severance compensation), liabilities for the payment of other post-retirement benefits, and other long-term liabilities, are measured on an actuarial basis and are stated at their fair value, by the discounting of the expected future payments to their present value, using discount rates derived from returns on Israel government bonds, with the addition of the average spread between the return on corporate bonds traded in the US rated "AA" and above, and the return on US government bonds

   In accordance with the said guidelines, the liabilities for payment of severance compensation include also inferred liabilities, as defined in international reporting rules, in respect of additional benefits (over and above the contractual liabilities) that would be paid to employees retiring in the future.

2. Payments stemming from a defined deposit plan, according to which, another entity (such as: an insurance company or a pension fund) has undertaken to accept the full liability for the payment of severance compensation to the employees, in consideration for receiving regular payments – are recognized in the payroll expense item in the Statement of Profit and Loss, as accrued.

3. Provisions in respect of liabilities for "absence entitling to compensation" (such as paid vacation allocation), are measured on the basis of the nominal contractual liability arising from the prevailing labor agreements (and not on an actuarial basis). The change in value of these provisions is recognized in the payroll expense in the Statement of Profit and Loss.

4. Assets in respect of a defined benefits plan, stemming from deposits with provident and severance compensation funds and which serve to cover the liabilities of the Bank and its consolidated subsidiaries for the payment of severance compensation, are measured according to fair value.

5. Changes in provisions in respect of liabilities for employee rights and changes in the fair value of assets of defined benefits plans are recognized in profit and loss or in equity in the item "other comprehensive profit", as follows:

   - Current changes deriving from the "time value" of provisions in respect of benefits payable at the termination of employment (or thereafter), which are measured on an actuarial basis (such as: liabilities for the payment of severance compensation, liabilities for the payment of other post retirement benefits, and liabilities for the payment of jubilee awards), are recognized as payroll expenses in profit and loss.
   - Changes in fair value of assets of defined benefits plans deriving from current changes in the "time value" of the return on assets of the plan forecasted at the beginning of the period are recognized as payroll expenses in profit and loss.
   - Changes in other provisions in respect of employee rights (such as: paid vacation), are recognized as payroll expenses in profit and loss as accrued.
   - Changes in provisions in respect of employee rights measured on an actuarial basis, and changes in assets of defined benefits plans stemming from actuarial amendments (such as: changes in actuarial assumptions, changes in the discounting rate, and changes in the fair value of assets of a defined benefit plan stemming from changes in returns on assets occurring on the capital market), are recognized in the financial statements as follows:
     - Actuarial changes in provisions in respect of liabilities for the payment of benefits upon termination of employment (or thereafter) and in the fair value of assets of defined benefits plans, are recognized in equity in the item "other comprehensive profit" and are amortized in following years to profit and loss by the straight line method, over the average future service period of the relevant employees.
     - Changes in provisions in respect of liabilities for other employee rights measured on an actuarial basis (such as: liabilities for the payment of jubilee awards) are recognized in the payroll expense item in the Statement of Profit and Loss, as accrued.

Q. Contingent Liabilities

(1) Appropriate provisions have been made for claims, in respect of which, in the opinion of the Management of the Bank and its legal advisors, a loss is anticipated.

(2) In accordance with directives of the Bank of Israel, the Bank classifies the claims filed against it into one of the following categories, according to the probability range of materialization of the loss exposure involved:

- **Probable -** generally defined as claims where the probability range of the materialization of the loss exposure exceeds 70%. In respect of such claims, an appropriate provision has been included in the financial statements based on the facts known to the Bank.

- **Reasonably possible -** generally defined as claims where the probability range of the materialization of the loss exposure exceeds 20% but is less than 70%. No provision has been made in respect of such claims; however full disclosure has been made in cases where the amount of the claim is material (see Note 24).

- **Remote-** generally defined as claims where the probability range of the materialization of the loss exposure is less than 20%. No provision has been made in respect of such claims, however full disclosure has been made in cases where the amount of the claim is material.

(3) Directives of Bank of Israel allow banking corporations in certain cases not to assess the prospects of a claim, if, in the opinion of Management of the bank, based on its legal advisors, it is not possible to assess the probability of materialization of the risk exposure to the claim. Material claims that fall within such criteria have been separately reported in Note 24B (9).

R. Credit Card Transactions

The item "Credit to the public" includes also debit balances deriving from credit card transactions made by Bank customers, using credit cards issued to them by the Bank in conjunction with the credit card companies (even prior to the sending to the customer of the debit advice by the credit card company).

S. The Basis of Recognition of Income and Expenses

(1) Financing income and expenses are recognized on an accrual basis, subject to the following:

- As to the policy regarding the recognition of income and expenses from derivative financial instruments - see Section T below.
- As regards the recognition of income from impaired debts – see Section J (5) above.
- Commission income in respect of the "setting-up" of loans is classified as interest income and recognized in profit and loss over the period of the loans by the "uniform return" method.
  At the same time, commission income in respect of the premature repayment of loans collected subsequently to January 1, 2014, is recognized in profit and loss upon collection thereof. Commissions collected prior to that date are recognized in profit and loss over a period of three years.
- Credit allocation commission and other financing commissions are recognized in profit and loss in accordance with the period of the transactions.

(2) Operating commissions in respect of provision of services are recognized in profit and loss upon the establishment of the entitlement to these commissions.

(3) As regards income from securities – see Section I above.

(4) Other income and expenses are recognized on the accrual basis.

T. Derivative Financial Instruments

(1) In its ordinary course of business, the Bank enters into transactions involving derivative financial instruments (such as: currency contracts, interest contracts, financial currency swap transactions, options on foreign currency exchange rates, etc.) both on behalf of its customers as a trader and on its own behalf, within the framework of management of the market risk to which the Bank is exposed (linkage based risk, interest rate and liquidity risk) and with a view of minimizing to the extent possible its exposure to such risk.

(2) According to Bank of Israel directives, derivative financial instruments are stated in the financial statements at their fair value. Changes in fair value of derivative instruments are recognized in

profit and loss or in shareholders' equity (as a component of "other comprehensive profit") in accordance with the designation of the derivative instruments.

In accordance with the said directives, certain benefits inherent in certain of the engagement contracts entered into by the Bank are deemed "embedded derivative instruments" (see Note 26) and are treated as follows:

The Directive states that benefits defined as "embedded derivative instruments" should be separated from the "host contract" and treated as derivative instruments – namely, they should be measured at fair value at any time. The embedded derivative instrument is stated in the balance sheet together with the host contract and changes in its fair value are recognized in profit and loss.

(3) At balance sheet date, the Bank had no hedge derivative instruments.

U. Offsetting of Assets and Liabilities

(1) The Bank offsets assets against liabilities deriving from the same counterparty and reflects their net balance in the balance sheet, where the following cumulative conditions exist:

(a) In respect of the said liabilities the Bank has an enforceable legal right to offset liabilities against assets.
(b) The Bank intends to pay its liabilities and to liquidate the assets simultaneously or on a net basis.

(2) The Bank offsets deposits, the repayment of which to the depositor is conditional upon the extent of collection of the loans granted out of such deposits, against the loans granted out of these deposits, in cases where the loans do not involve a risk of loss to the Bank. The net income from this activity is included in "Operating commissions".

V. Taxes on Income

(1) The Bank and its consolidated subsidiaries use the tax allocation method with respect to timing differences in the recognition of certain income and expense items for tax purposes. A provision for taxes has also been included in respect of the difference between the balance of depreciated cost of depreciable non-monetary assets, as stated in the balance sheet, and the balance of depreciated cost used for tax purposes.

The deferred taxes have been calculated according to the "liability method" at tax rates expected to apply in the period in which the deferred taxes are realized, based on the tax rates and laws in force on balance sheet date.

The realization of the deferred taxes is contingent upon the existence of adequate taxable income in the future. In the opinion of Management such deferred taxes will be realized in the future.

(2) The deferred tax liabilities do not take into consideration taxes which would apply in the event of the sale of the investments in investee companies, since it is the intention of the Bank to continue to hold such investments and not to dispose of them.

(3) No provision for deferred taxes has been made in respect of retained earnings accumulated by subsidiaries which are not "financial institutions" since such subsidiaries do not intend to distribute such retained earnings as dividends in the foreseeable future.

(4) Current taxes and deferred taxes are recognized in the Statement of Profit and Loss, except where they originate from a transaction or event directly attributable to capital.

(5) The provisions for taxes on income of the Bank and certain of its subsidiaries, which are defined as financial institutions for value added tax purposes, include profits tax levied on income under the Value Added Tax law. Value Added Tax levied on payroll of financial institutions is included in the Statements of Profit and Loss under "Payroll and related expenses".

For additional information regarding the amendment to the public reporting instructions, which adopts the US accepted accounting principles in the matter of "taxes on income", which is to take effect on January 1, 2017, and its possible implications on the measurement and disclosure rules in this respect – see Section C (2) (a), above.

W. **Fair value measurement and fair value alternatives**

Certain items (mostly derivative instruments and securities in the available-for-sale and the trading portfolios), are measured in the financial statements according to their fair value. Note 32 below presents information regarding the fair value of all financial instruments of the Bank.

Measurement of fair value of financial instruments is made in accordance with rules issued by Bank of Israel, which are based on Accounting standard IAS 157 published in the US.

According to these principles, fair value is defined as the price that would have been received from the sale of an asset, or the price that would have been paid in the transfer of a liability in a "regular transaction" (a transaction where exposure to market exists in the period prior to the date of measurement, for transactions involving assets or liabilities similar to the relevant instruments being measured), between participants in the market at date of measurement.

The rules published in the instruction allow the use of three different approaches for the assessment of fair value, as follows:

- **"Market approach"** – according to which, the fair value of assets and liabilities is determined on the basis of relevant prices and information obtained from market transactions involving similar or comparable assets and liabilities.
- **"Income approach"** – according to which, fair value is based on the capitalization of future cash flows to their present value, using accepted market discount rates in respect of the relevant assets and liabilities.
- **"Cost approach"** – according to which, fair value is based on replacement cost of the relevant asset or liability.

The instructions also differentiate between two types of data used in the determination of fair value:

- **"Observable data"** – reflecting the assumptions which other market participants use for the pricing of the asset or liability, and based upon data obtained from independent sources.
- **"Unobservable data"** – reflect estimate made by the banking corporation regarding the assumptions of other market participants, based on the best information available to the bank.

The guidelines included in the instructions lead the banking corporations to make use of observable data, to the extent possible, and to avoid, to the extent possible the use of unobservable data, when determining the fair value of assets and liabilities measured by this method. Furthermore, the instructions state a qualitative grading of assets and liabilities measured by the fair value method, as follows:

a) High quality class (Grade 1) – to which belong assets or liabilities, the determination of the fair value of which is based on quoted prices on an active market for identical assets and liabilities.
b) Medium quality class (Grade 2) – to which belong assets or liabilities, the determination of the fair value of which is based on direct or indirect observable data (which are not quoted prices on an active market) including quoted prices on an active market for similar assets and liabilities.
c) Low quality class (Grade 3) - to which belong assets or liabilities, the determination of the fair value of which is based on unobservable data (where relevant observable data is not available).

The assumptions and rules applied by the Bank for the classification of assets and liabilities to the different quality classes, as above, included:

- In the high quality class (Grade 1) are included: financial instruments and derivative financial instruments traded on an active market typified by a large number of participants and having significant trading turnovers, such as: investments in marketable securities and marketable option contracts.
- In the medium quality class (Grade 2) are included: financial instruments and derivative financial instruments not traded on an active market, determination of their fair value is based on active market quotations of similar instruments, or on quotations obtained from independent sources, such as: investments in non-marketable securities and transactions in derivative financial instruments of the "shekel-foreign currency", or "foreign currency-foreign currency" type.
- In the low quality class (Grade3) are included: non-marketable derivative financial instruments the fair value of which is based on non-active market quotations, such as: transactions in derivative financial instruments of the "CPI-foreign currency" type.

Fair value computations include also components in respect of credit risk (regarding debts) and counterparty credit risk (regarding derivative instruments). Measurement of the credit risk component is based on the rules applying to the computation of provisions for credit losses in respect of debts (including provisions for credit losses assessed on a collective basis). The measurement of a counterparty credit risk component (CVA) is based upon the credit spread of marketable CDS contracts of the counterparty to the transaction (where applicable) or on spreads based on the credit rating of the customer.

Moreover, banking corporations are permitted to apply the fair value method to certain financial instruments, which according to the public reporting directives of Bank of Israel; their fair value measurement is not required. Despite this, the Bank did not apply in the reported periods the fair value method to items in respect of which the fair value measurement method is not required.

X. Cash Flows Statement

The Statement of Cash Flows includes cash flows deriving from current operations, investment operations in assets and liabilities and financing operations. As a general rule, cash flows deriving from both transactions in asset items and liability items are presented in net amounts, except for cash flows relating to buildings and equipment, securities available-for-sale and the investments in investee companies. The cash item includes cash and deposits with banks for an initial period of up to three months.

Y. Earnings per Share

The earnings per share are calculated on the basis of the number of shares outstanding in the reported years, for each class of shares separately.

Z. Business Segment Information

A business segment is a component of a banking corporation engaged in operations that may produce income and incur expenditure, its operating results being examined on a current basis by Management and the Board of Directors in order to take decisions regarding the allocation of resources and assessment of its performance, and in respect of which separate financial data is available. The reporting format for the business segments of the Bank is determined by the public reporting directives of the Supervisor of Banks.

Classification by the Bank of financial results by business segments is based on attributing income and expense data to homogeneous classes of customers, the characteristics of their banking operations match the definitions determined for each business segment.

Distribution of financial data by segments of operation is made by way of two approaches:

- "Regulatory segments of operation" – in accordance with definitions determined by Bank of Israel for each regulatory segment of operation – see Note 27.
- "Segments of operation according to Management's approach" – in accordance with the definition of segments of operation that are compatible with the organizational structure and the operations of the Bank – see Note 28.

AA. Interested and related parties

Information regarding stated and off-balance sheet balances of interested and related parties, as well as regarding the results of transactions made with them, is presented with respect to any person defined as an interested party or related party according to definitions determined in the public reporting instructions, or as a "related party" according to the definitions determined in Proper Conduct of Banking Business Directive No. 312, or in US accepted accounting principles in the matter of "related parties".

For additional information regarding amendments to the definition of related parties, published by bank of Israel on September 29, 2016 – see Section D(2) above.

Note 2 - Interest income and expenses

Consolidated

	Year ended December 31,		
	2016	2015	2014
	NIS millions	NIS millions	NIS millions
A. Interest income from:			
Credit to the public	**1,014**	931	910
Deposits with Bank of Israel and cash	**3**	4	13
Deposits with banks	**7**	4	9
Bonds (see C below)	**33**	35	79
Other assets	**1**	-	-
Total interest income	**1,058**	974	1,011
B. Interest expense on:			
Deposits from the public	**(94)**	(78)	(175)
Deposits from the government	**(2)**	(2)	(3)
Deposits from banks	**(1)**	(2)	(4)
Subordinated debt notes	**(27)**	(19)	(29)
Other liabilities	-	(1)	-
Total interest expense	**(124)**	(102)	(211)
Total net interest income	**934**	872	800
C. Composition of accrual basis interest income from bonds			
Held to maturity	**10**	10	10
Available-for-sale	**23**	25	67
Trading	-	-	2
Total included in interest income	**33**	35	79

Note 3 - Non-Interest Financing Income

Consolidated

	Year ended December 31,		
	2016	2015	2014
	NIS millions	NIS millions	NIS millions
A. Non-interest financing income in respect of non-trading operations			
Net income (expenses) in respect of ALM derivative instruments[1]	**(12)**	[7] (51)	[7] 75
Gains on sale of available-for-sale bonds[4]	**30**	63	53
Loss on sale of available-for-sale bonds[4]	**(2)**	(2)	[5] (2)
Net exchange differences[6]	**19**	31	(86)
Gains on sale of available-for-sale shares	-	3	-
Loss on sale of available-for-sale shares	-	(9)	-
Total non-interest financing income in respect of non-trading operations	**35**	35	40
B. Non-interest financing income from trading operations[2] [3]			
Net income from other derivative instruments	**1**	[7]2	[7]2
Total non-interest income from trading operations	1	2	2
Total non-interest financing income	**36**	37	42

(1) Derivative instruments comprising a part of the Bank's asset and liability management layout, not designated for hedge relations.
(2) Including exchange rate differences from trading operations.
(3) For interest income on investments in trading bonds, see Note 2, above.
(4) Reclassified from accumulated other comprehensive income.
(5) Comprising a provision for impairment.
(6) Except for exchange differences on transactions classified to the item "Non-interest financing income from trading activities"
(7) Reclassified.

Note 4 - Commissions

Composition (in NIS millions):

	Year ended December 31,		
	2016	**2015**	**2014**
Account management	**148**	154	168
Credit cards	**33**	31	29
Securities and certain derivatives transactions	**19**	21	19
Financial products distribution commission	**10**	13	10
Credit management	**17**	17	14
Conversion differences	**30**	31	30
Foreign trade activity	**11**	10	10
Financing transactions commissions	**29**	26	26
Other commissions	**7**	7	7
Total operating commissions	**304**	310	313

Note 5 - Other Income

Composition (in NIS millions):

	Year ended December 31,		
	2016	**2015**	**2014**
Capital gain from sale of equipment and buildings	**8**	33	-
Capital loss from sale of equipment and buildings	**-**	-	-
Other	**1**	-	1
Total other income	**9**	33	1

Note 6 - Salaries and Related Expenses

Composition (in NIS millions):

	Year ended December 31,		
	2016	2015	2014
Salaries	**377**	365	342
Other related expenses including further education fund, vacation and sick leave	**17**	24	17
Long-term benefits (long service awards)	**(9)**	(45)	21
National insurance and payroll taxes	**102**	101	97
Pension expenses (see note 21):			
Defined Benefit	**50**	32	37
Defined deposit	**8**	8	8
Contributions expenses- defined deposit	**17**	16	11
Other post-retirement benefits and non-pension post-retirement benefits (see note 21)	**4**	2	3
Special benefits in respect of dismissal (see note 21)	**-**	-	33
Expenses regarding other employee benefits	**15**	15	16
Total salaries and related expenses	**581**	518	585

Note 7 - Other Expenses

Composition (in NIS millions):

	Year ended December 31,		
	2016	**2015**	**2014**
Marketing and advertising	**10**	11	11
Transportation and Communications	**17**	17	16
Computer services	**60**	61	54
Office expenses	**4**	4	4
Insurance	**5**	2	2
Professional services	**35**	30	33
Training and further education	**2**	4	3
Directors' fees	**3**	3	3
Management fees to the parent company	**2**	2	2
Commissions	**2**	2	2
Other	**35**	35	37
Total other Expenses	**175**	171	167

Note 8 - Provision for Taxes on Income

A. Composition (in NIS millions):

	Year ended December 31,		
	2016	**2015**	**2014**
Current taxes			
In respect of the current year	**121**	98	106
In respect of prior years [(1)]	**7**	2	(8)
Total current taxes	**128**	100	98
Deferred taxes			
In respect of the current year	**18**	34	(14)
In respect of prior years	-	2	10
Total deferred taxes *	**18**	36	(4)
Total provision for taxes	**146**	136	94
* Movement in deferred taxes:			
Creation and reversal of temporary differences	**(4)**	14	(23)
Change in the tax rate	**18**	4	-
Deferred taxes reclassified from equity to the statement of income	**4**	18	19
Total deferred taxes	**18**	36	(4)

B. Theoretical tax

Reconciliation between the theoretical tax which would apply had the operating profit been taxed at the statutory tax rate applying to a bank in Israel, and the actual provision for taxes on operating profit as recorded in the statement of profit and loss:

	Year ended December 31,		
	2016	**2015**	**2014**
	NIS millions		
Amount of the tax on the basis of statutory tax rate	**121**	129	90
Tax (tax savings) in respect of:			
Non-deductible expenses	**2**	2	1
Adjustment differences on depreciation and capital gains	**(2)**	(3)	-
Prior year taxes [(1)]	**7**	4	2
Adjustment of deferred taxes due to changes in tax rates	**18**	4	-
Other	**-**	-	1
Provision for taxes on profits	**146**	136	94
Statutory tax rate (percent)	**35.90**	37.58	37.71

(1) Including taxes deriving from implementation of agreements signed with the tax authorities regarding recognition of expenses from credit losses on troubled debts.

C. Taxes on income recognized outside the Statement of Profit and Loss

Accumulated balances of tax reflected in other comprehensive income:

	December 31,	
	2016	**2015**
	NIS millions	**NIS millions**
Current taxes	**(13)**	(21)
Deferred taxes	**(12)**	8
Total	**(25)**	(13)

Note 8 - Provision for Taxes on Profit (cont'd)

D. Reduction in tax rates

(1) Income Tax Ordinance Amendment Act (No. 216), 2016

On January 4, 2016, the Knesset passed the Income Tax Ordinance Amendment Act (No. 216), 2016, which reduced the tax rates applying to corporations in Israel as from January 1, 2016 (hereinafter – "the determining date") from a rate of 26.5% to 25%. In accordance therewith, the statutory tax rate applying to the Bank on the determining date was reduced from a rate of 37.18% to 35.90%.

Following the said Amendment to the Ordinance, the Bank updated in the first quarter of 2016 the provisions for deferred taxes in accordance with the new statutory tax rates. The revised provisions for deferred taxes, as stated, increased the tax expense of the Bank in the first quarter of 2016 by an amount of NIS 8 million.

(2) The Economic Efficiency Act (Legislation amendment for attainment of the budgetary goals for the years 2017-2018), 2016

On December 29, 2016, the Knesset passed the Economic Efficiency Act (Legislation amendment for attainment of the budgetary goals for the years 2017-2018), 2016**,** which, among other things, reduced the corporation tax rate by 1% in each of the years 2017 and 2018, down to a rate of 23%, effective as from January 1, 2018 and thereafter.

Following the approval of the Act, as stated, the Bank updated in the last quarter of 2016, the provisions for deferred taxes in accordance with the statutory tax rates that are expected to apply on the dates of realization of the deferred taxes. The revised provisions for deferred taxes, as stated, increased the tax expense of the Bank in the fourth quarter of 2016 by an amount of NIS 10 million.

In total, the tax expense of the Bank in 2016 increased as a result of the reduction in tax rates, as stated above, by an amount of NIS 18 million.

Note 8 - Provision for Taxes on Profit (cont'd)

E. The change in deferred tax assets and tax liabilities is attributed to the following items: (in NIS millions)

	December 31, 2016							
	Allowance for credit losses	**Interest and securities**	**Adjustment of depreciable non-financial assets** *	**Provision for vacation pay and awards**	**provision for severance pay to employees**	**Carry forward deductions**	**Other**	**Total**
Net balance at the beginning of the year	**110**	**(2)**	**(14)**	**58**	**113**	**-**	**-**	**265**
Changes recognized in Profit and Loss:								
-Due to tax rate change	**(9)**	**-**	**1**	**(3)**	**(7)**	-	-	**(18)**
-Other	**25**	**(13)**	**1**	**(27)**	**14**	-	-	-
Changes recognized in other comprehensive income:								
-Due to tax rate change	**-**	**1**	**-**	**-**	**(4)**	**-**	**-**	**(3)**
-Other	**-**	**13**	**-**	**-**	**15**	**-**	**-**	**28**
Net balance at the end of the year(1)	**126**	**(1)**	**(12)**	**28**	**131**	**-**	**-**	**272**
(1) Of which:								
- Deferred tax asset	**126**	**2**	**-**	**28**	**131**	**-**	**1**	**288**
- Balances which can be offset	**-**	**(3)**	**(12)**	**-**	**-**	**-**	**(1)**	**(16)**
Net deferred tax asset	**126**	**(1)**	**(12)**	**28**	**131**	**-**	**-**	**272**

Note 8 - Provision for Taxes on Profit (cont'd)

E. The change in deferred tax assets and tax liabilities is attributed to the following items: (in NIS millions) (cont'd)

	December 31, 2015							
	Allowance for credit losses	**Interest and securities**	**Adjustment of depreciable non-financial assets***	**Provision for vacation pay and awards**	**provision for severance pay to employees**	**Carry forward deductions**	**Other**	**Total**
Net balance at the beginning of the year	111	(4)	(11)	85	108	-	(1)	288
Changes recognized in Profit and Loss:								
-Due to tax rate change	(1)	(1)	-	(1)	(1)	-	-	(4)
-Other	-	(16)	(3)	(22)	8	-	1	(32)
Changes recognized in other comprehensive income:								
-Due to tax rate change	-	-	-	-	-	-	-	-
-Other	-	19	-	(4)	(2)	-	-	13
Net balance at the end of the year (1)	110	(2)	(14)	58	113	-	-	265
(1) Of which:								
- Deferred tax asset	110	2	1	58	113	-	1	285
- Balances which can be offset	-	(4)	(15)	-	-	-	(1)	(20)
Net deferred tax asset	110	(2)	(14)	58	113	-	-	265

* Depreciable non-financial assets.

Note 8 - Provision for Taxes on Profit (cont'd)

F. Balances of deferred tax assets and deferred tax liabilities:

Deferred tax assets

	Balances		Average tax rates		Recognized in profit and loss	
	December 31,		December 31,		December 31,	
	2016	2015	2016	2015	2016	2015
	NIS millions	NIS millions	%	%	NIS millions	NIS millions
Related to:						
Provision for vacation pay and other payroll benefits	**28**	58	**34.42**	37.18	**(30)**	23
Net provision for severance pay	**131**	113	**34.19**	37.18	**7**	(7)
securities	**2**	2	**34.19**	37.18	**-**	2
Adjustment of other non-monetary assets	**-**	1	**23.00**	26.50	**(1)**	(1)
Provisions for credit losses	**126**	110	**34.50**	37.18	**16**	1
Other timing differences	**1**	1	**24.50**	41.37	**-**	(1)
Total	**288**	285	**34.26**	37.16	**(8)**	17

Deferred tax liabilities

	Balances		Average tax rates		Recognized in profit and loss	
	December 31,		December 31,		December 31,	
	2016	2015	2016	2015	2016	2015
	NIS millions	NIS millions	%	%	NIS millions	NIS millions
Related to:						
Securities	**3**	4	**34.19**	37.18	**(13)**	15
Adjustment of depreciable non-monetary assets	**12**	15	**34.19**	36.45	**3**	4
Adjustment of other non-monetary assets	**1**	1	**10**	10	-	-
Total	**16**	20	**30.48**	31.55	**(10)**	19

G. Tax assessments

- The Bank has final tax assessments for the tax years up to and including the year 2013.
- Consolidated subsidiaries have tax assessments considered as final for tax years up to and including the year 2012.

Note 9 - Earnings per share

	Consolidated		
	2016	**2015**	**2014**
	NIS thousands	**NIS thousands**	**NIS thousands**
1. Earnings per share			
Share of NIS 0.1 par value	**1.55**	1.69	1.18
Share of NIS 0.01 par value	**0.15**	1.17	0.12
2. Weighted average number of shares			
Share of NIS 0.1 par value	**124,720**	124,720	124,720
Share of NIS 0.01 par value	**1,600**	1,600	1,600

Note 10 - Other cumulative comprehensive income (loss)

A. Changes in other comprehensive income (loss) after tax effect

	Securities [1]	Adjustments in respect of employee benefits	Total
	NIS millions		
Balance at January 1, 2014	74	(53)	21
Net change during 2014	(17)	(26)	(43)
Balance at December 31, 2014	57	(79)	(22)
Net change during 2015	(30)	7	(23)
Balance at December 31, 2015	27	(72)	(45)
Net change during 2016	**(23)**	**(29)**	**(52)**
Balance at December 31, 2016	**4**	**(101)**	**(97)**

(1) Adjustments for presentation of available-for- sale securities at fair value.

B. Changes in components of other cumulative comprehensive income (loss) before and after the tax effect

	For the year ended December 31, 2016		
	Before tax	**Tax effect**	**After tax**
	NIS millions	**NIS millions**	**NIS millions**
Adjustments for presentation of available-for- sale securities at fair value:			
- Net unrealized income (loss) from adjustments to fair value	**(9)**	**4**	**(6)**
Loss (income) on available-for-sale securities reclassified to the statement of income [1]	**(28)**	**11**	**(17)**
Net change from adjustments for securities	**(37)**	**14**	**(23)**
Employee benefits:			
Net actuarial income (loss)	**(65)**	**18**	**(47)**
Loss (income) reclassified to the statement of income [2]	**25**	**(7)**	**18**
Total net change from Employee benefits	**(40)**	**11**	**(29)**
Total net change during the period	**(77)**	**25**	**(52)**

1. Included in the Statement of Profit and Loss in the item "Non-interest financing income".
2. Included in the Statement of Profit and Loss in the item "Payroll and related expenses".

Note 10 - Other cumulative comprehensive income (loss) before and after the tax effect (cont'd)

B. Changes in components of other cumulative comprehensive income (loss) before and after the tax effect (cont'd)

	For the year ended December 31, 2015		
	Before tax	Tax effect	After tax
	NIS millions	NIS millions	NIS millions
Adjustments for presentation of available-for- sale securities at fair value**:**			
- Net unrealized income (loss) from adjustments to fair value	12	(4)	8
Loss (income) on available-for-sale securities reclassified to the statement of income (1)	(61)	23	(38)
Net change from adjustments for securities	(49)	19	(30)
Employee benefits:			
Net actuarial income (loss)	2	(1)	1
Loss (income) reclassified to the statement of income (2)	11	(5)	6
Total net change from Employee benefits	13	(6)	7
Total net change during the period	(36)	13	(23)

1. Included in the Statement of Profit and Loss in the item "Non-interest financing income".
2. Included in the Statement of Profit and Loss in the item "Payroll and related expenses".

	For the year ended December 31, 2014		
	Before tax	Tax effect	After tax
	NIS millions	NIS millions	NIS millions
Adjustments for presentation of available-for- sale securities at fair value**:**			
- Net unrealized income (loss) from adjustments to fair value	24	(9)	15
Loss (income) on available-for-sale securities reclassified to the statement of income	(51)	19	(32)
Net change from adjustments for securities	(27)	10	(17)
Employee benefits (1):			
Net actuarial income (loss)	(41)	15	(26)
Loss (income) reclassified to the statement of income	-	-	-
Total net change from Employee benefits	(41)	15	(26)
Total net change during the period	(68)	25	(43)

1. Included in the Statement of Profit and Loss in the item "Non-interest financing income".
2. Included in the Statement of Profit and Loss in the item "Payroll and related expenses".

Note 11 - Cash and Deposits with Banks

Composition on a consolidated basis:

	December 31 2016	December 31 2015
	NIS millions	NIS millions
Cash and deposits with Bank of Israel	**2,776**	5,086
Deposits with commercial banks	**646**	416
Deposits with special banking corporations	-	-
Total cash and deposits with banks	**3,422**	5,502
Including cash and deposits with Bank of Israel and with banks for an initial period of up to three months	**3,338**	5,407

Note 12 - Securities

	December 31, 2016				
			Adjustment to fair value		
	Stated value	Written-down cost*	Gains	Losses	Fair value**
			NIS millions		
Held for maturity (1)					
Bonds -					
▪ Israel Government	**204**	**204**	**24**	**-**	**228**
▪ Foreign governments	**19**	**19**	**-**	**-**	**19**
▪ Israel financial institutions	**83**	**83**	**3**	**-**	**86**
Total Held-for-maturity bonds	**306**	**306**	**27**	**-**	**333**
Available-for-sale Securities (4)					
Bonds (1) **-**					
▪ Israel Government	**5,171**	**5,174**	**7**	**10**	**5,171**
▪ Foreign governments	**295**	**296**	**-**	**1**	**295**
▪ financial institutions - In Israel (3)	**205**	**197**	**8**	**-**	**205**
	5,671	**5,667**	**15**	**11**	**5,671**
Shares (2)	**13**	**11**	**2**	**-**	**13**
Total Available-for-sale securities	**5,684**	**5,678**	(5)**17**	(6) (5)**11**	**5,684**
Trading securities					
Bonds (1) **-**					
▪ Israel Government	**2**	**2**	**-**	**-**	**2**
▪ Of other in Israel	**8**	**8**	**-**	**-**	**8**
▪ Of foreign others	**2**	**2**	**-**	**-**	**2**
Total trading securities	**12**	**12**	**-**	**-**	**12**
Total securities	**6,002**	**5,996**	**44**	**11**	**6,029**

* Shares – cost less provision for impairment, where required

** Fair value data are generally based on market quotations, which do not necessarily reflect the price to be received on sale of securities in large quantities. The fair value data for the available-for-sale portfolio include shares in the amount of NIS 3 million that do not have a readily available fair value and are stated at cost, less provision for impairment, which according to Management's assessment does not exceed their fair value.

Notes:

(1) Details as to the results of investment operations in bonds – see Notes 2 and 3.
(2) Includes a balance of NIS 10 million in respect of a 14.8% equity interest in A.I. America Israel Company Ltd.
(3) Includes impaired bonds of NIS 13 million, on which interest income is not accrued.
(4) For securities pledged as collateral, see Note 25.
(5) Included, net of the tax effect, in other comprehensive income under "Adjustments in respect of available-for-sale securities at fair value".
(6) The rate of loss on adjustments to fair value does not exceed 20% of the amortized cost of these bonds. The bonds, in respect of which such losses were recognized, are in a "loss position" for a period of under one year.

Note 12 - Securities (cont'd)

	December 31, 2015				
			Adjustment to fair value		
	Stated value	Written-down cost*	Gains	Losses	Fair value**
			NIS millions		
Held to maturity [(1)]					
Bonds -					
▪ Israel Government	206	206	26	-	232
▪ Foreign governments	20	20	-	-	20
▪ Israel financial institutions	84	84	6	-	90
Total Held-for-maturity bonds	310	310	32	-	342
Available-for-sale Securities [(4)]					
Bonds [(1)] **-**					
▪ Israel Government	2,509	2,476	34	1	2,509
▪ Foreign governments	78	78	-	-	78
▪ financial institutions - In Israel	204	207	-	3	204
- Foreign	8	8	-	-	8
▪ Of other - In Israel [(3)]	291	280	11	-	291
- Foreign	8	8	-	-	8
	3,098	3,057	45	4	3,098
Shares [(2)]	12	10	2	-	12
Total Available-for-sale securities	3,110	3,067	[(5)]47	[(6) (5)]4	3,110
Trading securities					
Bonds [(1)] **-**					
▪ Israel Government	-	-	-	-	-
▪ Foreign financial institutions	1	1	-	-	1
▪ Of other in Israel	9	9	-	-	9
▪ Of foreign others	2	2	-	-	2
Total trading securities	12	12	-	-	12
Total securities	3,432	3,389	79	4	3,464

* Shares – cost less provision for impairment, where required

** Fair value data are generally based on market quotations, which do not necessarily reflect the price to be received on sale of securities in large quantities. The fair value data for the available-for-sale portfolio include shares in the amount of NIS 2 million that do not have a readily available fair value and are stated at cost, less provision for impairment, which according to Management's assessment does not exceed their fair value.

Notes:

(1) Details as to the results of investment operations in bonds – see Notes 2 and 3.
(2) Includes a balance of NIS 10 million in respect of a 14.8% equity interest in A.I. America Israel Company Ltd.
(3) Includes impaired bonds of NIS 12 million, on which interest income is not accrued.
(4) For securities pledged as collateral, see Note 25.
(5) Included, net of the tax effect, in other comprehensive income under "Adjustments in respect of available-for-sale securities at fair value".
(6) The rate of loss on adjustments to fair value does not exceed 20% of the amortized cost of these bonds. The bonds, in respect of which such losses were recognized, are in a "loss position" for a period of under one year.

Note 13 - Credit to the Public and Provision for Credit Losses

A. Debts, credit to the public and the balance of allowance for credit losses

	December 31, 2016					
	Credit to public					
		Private individuals			Banks and	
	Commercial	Housing loans	Other	Total	Governments	Total
Recorded amount of debts [(1)]						
Examined on a specific basis	**11,751**	**-**	**40**	**11,791**	**646**	**12,437**
Examined on a collective basis, the allowance for which is computed by:						
- extent of arrears	**91**	**3,744**	**-**	**3,835**	**-**	**3,835**
- other	**2,829**	**-**	**3,894**	**6,723**	**-**	**6,723**
Total debts [(1)]	**14,671**	**3,744**	**3,934**	**22,349**	**646**	**22,995**
Impaired debts:						
-Restructured troubled debts	**105**	**-**	**18**	**122**	**-**	**122**
- Others	**199**	**-**	**1**	**200**	**-**	**200**
Total balance of impaired debts	**303**	**-**	**19**	**322**	**-**	**322**
Other problematic debts:						
Debts in arrears of 90 days or more	**14**	**34**	**15**	**63**	**-**	**63**
- Others	**115**	**29**	**18**	**162**	**-**	**162**
Total others Problematic debts	**129**	**63**	**33**	**225**	**-**	**225**
Total Problematic debts	**432**	**63**	**52**	**547**	**-**	**547**
Allowance for credit losses in respect of debts [(1)]						
Examined on a specific basis	**227**	**-**	**1**	**228**	**-**	**228**
Examined on a collective basis, the allowance for which is computed by:						
- extent of arrears	**-**	**4**	**-**	**4**	**-**	**4**
- other	**47**	**13**	**56**	**116**	**-**	**116**
Total allowance for credit losses *	**274**	**17**	**57**	**348**	**-**	**348**
* Of which – in respect of impaired debts	**77**	**-**	**-**	**77**	**-**	**77**

(1) Credit to the public, credit to governments, deposits with banks and other debts, excluding bonds.

Note 13 - Credit to the Public and Provision for Credit Losses (cont'd)

A. Debts, credit to the public and the balance of allowance for credit losses (cont'd)

	December 31, 2015					
	Credit to public					
		Private individuals			Banks and	
	Commercial	Housing loans	Other	Total	Governments	Total
Recorded amount of debts [(1)]						
Examined on a specific basis	13,779	-	2,337	16,116	416	16,532
Examined on a collective basis, the allowance for which is computed by:						
- extent of arrears	88	3,310	-	3,398	-	3,398
- other	52	-	1,188	1,240	-	1,240
Total debts [(1)]	13,919	3,310	3,525	20,754	416	21,170
Impaired debts:						
-Restructured troubled debts	113	-	20	133	-	133
- Others	193	-	6	199	-	199
Total balance of impaired debts	306	-	26	332	-	332
Other problematic debts:						
Debts in arrears of 90 days or more	1	24	7	32	-	32
- Others	180	33	35	248	-	248
Total others Problematic debts	181	57	42	280	-	280
Total Problematic debts	487	57	68	612	-	612
Allowance for credit losses in respect of debts [(1)]						
Examined on a specific basis	266	-	36	302	1	303
Examined on a collective basis, the allowance for which is computed by:						
- extent of arrears	-	4	-	4	-	4
- other	2	12	17	31	-	31
Total allowance for credit losses *	268	16	53	337	1	338
* Of which – in respect of impaired debts	70	-	2	72	-	72

Notes:

(1) Credit to the public, credit to governments, deposits with banks and other debts, excluding bonds.

Note 13 - Credit to the Public and Provision for Credit Losses (cont'd)

B. Change in the balance of the allowance for credit losses (in NIS millions)

	Year ended December 31, 2016					
	Credit to public					
		Private individuals			**Banks and**	
	Commercial	**Housing loans**	**Other**	**Total**	**Governments**	**Total**
Balance of allowance for credit losses, at beginning of year	**295**	**16**	**55**	**366**	**1**	**367**
Credit loss expense (income)	**26**	**1**	**10**	**37**	**(1)**	**36**
Accounting write offs	**(80)**	**-**	**(57)**	**(137)**	**-**	**(137)**
Collection of debts written off in previous years	**59**	**-**	**51**	**110**	**-**	**110**
Net accounting write-offs	**(21)**	**-**	**(6)**	**(27)**	**-**	**(27)**
Balance of allowance for credit losses at end of year*	**300**	**17**	**59**	**376**	**-**	**376**
* Of which – in respect of off balance sheet credit instruments	**26**	**-**	**2**	**28**	**-**	**28**

	Year ended December 31, 2015					
	Credit to public					
		Private individuals			**Banks and**	
	Commercial	**Housing loans**	**Other**	**Total**	**Governments**	**Total**
Balance of allowance for credit losses, at beginning of year	267	13	54	334	1	335
Credit loss expense (income)	58	3	6	67	-	67
Accounting write offs	(84)	-	(53)	(137)	-	(137)
Collection of debts written off in previous years	54	-	48	102	-	102
Net accounting write-offs	(30)	-	(5)	(35)	-	(35)
Balance of allowance for credit losses at end of year*	295	16	55	366	1	367
* Of which – in respect of off balance sheet credit instruments	27	-	2	29	-	29

Note 14 - Investee companies

A. Composition

	Year ended December 31, 2016	2015
	NIS millions	
Affiliated companies		
Shares on equity basis including goodwill	**3**	3
Shareholders' loans	**2**	2
Accumulated profits since acquisition	**4**	2
Total investment in Affiliated companies	**9**	7

B. Bank's share in profits of affiliates companies

	2016	2015
Share in ordinary profits of investees	**3**	3
Provision for taxes	**1**	1
Share in ordinary profits of investees after tax	**2**	2

C. Details of investee companies

	Business of investee	Share in Equity, Voting and Profits (1)	Equity value of investment		Contribution to net profit		Recorded dividend	
			December 31,					
			2016	2015	2016	2015	2016	2015
		%	NIS millions					
Affiliated companies								
Tafnit Discont – Investment Portfolio Management Ltd.	Investment Portfolio management	31.0	(2)**9**	(2)7	**2**	2	**-**	6
Golden Gate Bridge Fund	Venture capital fund	20.0	**-**	-	**-**	-	**-**	-
Consolidated companies								
Mercantile Properties Ltd.	Inactive	99.62	**-**	-	**-**	-	**-**	1
Mercantile Issuance Ltd.	Issuance company	100.0	**-**	-	**-**	-	**-**	-
Mercantile Investments Ltd.	Inactive	100.0	**-**	-	**-**	-	**-**	-
Marbit Insurance Agency (1996) Ltd	Insurance agency	100.0	**3**	2	**1**	1	**-**	-
B.M.D. Underwriting & investment Promotion Ltd.	Inactive	100.0	**8**	8	**-**	-	**-**	-
Total			**20**	17	**3**	3	**-**	7

Notes

(1) Bank's share in the equity, voting rights and rights to profits.
(2) Of which: investment in loans – NIS 2 million (December 31, 2015 – identical).

Note 15 - Buildings and Equipment

A. Composition on a consolidated basis:

	Buildings and land	Equipment, furniture and motor vehicles	Software costs	Total
	NIS millions			
Cost (1)				
Balance as at December 31, 2014	426	344	411	1,181
Additions	20	22	18	60
Subtraction	(66)	-	-	(66)
Balance as at December 31, 2015	380	366	429	1,175
Additions	**28**	**23**	**26**	**77**
Subtraction	**(14)**	**(3)**	**-**	**(17)**
Balance as at December 31 ,2016	**394**	**386**	**455**	**1,235**
Accumulated depreciation (1) (2)				
Balance as at December 31, 2014	181	273	330	784
Depreciation for the year	16	16	25	57
Subtraction	(12)	-	-	(12)
Balance as at December 31, 2015	185	289	355	829
Depreciation for the year	**15**	**16**	**25**	**56**
Subtraction	**(5)**	**(3)**	**-**	**(8)**
Balance as at December 31 ,2016	**195**	**302**	**380**	**877**
Depreciated balance as at December 31, 2016	**199**	**84**	**75**	**358**
Depreciated balance as at December 31, 2015	195	77	74	346
Depreciated balance as at December 31, 2014	245	71	81	397
Average rate of depreciation for 2016 (%)	**8.0**	**10.2**	**20.0**	**10.6**
Average rate of depreciation for 2015 (%) (3)	7.6	10.6	20.0	11.5

(1) The balance includes capitalized software development costs in the sum of about NIS 45 million (December 31, 2015 – identical).
(2) The accumulated depreciation includes losses on impairment amounting to NIS 2 million (December 31, 2013 – identical).
(3) Reclassified.

Note 15 - Buildings and Equipment (cont'd)

B. Rights in real estate

(1) The Bank owns lease rights and protected tenant rights in land and buildings for periods ending in the years 2017 to 2044. The amortized balance of the said rights is as follows:

	December 31, 2016	December 31, 2015
	NIS millions	NIS millions
Capitalized lease	**83**	*88
Protected tenancy and non-capitalized lease	**3**	3
	86	91

(2) Land and buildings, the depreciated cost of which amounted to NIS 1 million, are not in use by the Bank and comprise "investment property" (December 31, 2015 - NIS 3 million).

(3) Rights to real estate, the depreciated cost of which amounted to NIS 105 million, have not yet been registered in the name of the Bank at the Land Registry Office (December 31, 2015 - NIS 108 million), due to delays in formalities preceding registration on the part of the Director of the Israel Lands Authority (of which, NIS 60 million in respect of the Head Office building of the Bank acquired in 2009).

(4) The item includes buildings designated for sale, the depreciated cost of which as of December 31, 2016 amounted to NIS 2 million (December 31, 2015 - NIS 8 million). For additional details respecting commitments for the sale of such buildings, see Note 24B(12) below.

* Reclassified

Note 16 - Other Assets

Composition:

	Year ended December 31,	
	2016	2015
	NIS millions	NIS millions
Current taxes – Excess advance tax payments over tax provision	**28**	22
Deferred tax assets, net	**272**	265
Prepaid expenses	**9**	8
Income receivable	**14**	28
Other debtors and debit balances	**23**	18
Total other assets	**346**	341

Note 17 - Deposits from the Public

A. Composition [(1)]:

	December 31 2016	December 31 2015
	NIS millions	NIS millions
Of which:		
Demand deposits:		
Non-interest bearing	**5,776**	5,146
Interest bearing	**2,128**	1,918
Total demand deposits	**7,904**	7,064
Time deposits	**19,295**	18,324
Total deposits from the public	**27,199**	25,388

B. composition of public deposits according to depositors

	December 31 2016	December 31 2015
	NIS millions	NIS millions
Of which:		
Private individuals	**11,929**	11,730
Institutional entities	**4,115**	4,489
Corporations and others	**11,155**	9,169
Total public deposits	**27,199**	25,388

C. distribution of deposits by size of deposit of the depositor:

Composition (in NIS millions)**:**

		December 31 2016	December 31 2015
		NIS millions	NIS millions
From	**To**		
-	1	**11,421**	10,866
1	10	**6,609**	6,247
10	100	**2,539**	2,604
100	500	**3,742**	3,877
Above 500	-	**2,888**	1,794
Total		**27,199**	25,388

Note 18 - Deposits from Banks

	December 31 2016	December 31 2015
	NIS millions	NIS millions
Banks in Israel		
Commercial banks:		
Demand deposits	**67**	81
Time deposits	**100**	300
Acceptances	**-**	-
Total deposits from banks in Israel	**167**	381
Banks outside of Israel		
Commercial banks:		
Demand deposits	**10**	6
Time deposits	**28**	25
Acceptances	**54**	47
Total deposits from foreign banks	**92**	78
Total deposits from banks	**259**	459

Note 19 – Bonds and Subordinated Capital Notes

A. Composition:

	Interest Rate	Average Maturity *	Internal rate of return *	Consolidated and the Bank December 31 2016	Consolidated and the Bank December 31 2015
	%	Years	%	NIS millions	NIS millions
(1) Marketable bonds					
Non-linked Israeli currency	2.1	5.2	2.1	**257**	-
(2) Subordinate Capital Notes					
CPI-linked Israeli currency	3.3-6.9	**4.6**	**3.9**	**669**	672
				926	672

* The average maturity is the average of the payment periods based on weighting the future cash flows, capitalized according to the internal rate of return. The internal rate of return is the interest rate which discounts the future cash flows to the stated amount of this item.

B. The rights attached to the debt notes are subordinate to the rights of all other creditors of the Bank, whether secured or unsecured.

C. On March 31, 2016, the Bank issued marketable bonds in the amount pf NIS 253 million. These bonds are non-linked, carry fixed interest at the rate of 2.07% and are redeemable at the end of six years from date of issue thereof.

Note 20 - Other Liabilities

Composition:

	Year ended December 31, 2016	2015
	NIS millions	
Provision for "long service awards" (Note 21)	**-**	78
Provisions for payroll and related expenses	**177**	131
Provisions for computer services	**21**	24
Excess liabilities in respect of employee benefits over assets of the plan (Note 21)	**383**	304
Provision for doubtful debts in respect of off-balance sheet items (Note 13B)	**28**	29
Deferred income	**32**	28
Institutions	**50**	11
Creditors regarding credit card activity	**550**	511
Other creditors and credit balances	**67**	65
Total other liabilities	**1,308**	1,181

Note 21 - Employee benefits

A. General

(1) Severance compensation

A. The liabilities of the Bank for the payment of severance compensation to its employees are covered by deposits with severance compensation funds and by appropriate provisions. The liabilities for severance compensation are computed on an actuarial basis, which also takes into account benefits in excess of existing contractual obligations, which the Bank may have to pay to employees retiring in the future. The provision in respect of these liabilities has been discounted to present value at balance sheet date using a discount rate of 1.6% (December 31, 2015 – 1.7%), based on rules specified in instructions of Bank of Israel. Furthermore, the General Manager and a number of other officers are entitled to an additional award in an amount of between four and nine monthly salaries.

B. The liability of the Bank for severance compensation does not include certain components in respect of rights to severance compensation relating to employees who had joined a pension scheme – beginning with the date of joining the scheme, due to the agreement that the pension fund is liable for the payment of amounts due to employees in respect of such components. Furthermore, the amounts deposited for severance compensation do not include the amounts accumulated with the pension fund in respect of the said components, as monies deposited with the fund are not under the control of the Bank.

Note 21 - Employee benefits (cont'd)

A. General (cont'd)

(2) Long service awards ("jubilee awards")

(A) General

In accordance with the labour agreements in effect at the Bank up until 2015, employees are entitled to "jubilee awards" upon completing certain periods of service with the Bank. The said awards include the payment of an amount equal to a certain number of monthly salaries as well as a number of paid vacation days, all in accordance with the levels of seniority of service (with respect to changes in the labour agreements in this matter, see Section B. below).

The financial statements in prior years, included a provision in respect of the full liability of the Bank for the payment of the said award, based on an actuarial computation, which takes into account the probability of entitlement to this award.

The provision for the said awards had been discounted to present value in accordance with rules promulgated by Bank of Israel.

(B) Amendment of the labour agreement in the matter of "Jubilee awards"

On December 28, 2016, the Bank signed an agreement with the Employee Representative Committee, whereby the parties agreed to settle the Bank's liability for the payment of the "Jubilee award" to its employees by way of a one-off payment to the employees in the amount of NIS 61 million, based on the stated actuarial provision for "Jubilee awards" as of September 30, 2016, as discounted to present value using an annual interest rate of 3.5% (instead of the interest rate in effect on September 30, 2016).

The profit arising to the Bank from the settlement of this liability amounts to NIS 19 million, and is reflected in the reported period in the statement of profit and loss in the item "Payroll expenses".

In accordance with the said agreement, this one-off payment settles in full the Bank's liability for the payment of "Jubilee awards" to its employees.

Accordingly, as from December 31, 2016, provisions for "Jubilee awards" are no longer included in the books of the Bank.

(3) Vacation

Employees of the Bank are entitled to paid annual vacation in accordance with labour agreements in effect at the Bank and subject to the provisions of the Annual Vacation Act, 1951. The financial statements include provisions in respect of this liability. Computation of the provision is based upon the most recent monthly salary with the addition of related benefits.

(4) Post-retirement benefits

Employees of the Bank are entitled to certain post-retirement benefits. The liability of the Bank in respect of these benefits as of balance sheet date is based on an actuarial computation and discounted to present value at discount rates of between 1.6%-2.2% (December 31, 2015 – 1.8%-2.5%) based on rules specified in instructions of Bank of Israel.

(5) Sick leave

An agreement was signed on April 28, 2015, by the Bank, the New Federation of Labor and the employees' representative committee, according to which, employees, upon reaching retirement age, are entitled to convert a part of their unutilized sick leave accumulated to their credit, into vacation days, subject to the fulfilment of certain preconditions.
The Bank has created a provision in respect of this liability, which is included in the financial statements in the item "other liabilities".

Note 21 - Employee benefits (cont'd)

B. Details regarding the liabilities by type of benefits and assets of the benefit plan

	December 31 2016	December 31 2015
	NIS millions	NIS millions
Liability for the payment of severance compensation	**573**	537
Deposits for the payment of severance compensation	**(190)**	(233)
	383	304
Liability for the payment of " long service awards (see Section A(2) above)	**-**	78
Liability for the payment of sick leave	**28**	27
Liability for the payment of unutilized sick leave	**7**	7
Liability for the payment of post-retirement retiree benefits	**47**	44
Excess liabilities over deposits for benefits to employees	**465**	460
Included in the item "Other assets"	**-**	-
Included in the item "other liabilities"	**465**	460
Total	**465**	460

Note 21 - Employee benefits (cont'd)

C. Information regarding defined benefits plans (liabilities for the payment of severance compensation and of certain post-retirement benefits)

1. Commitment and financing status

(a) Changes in liabilities in respect of defined benefits:

	Provision for severance compensation	
	Year ended December 31	
	2016	2015
	NIS millions	NIS millions
Balance at beginning of year	**537**	538
Cost of service	**17**	20
Cost of interest	**17**	17
Actuarial loss (income)	**58**	(8)
Total accruals	**629**	567
Benefits paid	**(56)**	(30)
Balance at end of year	**573**	537

	Post-retirement retiree benefits	
	Year ended December 31	
	2016	2015
	NIS millions	NIS millions
Balance at beginning of year	**44**	63
Cost of service	**1**	2
Cost of interest	**2**	3
Actuarial loss (income)	**1**	(6)
Total accruals	**48**	62
Benefits paid	**(1)**	(2)
Reductions, settlements, special and contractual benefits in respect of retirement	**-**	(16)
Balance at end of year	**47**	44

Note 21 - Employee benefits (cont'd)

C. Information regarding defined benefits plans (liabilities for the payment of severance compensation and of certain post-retirement benefits) (cont'd)

1. Commitment and financing status (cont'd)

(b) Change in fair value of the plan's assets

	Year ended December 31	
	2016	2015
	NIS millions	NIS millions
Balance at beginning of year	**233**	253
Anticipated return on assts of the plan	**8**	10
Actuarial loss	**(6)**	(12)
Deposits by the Bank to the plan	**11**	12
Total accruals	**246**	263
Benefits paid	**(56)**	(30)
Balance at end of year	**190**	233

(c) Balance sheet data

	Post-retirement retiree benefits*		Provision for severance compensation, net	
	December 31		December 31	
	2016	2015	2016	2015
	NIS millions	NIS millions	NIS millions	NIS millions
Included in the item "Other liabilities"	**47**	44	**383**	304
Commitment in respect of anticipated benefits	**47**	44	**573**	537
Fair value of the program's assets	**-**	-	**(190)**	(233)
Net anticipated benefit	**47**	44	**383**	304

* The commitment in respect of benefits to retirees comprises also "commitment in respect of accrued benefits"

Note 21 - Employee benefits (cont’d)

C. Information regarding defined benefits plans (liabilities for the payment of severance compensation and of certain post-retirement benefits) (cont'd)

1. Commitment and financing status (cont'd)

(d) Amounts recognized in other cumulative comprehensive income, before tax effect

	Post-retirement retiree benefits		Provision for severance compensation, net	
	December 31		December 31	
	2016	2015	2016	2015
	NIS millions	NIS millions	NIS millions	NIS millions
Assets at initial application date	**-**	-	**-**	-
Actuarial loss, net	**12**	12	**142**	102
Total	**12**	12	**142**	102

(e) Excess liabilities over assets of the plan

	Provision for severance compensation, net	
	December 31 2016	December 31 2015
	NIS millions	NIS millions
Commitment in respect of anticipated benefits	**573**	537
Fair value of the program's assets	**(190)**	(233)
Net liability	**383**	304

Note 21 - Employee benefits (cont'd)

C. Information regarding defined benefits plans (liabilities for the payment of severance compensation and of certain post-retirement benefits) (cont'd)

2. Profit and loss data

(a) Components of benefit costs and changes in assets and liabilities recognized in the statement of income:

	Provision for severance compensation, net		
	Year ended December 31		
	2016	**2015**	**2014**
	NIS millions	**NIS millions**	**NIS millions**
Cost of service	**17**	20	24
Cost of interest	**17**	17	18
Total current accruals	**34**	37	42
Anticipated return on assets of the plan	**(8)**	(10)	(1) (5)
Amortization of unrecognized amounts:			
Net actuarial loss	**8**	5	-
Other, including loss from reduction, settlements and special benefits upon retirement	**16**	-	(2) 33
Total net cost of benefits	**50**	32	70
Total expense regarding defined deposits pension plans	**8**	8	8
Total expenses	**58**	40	78

(1) According to Bank of Israel instructions, actual return on assets of the plan has been reported.
(2) Comprises provision for enlarged severance compensation in respect of voluntary retirement of employees, which was approved in 2014.

	Post-retirement retiree benefits		
	Year ended December 31		
	2016	**2015**	**2014**
	NIS millions	**NIS millions**	**NIS millions**
Cost of service	**1**	2	1
Cost of interest	**2**	3	3
Total current accruals	**3**	5	4
Amortization of unrecognized amounts:			
Net actuarial loss	**1**	1	-
Gain on reduction and settlements	**-**	(4)	(1)
Total net cost of benefits	**4**	2	3

Note 21 - Employee benefits (cont’d)

C. Information regarding defined benefits plans (liabilities for the payment of severance compensation and of certain post-retirement benefits) (cont'd)

2. Profit and loss data (cont'd)

(b) Changes in assets and liabilities recognized in accumulated other comprehensive income, before tax effect

	Provision for severance compensation		
	Year ended December 31		
	2016	**2015**	**2014**
	NIS millions	**NIS millions**	**NIS millions**
Net actuarial loss for the year	**64**	575	50
Amortization of actuarial loss	**(8)**	(5)	-
Total current changes	**56**	52	50
Amortization of an asset in respect of initial application	**(16)**	-	-
Total recognized in other comprehensive income	**-**	(53)	(17)
Total net cost of benefits	**40**	(1)	33
Total amount recognized in net cost of benefits and in other comprehensive income	**90**	31	103

	Post-retirement retiree benefits		
	Year ended December 31		
	2016	**2015**	**2014**
	NIS millions	**NIS millions**	**NIS millions**
Net actuarial loss for the year	**1**	2	8
Amortization of actuarial loss	**(1)**	(1)	-
Total current changes	**-**	1	8
Amortization of actuarial loss in respect of settlement	**-**	(5)	-
Amortization of an asset in respect of initial application	**-**	(8)	-
Total recognized in other comprehensive income	**-**	(12)	8
Total net cost of benefits	**4**	2	3
Total amount recognized in net cost of benefits and in other comprehensive income	**4**	(10)	11

Note 21 - Employee benefits (cont’d)

C. Information regarding defined benefits plans (liabilities for the payment of severance compensation and of certain post-retirement benefits) (cont'd)

2. Profit and loss data (cont'd)

(c) Estimate of amounts included in other cumulative comprehensive income, before tax effect, expected to be amortized to the statement of income in the following year:

	Provision for severance compensation December 31		Post-retirement retiree benefits December 31	
	Estimate for 2017	Year ended December 31, 2016	Estimate for 2017	Year ended December 31, 2016
	NIS millions	NIS millions	NIS millions	NIS millions
Net actuarial loss	**8**	24	**1**	1
Cost of previous service	**-**	-	**-**	-
Total	**8**	24	**1**	1

3. Assumptions and sensitivity tests

(a) Assumptions used in determining the commitment in respect of benefits (percentages):

	December 31 2016	December 31 2015
	%	%
Discount rate	**1.6-2.2**	1.7-2.5
CPI growth rate	**2.0**	2.0
Remuneration growth rate	**4.3**	4.3
Retirement rate	**0.0-23.5**	0.0-23.5

(b) Assumptions used in determining payroll costs (percentages):

	Year ended December 31		
	2016	2015	2014
	%	%	%
Discount rate	**1.3-2.5**	1.0-2.7	1.4-2.4
Anticipated return on the plan's assets	**3.8**	3.8	*1.8
Remuneration growth rate	**4.3**	4.3	4.5

* According to Bank of Israel instructions, actual return on assets of the plan has been reported.

Note 21 - Employee benefits (cont'd)

C. Information regarding defined benefits plans (liabilities for the payment of severance compensation and of certain post-retirement benefits) (cont'd)

3. Assumptions and sensitivity tests (cont'd)

(c) Effect of a one percentage point change on the commitments for the payment of benefits

	Provision for severance compensation		
	Increase of one percentage point		
	December 31		
	2016	2015	2014
	NIS millions	NIS millions	NIS millions
Change in discount rate	**(64)**	(62)	(59)
Change in remuneration/CPI growth rate	**64**	63	63
Change in retirement rate	**31**	21	21

	Provision for severance compensation		
	Decrease of one percentage point		
	December 31		
	2016	2015	2014
	NIS millions	NIS millions	NIS millions
Change in discount rate	**64**	62	59
Change in remuneration/CPI growth rate	**(64)**	(63)	(59)
Change in retirement rate	**(31)**	(21)	(21)

	Post retirement retiree benefits		
	Increase of one percentage point		
	December 31		
	2016	2015	2014
	NIS millions	NIS millions	NIS millions
Change in discount rate	**(9)**	(9)	(13)
Change in remuneration/CPI growth rate	**-**	-	-
Change in retirement rate	**(1)**	(1)	(1)

	Post retirement retiree benefits		
	Decrease of one percentage point		
	December 31		
	2016	2015	2014
	NIS millions	NIS millions	NIS millions
Change in discount rate	**9**	9	13
Change in remuneration/CPI growth rate	**-**	-	-
Change in retirement rate	**1**	1	1

Note 21 - Employee benefits (cont’d)

C. Information regarding defined benefits plans (liabilities for the payment of severance compensation and of certain post-retirement benefits) (cont'd)

4. The plan's assets

(a) Distribution of the fair value by quality levels:

	December 31, 2016			
	Level I	Level II	Level III	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Cash and deposits with banks	**16**	**-**	**-**	**16**
Bonds:				
- Government	**12**	**-**	**-**	**12**
- Corporate	**73**	**33**	**-**	**106**
Shares	**37**	**13**	**-**	**50**
Other	**-**	**-**	**6**	**6**
Total assets of the plan	**138**	**46**	**6**	**190**

	December 31, 2015			
	Level I	Level II	Level III	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Cash and deposits with banks	6	-	-	6
Bonds:				
- Government	56	-	-	56
- Corporate	66	27	-	93
Shares	48	15	-	63
Other	-	10	5	15
Total assets of the plan	176	52	5	233

(b) Allotment target of the plan's assets by type of asset:

	Allotment target	Actual proportionate share	
	December 31	December 31	
	2017	2016	2015
	%	%	%
Cash and deposits with banks	**6**	**9**	3
Bonds:			
- Government	**6**	**6**	24
- Corporate	**57**	**56**	40
Shares	**28**	**26**	27
Other	**3**	**3**	6
Total assets of the plan	**100**	**100**	100

Note 21 - Employee benefits (cont'd)

C. Information regarding defined benefits plans (liabilities for the payment of severance compensation and of certain post-retirement benefits) (cont'd)

4. Cash flow for plan's assets

(a) Deposits

	Anticipated	Actual deposits	
	2017	2016	2015
	NIS millions	NIS millions	NIS millions
Total deposits	**11**	**11**	12

(b) Benefits expected to be paid by the Bank in the future:

Year	NIS millions
2017	**40**
2018	**32**
2019	**33**
2020	**33**
2021	**29**
2022-2026	**147**
2027 and thereafter	**418**
Total	**732**

D. Efficiency

The Board of Directors approved on September 11, 2016, an efficiency program devised by Management of the Bank, which, inter alia, includes an employee voluntary retirement plan under preferential terms (hereinafter – "the plan").

The plan was applied by the Bank in the fourth quarter of 2016, at a cost of NIS 43 million.

Following the implementation of the plan, the Bank's commitment for the payment of severance compensation increased by an amount of NIS 17 million.

Moreover, the actuarial assessments for the payment of severance compensation were updated in the reported period, based upon updated data regarding the rate of employee retirement and the amounts of compensation paid to employees, as well as the future rates of employee retirement as anticipated by Management and the increased severance payments that the Bank is expected to make to retiring employees. The updating of the said forecasts

increased the liability of the Bank for the payment of severance compensation by an additional amount of NIS 37 million.
The provisions of the Bank for the payment of severance compensation in accordance with the plan and in respect of the updating of the actuarial forecasts increased in total by an amount of NIS 54 million.

The above growth in the liabilities of the Bank was classified as an "actuarial difference" and recognized in the item "Other comprehensive income", being part of the equity capital of the Bank (net of a tax savings of NIS 19 million).

Furthermore, in view of the volume of payments made by the Bank in 2016 to retiring employees (principally due to the implementation of the plan), comprising "significant settlement" of the Bank's obligation for the payment of severance compensation, the Bank accelerated in 2016 the amortization of the "actuarial differences" included in the equity capital. The said amortization amounted to NIS 16 million, and is reflected in the item Payroll and related expenses" in the statement of profit and loss.

Note 22 - Shareholders' Equity

Composition:

	Balance as at December 31, 2016		**Balance as at December 31, 2015**	
	Authorized	**Issued and paid-up**	**Authorized**	**Issued and paid-up**
	NIS	**NIS**	**NIS**	**NIS**
Ordinary shares - Class "A" of NIS 0.1 each	**12,250**	**6,222**	12,250	6,222
Ordinary shares - Class "B" of NIS 0.1 each	**12,250**	**6,205**	12,250	6,205
Ordinary shares of NIS 0.01 each	**500**	**16**	500	16
Total shares	**25,000**	**12,443**	25,000	12,443

Note 23 - Capital Adequacy, leverage and liquidity

A. Capital adequacy

(1) General

The capital adequacy ratios are computed in accordance with Proper Conduct of Banking Business Directives Nos. 201-211, published in 2013 (hereinafter – "the Basel rules").

(2) Amendment to Proper Conduct of Banking Business Directive No. 329 in the matter of "additional capital requirement"

In the wake of significant price increases in the housing market in Israel (accompanied by an accelerated growth in the scope of housing loans and in their relative weight in the credit portfolios of banking corporations), and which, according to Bank of Israel, increased the risks inherent in credit portfolios of banking corporations, Bank of Israel published on September 28, 2014, an amendment to Proper Conduct of Banking Business Directives No. 329, in which additional minimum equity capital requirements and

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

A. Capital adequacy (cont'd)

comprehensive capital requirements have been determined for each of the banking corporations (in addition to the restrictions determined in Proper Conduct of Banking Business Directives No. 201), at a rate comprising 1% of the volume of the housing loan portfolio of each of the banking corporations. The additional minimum capital requirements became effective on January 1, 2015, and are being applied gradually during eight consecutive quarters as from April 1, 2015, and until January 1, 2017.

The new guidelines increased the minimum capital requirements of the Bank as of December 31, 2016, by 0.16%. An assessment performed by the Bank, based on data of its housing loan portfolio as of December 31, 2016, indicates that the new guidelines are expected to increase the minimum capital requirements of the Bank as of January 1, 2017, by an additional 0.02% to a rate of 9.18% (in respect of the Tier I equity capital ratio), and to 12.68% (in respect of the comprehensive capital ratio).

(3) Transitional instructions

Transitional instructions have been determined in the Basel Rules allowing the gradual adoption of the guidelines with respect to stricter criteria for the recognition of capital, for regulatory adjustments and for the adoption of certain accounting principles, as follows:

- The requirement for the deduction of the "surplus deferred taxes" (as defined in the instructions, shall be applied gradually in the years 2014-2017 (hereinafter – "the transitional period"), and shall be adopted in full as from January 1, 2018. The gradual adoption includes the deduction of only a certain part of the "surplus deferred taxes", and the recognition of the other part as "risk assets".
- Despite the fact that the subordinate debt notes issued prior to December 31, 2013, are not qualified for recognition as "Tier II regulatory capital component", a mechanism was defined for the gradual adoption of the rules regarding these debt notes, to be applied in the years 2014-2021 (hereinafter – "the transitional period"), according to which, during the transitional period, a part of the debt notes may be recognized as Tier II capital, at gradually reduced rates, until their full elimination in full at the end of the transitional period.
- The balance of actuarial gains or losses (as defined in the transitional instructions), stemming from the adoption of the US accepted accounting principles regarding "employee rights", shall be gradually attributed to the Tier I equity capital in the years 2014-2017 (hereinafter – "the transitional period"), until its inclusion in full in the capital of the Bank at the end of the transitional period (January 1, 2018).

(4) Purchase of indemnification for the "Sale guarantees" portfolio

During April 2016, the Bank entered into an agreement with reinsurers of a high international rating, whereby the said insurers are committed to indemnify the Bank in respect of possible future credit losses, that might arise upon exercise of the guarantees mentioned in the agreement.

The agreement applies to guarantees (including commitments to the issue of guarantees) issued by the Bank within the framework of housing project financing under the Apartment Sale Act and other guarantees related to such projects. The validity of the agreement is from May 1, 2016 to December 31, 2016.The volume of the guarantees (including commitments to issue guarantees) to which the agreement applies amounts as of December 31, 2016, to NIS 1.5 billion.

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

A. Capital adequacy (cont'd)

The said indemnification commitment by the insurers, reduced the risk assets of the Bank as of December 31, 2016 (in accordance with Bank of Israel approval) by an amount of NIS 0.6 billion, comprising an increase of 0.30 percentage points in the Tier I equity capital ratio.

On January 18, 2017, the validity of the said agreement was extended for an additional period ending on December 31, 2017.

(5) Deduction from equity in respect of a deferred tax assets

On April 3, 2016, Bank of Israel issued guidelines clarifying certain aspects regarding the application of the requirement for the deduction from equity of surplus deferred tax assets (determined in Proper Conduct of Banking Business Directive No. 202 – hereinafter - "the Directive"). According to the new guidelines, banking corporations were permitted not to deduct surplus deferred tax assets (as defined in the Directive), up to the amount of the provisions for payroll tax included in the liabilities of the bank, where, according to estimates of the bank, the realization of the deferred tax asset is highly probable.
The said deferred tax assets not deducted from equity, following the publication of the above mentioned clarifications, are to be averaged as a "risk asset" at the rate of 250%.
The Bank applies the guidelines published by Bank of Israel as from March 31, 2016 and thereafter.
In accordance with the rules of the said guidelines, however, the new instructions had not been applied with respect to the comparative data for prior periods.
The application of the measurement rules contained in these guidelines, has contributed to an increase of 0.09 percentage points in the Tier I equity capital ratio of the Bank and to an increase of 0.08 percentage points in the comprehensive capital ratio as of December 31, 2016.

(6) Fluctuations in components of capital

The capital of the Bank used for the computation of the capital adequacy ratio, includes components, the change in value thereof stems, inter alia, from periodic changes in market variables as well as in actuarial assessments, such as:

- Fluctuations in market value of securities used for the measurement of fair value of bonds held in the available-for-sale portfolio, which are recognized in other comprehensive profit in the item "Adjustments to fair value of securities".
- Fluctuations in market value of government bonds and in the spread on high quality corporate bonds traded in the US, used for the computation of fair value of certain employee rights, which are recognized in other comprehensive profit in the item "Actuarial differences in respect of employee rights".

(7) Targets

In view of the capital requirements determined by Bank of Israel within the framework of Basel III Rules, and in Proper Conduct of Banking Business Directive No. 329 (see Section 2 above), the Board of Directors of the Bank has set limitations regarding the minimum capital ratios of the Bank, as follows:

- In accordance with the resolution of the Board of Directors dated November 17, 2014, the Tier I equity capital ratio of the Bank shall not be lower than 9.2%.
- In accordance with the resolution of the Board of Directors dated November 17, 2015, the overall capital adequacy ratio of the Bank shall not be lower than 12.7%.

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

A. Capital adequacy (cont'd)

(8) Relief in respect of efficiency program

On January 12, 2016, Bank of Israel issued a letter in the matter of "Operational efficiency of the banking sector in Israel". In this letter, Bank of Israel announced relief as regards the computation of the capital adequacy ratio that would be granted to banks implementing an efficiency program (complying with yardsticks set by Bank of Israel), including permission to spread over a period of five years, the implications resulting from the efficiency program.

In the course of 2016, the Bank introduced an efficiency program at a cost of NIS 43 million, which was approved by Bank of Israel for the purpose of the said relief. Following the implementation of the program, the Bank increased the provisions for the payment of severance compensation to employees by an amount of NIS 17 million.

The said increase in provisions was classified as an "actuarial difference" recognized (net of a tax savings of NIS 6 million) in the item "other comprehensive profit" being part of the equity capital.

(9) Financial information

	December 31 2016	December 31 2015
	NIS millions	NIS millions
(a) Tier I equity capital		
Equity capital	**2,244**	2,103
Difference between equity capital and Tier I capital and regulatory adjustment	**(2) 48**	25
Total Tier I equity capital after adjustments and deductions	**2,292**	2,128
Tier II capital after deductions	**627**	680
Total comprehensive capital	**2,919**	2,808
(b) Weighted risk assets balance		
Credit risk	**19,164**	18,110
Market Risk	**22**	31
Operational risk	**1,930**	1,871
Total weighted risk assets balance	**21,116**	20,012

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

A. Capital adequacy (cont'd)

(9) Financial information (cont'd)

(c) Ratio of capital to risk assets	December 31 2016 %	December 31 2015 %
Ratio of Tier I equity capital to risk assets	(2) **10.85**	10.63
Ratio of comprehensive capital to risk assets	(2) **13.82**	14.03
Ratio of minimum Tier I equity capital required by the Supervisor of Banks	(1) **9.16**	(1) 9.06
Minimum comprehensive capital adequacy ratio required by the Supervisor of Banks	(1) **12.66**	(1) 12.56

	December 31 2016 NIS millions	December 31 2015 NIS millions
(d) Capital components for calculating ratio of capital		
1. Tier I capital		
Equity capital	**2,244**	2,103
Difference between equity capital and Tier I capital	**41**	49
Total Tier I capital before regulatory adjustments	**2,285**	2,152
Regulatory adjustments:		
Deferred tax assets	**-**	(20)
Investment in capital of financial corporations that are not consolidated in reports to the public	**(2)**	(2)
Other regulatory adjustments	**(1)**	(2)
Total regulatory adjustments	**(7)**	(24)
Total Tier I capital	**2,292**	2,128
2. Tier II capital		
Regulatory instruments	**388**	453
Provision and reserves	**239**	227
Total Tier II capital before deductions	**627**	680
Deductions	**-**	-
Total Tier II capital	**627**	680
Qualified comprehensive capita	**2,919**	2,808

(1) In accordance with guidelines determined in the amendment to Proper Conduct of Banking Business Directive 329 (see item A(2) above), the minimal capital requirement applying to the Bank was increased as from April 1, 2015, by 0.02%-0.03% per quarter. According to these guidelines, this rate is expected to rise gradually, up to a maximum increment of 0.18% on January 1. 2017 (based on data of the Bank's housing loan portfolio as of December 31, 2016).

(2) The data includes adjustments in respect of the efficiency program, in accordance with guidelines on the matter published by Bank of Israel on January 12, 2016 (see extended discussion in item (8) above).

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

A. Capital adequacy (cont'd)

(9) Financial information (cont'd)

(e) The effect of the transitional instructions on the Tier I capital adequacy ratio	December 31 2016	December 31 2015
	%	%
Ratio of Tier I capital before the effect of the transitional instructions and of adjustments in respect of the efficiency program	**10.60**	10.25
Effect of the transitional instructions [(1)]	**0.20** -	0.38 -
Tier I equity capital ratio before effect of adjustments in respect of the efficiency program	**10.8**	10.63
Effect of adjustments in respect of the efficiency program	**0.05**	-
Ratio of Tier I capital	**10.85**	10.63

(1) Including the implications stemming from the application of new accounting principles in the matter of "employee rights", in effect as from January 1, 2015.

B. Liquidity coverage ratio

In accordance with Proper Conduct of Banking Business Directive No 221 in the matter of "liquidity coverage ratio", banking corporations are required to maintain a liquidity coverage ratio (defined as the ratio between "the inventory of high quality liquid assets" and the total net cash outflow during a future period of thirty days), of not lower than 100%. The instruction determined rules both as to the "inventory of high quality liquid assets", and as to the "net cash outflow during a future period of thirty days", as follows:

- **Inventory of high quality liquid assets** – includes very high quality liquid assets ("Level 1"), including cash on hand, deposits with bank of Israel and securities of the Government of Israel, as well as other quality liquid assets ("Level 2"), mostly: securities awarded a high quality rating.
- **Cash outflow during a period of thirty days** – defined as the expected cash outflow under a defined stress test during a future period of thirty days, including expected cash outflows in respect of retail deposits, deposits from non-financial corporations and financial corporations (assuming different "recycling rates" in respect of each of the classes of deposits).

Notwithstanding the above, the Directive contains transitional instructions permitting banking corporations to maintain at date of initial application of the guidelines (April 1, 2015), a liquidity coverage ratio of only 60%. This relief shall be gradually reduced until its elimination in full on January 1, 2017. Following are data regarding the liquidity coverage ratio at the Bank:

	December 31, 2016	December 31, 2015
Liquidity ratio:	%	%
Liquidity coverage ratio	**142.1**	[(2)] 125.2
Minimal liquidity coverage ratio required by the Supervisor of Banks	[(1)]**80.0**	[(1)]60.0

1.Until December 31, 2015- 60%; in 2016 – 80%; as from January 1, 2017 – 100%.
2.Reclassified.

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

C. Leverage ratio

In accordance with guidelines contained in Proper Conduct of Banking Business Directive No 218 in the matter of "leverage ratio", this ratio has been determined as the ratio between the "measurement of capital" and the "measurement of exposure", as follows:

- **"Capital measurement"** – defined as "Tier I equity capital", including implications stemming from the transitional instructions.
- **"Exposure measurement"** – defined as combination of the following exposures: "balance sheet exposure" (assets stated in the financial statements), "exposure to derivatives", "exposure to transactions for the financing of securities", and "exposure regarding off-balance sheet items".

In accordance with the said guidelines, banking corporations are required to maintain a leverage ratio of not less than 5% as from January 1, 2018, at the latest. Following are data regarding the leverage ratio components at the Bank:

	December 31, 2016	**December 31, 2015**
Components of the computation:	**NIS millions**	**NIS millions**
Tier I capital	**2,292**	2,128
Total exposures	**34,901**	32,454

	December 31, 2016	**December 31, 2015**
Leverage ratio:	**%**	**%**
Leverage ratio	**6.6**	6.6
Minimal leverage ratio required by the Supervisor of Banks	**(1)5.0**	(1)5.0

(1) As from January 1, 2018.

Note 24 - Contingent Liabilities and Special Commitments

A. Off-balance sheet engagements regarding operations based on extent of collection (1)

(1) Balance of credit granted out of deposits according to the extent of collections (2)

	Consolidated and the Bank	
	December 31, 2016	**December 31, 2015**
	NIS millions	**NIS millions**
In Israeli currency linked to the CPI	**18**	21

(1) Credits and deposits the repayment of which to the depositor is subject to the collection of the credit (or deposits) with a collection commission instead of a margin.
(2) Standing loans and Government deposits made in their respect in the amount of NIS 5 million (December 31, 2015– NIS 7 million) are not included in this table.

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

(2) Cash flow in respect of collection commission on such operations in NIS millions

	December 31,							
	2016							2015
	Up to 1 Year*	1 to 3 years*	3 to 5 years*	5 to10 years*	10 to 20 years	Over 20 Years	Total*	Total*
CPI linked segment:								
Future contractual cash flows	-	-	-	-	-	-	-	-
Anticipated future cash flows, net of early repayments per Management estimates	-	-	-	-	-	-	-	-
Discounted anticipated future cash flows, net of early repayments per Management estimates	-	-	-	-	-	-	-	-

* Total income anticipated in this period - Less than NIS 0.5 million.

B. Other Contingent Liabilities and Special Commitments

(1) The following liabilities and other commitments exist as of balance sheet date:

	Consolidated and the Bank	
	December 31, 2016	December 31, 2015
	NIS millions	NIS millions
Commitments for investment in buildings and equipment	**25**	30
Long-term rental agreements	**292**	301
Following are the rental payments in the coming years:		
First year	**30**	27
Second year	**29**	29
Third year	**29**	28
Fourth year	**29**	28
Fifth year	**27**	27
Sixth year and thereafter	**148**	162
Total rental payable	**292**	301

(2) In addition to that stated above, a number of the Bank's branches are located in buildings rented under the Tenant Protection Act. The rent payable in the coming year amounts to some NIS 1 million (December 31, 2015– identical).

(3) The Bank is committed to invest in four active venture capital funds. The maximum future commitment of the Bank to invest in these funds, in excess of the investment made up to balance sheet date, amounts to NIS 2 million (December 31, 2015 – NIS 3 million).

(4) The Bank, which is a member of the Tel Aviv Stock Exchange, has undertaken to indemnify, the Clearing House of the Exchange, jointly with the other members of the Exchange, for any damages it may sustain as a result of the inadequate holding of securities or from the lack of adequate financial cover by any one of the members of the Exchange.

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Other Contingent Liabilities and Special Commitments (cont'd)

With a view of ensuring the regular operations of the Stock Exchange, the Board of Directors of the Tel Aviv Stock exchange Clearing House decided on establishing a Risk Fund in which all members of the Clearing House (including the Bank) shall participate.
The share of the Bank in the Risk Fund, as stated, amounts at December 31, 2016, to NIS 17 million (December 31, 2015 – NIS 7 million). The volume of the Risk Fund and the rate of participation therein by the Bank are updated annually by the Stock Exchange Clearing House. For additional details as to the collateral deposited by the Bank as cover for these liabilities – see Note 25.

(5) The Bank, which is a member of Maof Clearing House Ltd., is responsible towards the Clearing House, along with other members, for any monetary obligations resulting from option transactions carried out on the Stock Exchange.
In addition, the Bank has committed towards the Maof Clearing House Ltd. to pay any monetary charge that might result from transactions made by its customers with respect to the writing of options settled by the Clearing House.

For this purpose, the Maof Clearing House established a Risk Fund. The Bank's share in this Risk Fund, as at balance sheet date, amounts to NIS 5 million (December 31, 2015– identical), comprising 0.17% of the total Risk Fund at such date. The Bank is required to provide collateral in favour of the Maof Clearing House in an amount which would cover its possible liability in respect of its share in the Risk Fund, as well as in respect of a liability deriving from its commitment towards the Clearing House (see Note 25).

(6) A member of a provident fund, which had been managed by the Bank in the past, approached the present manager of the fund raising various claims regarding the life assurance plan made in his respect as a provident fund member, also informing the present manager of his intention to file a motion for approval of a class action suit in this matter.
The present manager of the provident fund informed the Bank of this approach, within the premises of the agreement for the sale of the provident fund signed by the Bank in the past. The Bank has no information regarding the years to which the member refers in his claim and regarding the financial damaged claimed by the member.

(7) Reports appearing in the media during the reported period indicate that, within the framework of legal proceedings conducted in Australia in the matter of tax assessments relating to a local company, including matters relating to banking operations conducted by this company with the Bank in the years 1997-2009, the Australian Court decided to admit the request of the local tax authorities for the presentation of documents and evidence by the Bank, by means of its Chairman of the Board.
Following an appeal filed by the company, the Australian Court decided on July 12, 2016, to admit the appeal and cancel the previous decision.

(8) In the ordinary course of its business, lawsuits have been filed against the Bank, including class actions and motions for the approval of certain lawsuits as class action suits. Among other things, these suits include claims regarding improper interest charges (or not in accordance with agreements made), the subjecting of one service to another service, failure to execute instructions, improper charging of accounts and the failure to use proper judgment.

Based on legal advice received as to the prospects of the said claims, including the motions for the approval of class action suits, the Bank's Management believes that adequate provisions have been included in the financial statements, insofar as required, to cover possible liabilities resulting from the said claims.

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(8) (cont'd)

The total additional exposure with regard to claims filed against the Bank regarding various matters, as described above, where the prospects of their materializing are not remote, amounted at December 31, 2016 to NIS 32 million (December 31, 2015 – NIS 33 million).

Following are details of the material actions that had been filed against the Bank:

a. On March 24, 2013, a former employee of the parent company, who had retired in the year 2006 under an early retirement scheme, filed an action against the parent company and another respondent, claiming that the parent company had violated the early retirement agreement signed with him and that it had miscalculated the amounts due to him upon his retirement. The damage claimed by the former employee is assessed by him at NIS 2 million.

   Concurrently, the said Plaintiff filed a motion with the District Court for approval of his personal action as a class action suit referring, in addition to the Defendants in the personal action, also to two banks owned by the parent company (including the Bank), this due to his claim that the cause of action for the claim against the parent company (being in the main a mistaken calculation and short payment of severance pay upon the retirement of employees) applies, in his opinion, also to the Bank.

   The total amount of the damage caused by all defendants mentioned in the class action to their employees upon retirement is assessed by the Plaintiff at NIS 40 million (it was not possible to perceive in the claim brief the share of the Bank in the alleged damage to all class members).

   In the opinion of the Bank's Management, whereas the labour agreements in effect at the Bank differ from those in effect at the parent company, the assumptions standing at the base of the motion for a class action, do not apply to the Bank, and therefore the claims made by the Plaintiff are not relevant to the Bank. Accordingly, the Bank filed with the Court on July 15, 2013, a motion for the *in limine* dismissal of the motion for approval of a class action. To date the Court has not yet ruled in the matter.

   The Plaintiff submitted his principal arguments to the Court on November 3, 2014. Within the framework of these arguments the plaintiff stated his wish to withdraw the action against the Bank, though, in practice, to date he has not taken any steps in the matter.

   On June 18, 2016, the Regional Labour Tribunal decided to dismiss *in limine* the motion for approval of the class action filed against the Bank.

b. An Association filed a motion on April 18, 2016, with the Supreme Court of Justice against the Supervisor of Banks, the Governor of Bank of Israel, and most of the banking corporations operating in Israel (including the Bank), for the issue of an *order nisi* instructing the Governor of Bank of Israel and the Supervisor of Banks to order the banks named in the motion to change the method of computation of the interest charged on credit extended by them.

   As claimed by the Appellant, the amounts of interest charged to customers of the banking corporations in respect of credit extended to them are erroneous, stemming from an incorrect method of calculation (which includes a component of compound interest), and which, allegedly, contradict the agreement signed between the banks and their customers. It is accordingly alleged that customers of these banks suffered a damage as a result of the excess interest charged by this

Note 24 - Contingent Liabilities and Special Commitments (cont’d)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(8) (cont'd)

method. On May 1, 2016, the Supreme Court (sitting as a High Court of Justice) decided to dismiss the motion *in limine.*

c. An action was filed on March 2, 2014, against the Bank and four additional banks together with a motion for its approval as a class action suit, by one of the Bank's customers and by four other Plaintiffs (being customers of the other defendant banks), whose banking operations included, among other things, the exchange of foreign currency to local currency (and vice versa), through the selling and buying of foreign currency.

   The Plaintiffs allege that the exchange rates used by the defendant banks for the selling or buying foreign currency for their customers are different from the exchange rates prevalent on the interbank market. The profit accrued to the defendant banks in respect of such practice, constitutes in the opinion of the Plaintiffs "currency exchange commission", which is not included in the price lists of the defendant banks, in contradiction to the Banking Act (Service to customer), 1981, and in contradiction to the Banking Rules (proper disclosure and delivery of documents), 1992.

   In addition, the purchase or sale of foreign currency, as stated, involves the payment of an "exchange commission". The Plaintiffs allege that the price determined for this commission is identical at all the defendant banks, and therefore constitutes a forbidden "binding arrangement". The amount of the personal damage allegedly caused to the customer, is assessed by him at NIS 800, and the total amount stated in the motion for approval of a class action against all the five defendant banks is assessed by the Plaintiffs at NIS 2.07 billion (the action brief does not state the share of the Bank in the total amount claimed).

d. An action together with a motion for approval of the action as a class action suit was filed against the Bank on January 5, 2014, by a customer alleging damage caused to him in respect of "excess" interest amounts charged to him for credit facilities on his current account.

   The customer claims that in recent years the Bank has raised several times the interest rate on overdrawn amounts in his account even before expiry of the credit facilities granted to him while there has been no deterioration in his business situation. According to the Plaintiff, this manner of operation is in disagreement with the set of agreements entered into between him and the Bank and contradicts binding legal verdicts and instructions of Bank of Israel.

   Accordingly, the plaintiff requests the reimbursement of excess interest payments in respect of the periods from date of rise in interest rates to the date of expiry of the credit facilities. The alleged personal damage caused to the customer, as assessed by him, amounts to NIS 400, and the total amount stated in the motion for approval of the class action, representing, according to the Plaintiff, the estimated excess cost caused to all customers of the Bank in this respect, amounts to NIS 139 million, with the addition of interest and linkage increments.

e. An action together with a motion for approval of the action as a class action suit was filed against the Bank on September 7, 2015, by a customer of the Bank, who had received in the past a housing loan. Following financial difficulties of the borrower and his inability to repay the loan, the Bank instituted legal proceedings against him, including debt execution proceedings.

Note 24 - Contingent Liabilities and Special Commitments (cont’d)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(8) (cont'd)

The borrower alleges that, from a review of the documents received by him from the Debt Execution Registrar, within the framework of the proceedings conducted against him, he learnt that the commission amounts charged to him by the Bank prima facie exceed the amounts stated in the Bank's pricelist.

The alleged personal damaged caused to the Plaintiff is assessed by him at NIS 234. The total amount stated in the motion for approval of a class action against the Bank, representing according to the Plaintiff the excess commission amounts charged by the Bank to all Bank customers, is assessed by him at NIS 6 million. In addition, the Plaintiff claims that the Bank did not report to the Debt Execution Office the amounts paid by him within the framework of the negotiations for a compromise agreement conducted between himself and the Bank.

On January 2, 2017, the Court decided to dismiss the action as well as the motion for its approval as a class action.

f. An action together with a motion for approval of the action as a class action suit was filed on December 23, 2015, against the parent company and against the Bank by a customer of the parent company, who on several occasions was charged by the parent company with commission fee in respect of "delivery of notices" service, in connection with warning notices that had been sent to him regarding deviations from credit facilities recorded in his account.

The Plaintiff argues that his account had been charged by the parent company with a commission fee in respect of this service, despite the fact that in practice he did not deviate from the credit facility granted to him in his current account.

Furthermore, the Plaintiff argues that the delivery of the notice and the charging of a commission fee in respect thereof stems from a wrong automatic modus operandi in practice at the parent company. The Bank has been attached to the action, despite the fact that the Plaintiff is not a customer of the Bank, because of the fact that the operating systems of the Bank are based on the central computer system of the parent company, and therefore, the Plaintiff assumes, that the wrong modus operandi (as claimed by him) in practice at the parent company, is prima facie in practice also at the Bank.

The alleged personal damage caused to the Plaintiff is assessed by him at NIS 272, and the total amount stated in the motion for approval of a class action, reflecting the total damage caused prima facie to all customers of the two banks, in respect of the alleged modus operandi, is assessed by the Plaintiff at NIS 61 million (the action brief does state the share of the Bank in the total amount claimed).

(9) Following are details of material actions filed against the Bank, the prospects of which cannot at this stage be assessed:

a. An action together with a motion for approval of the action as a class action suit was filed on August 17, 2016, against the Bank and against nine additional banks (hereinafter – "the defendant banks") by an Association requesting to represent customers of the defendant banks, alleging damage caused to them due to excess commission fees allegedly charged to them by the defendant banks (the Bank received notice of the motion on November 1, 2016).

Note 24 - Contingent Liabilities and Special Commitments (cont’d)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(9) (cont'd)

As claimed by the Plaintiff, the practice of the defendant banks is to charge customers not defined as a "small business" within the meaning of the term in the Banking Rules (Customer service) (Commissions), 2008 (hereinafter – "the Banking Rules") with different commission fees deviating from amounts published in the "full pricelist" published in the Banking Rules, because, in the opinion of the Plaintiff, the said "full pricelist" applies to all customers of banks and not only to "private individuals" and "small businesses".

As estimated by the Plaintiff, the alleged excessive amounts of commission fees charged to customers of the defendant banks due to this practice, amount to NIS 1 billion (the said motion for approval of a class action does not specify the share of the Bank in the total amount of the claim).

Due to the short period that had passed since the filing of the claim, it is not possible to asses at this stage the prospects of the claim.

b. An action together with a motion for approval of the action as a class action suit was filed on January 4, 2017, against the Bank and two additional banks (hereinafter – "the defendant banks") by a number of customers of the defendant banks, in respect of the damage caused to them, allegedly due to an erroneous mode of operation, whereby the practice of these banks is to charge the accounts of their customers with interest on arrears at a higher frequency than that agreed with them (once in each quarter). The personal damage allegedly caused to the Plaintiffs is estimated by them at NIS 3,207, while the total amount stated in the motion, reflecting the alleged total damage caused to all customers charged with interest on arrears by the defendant banks, is estimated by the Plaintiffs at NIS 340 million (of which, the Bank's share is estimated by the Plaintiffs at NIS 12 million).

Due to the short period that had passed since the filing of the claim, it is not possible to asses at this stage the prospects of the claim.

(10) The Bank's central computer system is based on systems used by the parent company, which operates and maintains these systems. The computer services received by the Bank from the parent company are based on economically based agreements.

These agreements include:

- An agreement for the provision of computer services for an unspecified period, detailing the scope, quality and availability of the computer services provided to the Bank, including an undertaking for the continuity of these services, both during the engagement period and during the transitional period, in case one of the parties decides to discontinue the existing engagement.
- "Pricing agreement", which states the cost of the computer services, is renewable from time to time. The validity of the previous pricing agreement terminated on December 31, 2016. Furthermore, the previous pricing agreement included a transitional mechanism, according to which the terms and costs determined in the agreement continue to apply also in 2017 in case where an updated pricing agreement is not signed during 2016. In December 2016, the parties agreed to extend the validity of the previous pricing agreement and its terms by one additional year until December 31, 2017.

The agreement was approved by the Audit Committee of the Board on January 22, 2017.

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(11) Granting of an exemption and commitment to indemnify Directors and Officers:

On November 29, 2009, the general meeting of shareholders of the Bank approved a resolution according to which the Bank has committed to grant exemption in advance and indemnity to Directors and Officers of the Bank under certain conditions, as detailed below.

In view of the period of time that had passed since date of approval of the previous resolution, and the developments that had occurred in this respect, the Board of Directors approved on January 31, 2016, an amendment to the previous commitment documents, detailing the undertaking of the Bank and its terms, as follows:

In terms of the document, the Bank has committed to exempt in advance Directors and Officers of the Bank, as well as Directors and other officers of subsidiary companies, from responsibility for damage that the Bank (and those subsidiary companies) may sustain as a result of the violation of the duty of care on the part of the Director or Officer.

In addition, the Bank has committed to indemnify Directors and Officers with respect to financial liability that may be imposed on them and with respect to reasonable legal expenses that may be borne by them in connection with certain types of events detailed in the letter of indemnification. The exemption from responsibility and the commitment to grant indemnity, as stated, are subject to the terms and conditions as follows:

a. The exemption from responsibility and the commitment to grant indemnity shall apply to all Directors and Officers of the Bank and of those subsidiaries in respect of acts of commission or omission performed by them in their line of duty.

b. The exemption from responsibility and the commitment to grant indemnity shall not apply in the case of events involving the following acts of commission or omission:

- Violation of a fiduciary duty;
- Violation of the duty of care committed intentionally and recklessly (excluding if committed negligently only);
- An action taken with the intention of undue personal gain;
- A fine or monetary sanction imposed on the Officer.

c. Within the framework of the amendment to the previous resolution, the maximum amount of indemnity which shall be granted to all Directors and Officers of the Bank, has been increased from 10% of the shareholders' equity of the Bank to 25%, on condition that realization of the indemnity shall not deviate from the collective indemnity limitations as determined by the parent company.

(12) Sale of buildings:

a. On January 28, 2016, the Bank signed an agreement for he sale of rights in a building owned by it, in consideration for NIS 11 million, with the addition of VAT. The gain on the amounted to NIS 6 million and was recognized in the statement of profit and loss in the item "Other income".

b. On November 26, 2014, the Bank signed an agreement for the sale of a building owned by it in consideration for NIS 6 million. The gain on the sale amounted to NIS 2 million, and was recognized in the books of the bank in the first quarter of 2016, upon the transfer of possession of the asset to the purchaser.

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(12) (cont'd)

c. On November 30, 2016, the Bank signed an agreement for the sale of a building owned by it in consideration for NIS 6 million. The gain on the sale is estimated at NIS 4 million, and would be recognized in the books of the Bank upon the transfer of possession of the asset to the purchaser.

(13) Issue of bonds

On March 31, 2016, the Bank, through a designated subsidiary (hereinafter – "the subsidiary"), issued a series of marketable bonds in the amount of NIS 253 million.

The bonds are non-linked, carry interest at the rate of 2.07% p.a. (exceeding by 0.79 percentage points the rate of return at which similar government bonds were traded at date of the issue), and are redeemable at the end of six years from date of issue.

Further to that stated above, the subsidiary published on December 21, 2016, a shelf Prospectus, allowing it to issue additional marketable bonds or debt notes. The amount of such issue, its date and class of securities have not yet been determined.

(14) On September 10, 2015, the Ministry of Finance published a tender for the granting of loans to "small and middle-market businesses", partly guaranteed by the State, this being part of a new designated fund (the "small business fund"), in a maximum amount of NIS 1,800 million. Following legislative and arrangement procedures instituted by the Government and intended to increase competition in the field of granting credit to the retail business sector, the said tender was directed at banking corporations and institutional bodies jointly. Accordingly, each of the banking corporations successful in the tender, is required to share the credit that would be extended by it with another institutional body.

On January 17, 2016, the Ministry of Finance informed the Bank of its decision to accept the proposal of the Bank (and its institutional partner) as one of the successful proposals in the tender. The maximum amount of credit (including the share of the institutional partner) which the Bank may grant to customers within the framework of the fund, amounts to NIS 650 million.

Note 25 - Liens

A. In accordance with the agreement entered into between the Bank and the Maof Clearing House, the Bank deposited security in favour of Maof Clearing House, in respect of its responsibility towards the Clearing House for transactions it and its customers effected and for its share in the risk fund (see Note 24 B (5)).
According to the agreement, Clearing House agreed to refund the amount of the security, including all income earned thereon, to the Bank. Nevertheless, Maof Clearing House has the right to liquidate the security -in full or in part- at its discretion, against the reduction of an equal amount of the Bank's debt to it (see Section E below).

B. In accordance with the agreement entered into between the Bank and the Stock Exchange Clearing House, the Bank deposited security in favor of the Stock Exchange Clearing House, in respect of its responsibility to indemnify the Stock Exchange Clearing House in respect of a monetary damage resulting from the inadequate holding of securities (or a shortage in the financial cover of one of its members) and in respect of the share of the Bank in the risk fund established by the Stock Exchange Clearing House (see Note 24B(4)).
As security for this agreement, the Bank registered on April 13, 2005, a first degree fixed lien in favour of the Stock Exchange Clearing House in respect of this security and the rights attached to it (see Section E below).

C. With a view of improving efficiency of clearing financial transactions in the market and reducing exposure of Bank of Israel in this field, Bank of Israel launched a “real time” settlement system for large amounts (RTGS), which allows the swift and final transfer of funds between banks connected to the system, provided that the balance of liquidity of such banks is not less than the volume required for such transfer of funds. In view of the new settlement arrangements, the Bank may require from time to time short-term credit from Bank of Israel.

For the purpose of securing the payment in full of amounts that may become due to Bank of Israel in respect of the said credit, the Bank registered on November 15, 2010, a first degree fixed charge in favour of Bank of Israel on all the assets and liabilities deposited by it in the "collateral account" managed at the Stock Exchange Clearing House (in addition to a first degree floating charge registered on such assets on July 23, 2007).

Following are details regarding the composition of the assets deposited:

		December 31, 2016	December 31, 2015
		NIS millions	
Securities deposited [1]	- Average balance	**295**	296
	- Year-end balance	**296**	295
	- Highest balance during the year	**296**	297

D. In addition, from time to time the Bank deposits funds with bank of Israel comprising (together with securities deposited, as stated) collateral enabling the Bank to participate in credit tenders of Bank of Israel, when required.

Below are details of deposits made by the Bank with Bank of Israel (in NIS millions):

	2016			**2015**
	Balance as of December 31	Highest balance during the year	Average balance during the year	Balance as of December 31
Deposits with the Bank of Israel	**2,379**	**4,446**	**2,832**	4,663

In 2016, the Bank did not participate in any of the said tenders (2015 – the same).

Note 25 – Liens (cont'd)

E. Below are details of securities deposited in favour of the Maof Clearing House and the Stock Exchange Clearing House (in NIS millions):

	2016			2015
	Balance as of December 31	Highest balance during the year	Average balance during the year	Balance as of December 31
- Maof Clearing House				
- Cash	**2**	**2**	**2**	2
- Securities [(1)]	**48**	**64**	**55**	66
Total	**50**	**66**	**57**	68
- Stock Exchange Clearing House				
- Cash	**4**	**4**	**3**	2
- Securities [(1)]	**13**	**13**	**11**	10
Total	**17**	**17**	**14**	12

(1) The data reflect the value of the deposited securities for the entity in whose favour the securities have been pledged.

F. The Bank deposits bonds with foreign brokers as collateral for the settlement of option transactions made by its customers. The value of this collateral as of December 31, 2016, amounted to NIS 1 million (the highest and average balance in 2016 – NIS 1 million).

G. Within the framework of the activity involving derivative instruments, the Bank enters into CSA agreements with other banks (serving as counterparty to such transactions) in order to reduce the credit risk inherent in derivative instruments activity.

In accordance with such agreements, in the event that the credit exposure of one of the parties to the derivative transaction exceeds a certain predetermined limit, the other party to the transaction is obligated to provide a deposit to the first party in an amount equal to that of the excess exposure. The total amount of deposits made by the Bank in respect of such agreements total NIS 3 million as of December 31, 2016 (NIS 11 million as of December 31, 2015).

Note 26 - Derivative Instruments

A. General

(a) The current operations of the Bank involve exposure to various market risks: among them linkage basis, interest and liquidity risks. As part of the Bank's management of its market risks and for the purpose of limiting its exposure to such risks, to as great an extent as possible, the Bank employs a wide range of derivative financial instruments, such as:

Foreign currency contracts – (including options) **-** Contracts for the exchange of two currencies at a future date at an exchange rate fixed in advance. Financial instruments of this type include inter alia: forward contracts, currency swap contracts, and options assuring the future exchange rate between two currencies.

Interest contracts – Transactions for the exchange between cash flows deriving from interest calculated according to fixed rates, as against interest calculated according to variable rates and also contracts to assure future interest rates.

Note 26 - Derivative Instruments (cont'd)

A. General (cont'd)

(a) (cont'd)

Share price options – Options on the Maof share index and other shares in which the Bank acts only as a broker for its customers.

Contracts in respect of metals – Transactions to assure the future price of metals. In such transactions the Bank acts solely as a broker for its customers, and the customer undertakes to effect an opposite transaction to the original future transaction until the date of the exercise of the original transaction.

(b) The activity in derivative financial instruments involves the exposure to the following risks:

Credit risk – This constitutes the anticipated loss to the Bank in the event that the other party to the contract will not fulfil the terms of the contract. Since the stated amount of the transaction, does not necessarily reflect the credit risk inherent therein, the credit risk involved in derivative financial instruments, is defined on the basis of the cost of the commitment in a similar transaction, were it to be effected at the date of the measurement of the risk for a customer of a similar nature, for the period remaining until the date of the expiration of the derivative instrument.

The bank fixes specific credit facilities for customers dealing in derivative instruments. The related credit risk is reviewed on a current basis, similar to that of other credit facilities granted by the Bank. The Bank's policy regarding the security it requires from customers dealing in derivative financial instruments is similar to its security policy regarding other credit risks.

Market risk – This constitutes the exposure of the Bank to a loss in respect of the fluctuations in the fair value of a derivative instrument due to changes in market variables such as: exchange rates, interest rates and rates of inflation.

Liquidity risk – This constitutes the exposure of the Bank to a loss resulting from its inability to close rapidly an exposure in a derivative financial instrument, by a settlement in cash or by the creation of an opposite exposure. This type of risk exists mainly in regard to transactions having a low marketability, or which are not traded on regular exchanges or institutional markets. In the opinion of the Management of the Bank, considering its share of the activity in derivative financial instruments of the banking industry, the Bank can close its positions in derivative financial instruments relatively quickly and therefore its exposure to liquidity risks from this activity is not significant.

(c) Furthermore, in the course of its operations, the Bank enters into transactions involving contracts which, in themselves do not constitute derivative financial instruments, but are considered as "host contracts" which include "embedded derivative instruments". The "host contracts" are financial instruments which grant a benefit (option) to the other party to the transaction under certain conditions, the economic characteristics of which, are not clearly and closely connected to those of the host contracts (for example: a deposit which assures the customer the higher of: CPI linkage increments or foreign currency linkage differences). In accordance with directives of Bank of Israel such benefits are to be considered as "embedded derivative instruments".

Note 26 - Derivative Instruments (cont'd)

B. Consolidated volume of activity (NIS millions)

	December 31, 2016					
	Interest rate contracts					
	CPI	Foreign currency	Foreign currency contracts	Contracts on shares	Commodities and other contracts	Total
(a) Par value of derivative instruments:						
1. ALM derivatives [(1)(2)]						
Forward contracts	610	-	455	-	-	1,065
Other option contracts:						
Options written	-	-	4	787	-	791
Options purchased	-	-	4	787	-	791
Swaps [(3)]	-	628	1,044	-	-	1,672
Total ALM derivatives	610	628	1,507	-	-	2,745
2. Other derivatives [(1)]						
Forward contracts	-	-	-	-	-	-
Marketable option contracts:						
Options written	-	-	4	787	-	791
Options purchased	-	-	4	787	-	791
Other option contracts:						
Options written	-	-	2	-	-	2
Options purchased	-	-	2	-	-	2
Total other derivatives	-	-	12	1,574	-	1,586
3. Foreign currency swap contracts (SPOT)	-	-	149	-	-	149
(b) Gross fair value of derivative instruments:						
1. ALM derivatives [(2)]						
Positive gross fair value	4	-	21	-	-	25
Negative gross fair value	-	9	67	-	-	76
2. Other derivatives						
Positive gross fair value	-	-	-	4	-	4
Negative gross fair value	-	-	-	4	-	4
3. Total						
Positive gross fair value [(4)]	4	-	21	4	-	29
Amounts offset in the balance sheet	-	-	-	-	-	-
Stated balance of assets in respect of derivative instruments	4	-	21	4	-	29
Negative gross fair value[(4) (5)]	-	9	67	4	-	80
Amounts offset in the balance sheet	-	-	-	-	-	-
Stated balance of liabilities in respect of derivative instruments	-	9	67	4	-	80

1. Excluding foreign currency SWAP contracts (SPOT).
2. Derivatives constituting part of the bank's assets and liabilities management system that have not been designated for hedging relationships.
3. Including Interest Rate SWAP contracts amounting to NIS 558 million, in which the Bank has agreed to pay a fixed interest rate:
4. Of which gross positive fair value of assets in respect of embedded derivative instruments amounting to NIS 3 million, and negative gross fair value of NIS 1 million.
5. Of which NIS 57 million constitutes the balance of the liabilities in respect of foreign currency contracts not subject to a net settlement agreement (as of December 31,2016, the Bank had no assets in respect of derivative instruments not subject to a net settlement agreement).

Note 26 - Derivative Instruments (cont'd)

B. Consolidated volume of activity (NIS millions) (cont'd)

	December 31, 2015					
	Interest rate contracts					
	CPI	Foreign currency	Foreign currency contracts	Contracts on shares	Commodities and other contracts	Total
(a) Par value of derivative instruments:						
1. ALM derivatives [1][2]						
Forward contracts	1,258	-	452	-	-	1,710
Other option contracts [4]:						
Options written	-	-	4	-	-	4
Options purchased	-	-	18	-	-	18
Swaps [3]	-	796	2,705	-	-	3,501
Total ALM derivatives	1,258	796	3,179	-	-	5,233
2. Other derivatives [1]						
Forward contracts	-	-	-	-	-	-
Marketable option contracts:						
Options written	-	-	1	1,563	-	1,564
Options purchased	-	-	1	1,563	-	1,564
Other option contracts:						
Options written	-	-	12	-	-	12
Options purchased	-	-	12	-	-	12
Total Other derivatives	-	-	26	3,126	-	3,152
3. Foreign currency swap contracts (SPOT)	-	-	122	-	-	122
(b) Gross fair value of derivative instruments:						
1. ALM derivatives [2]						
Positive gross fair value	-	-	27	-	-	27
Negative gross fair value	16	26	73	-	-	115
2. Other derivatives						
Positive gross fair value	-	-	-	8	-	8
Negative gross fair value	-	-	-	8	-	8
3. Total						
Positive gross fair value [4]	-	-	27	8	-	35
Amounts offset in the balance sheet	-	-	-	-	-	-
Stated balance of assets in respect of derivative instruments	-	-	27	8	-	35
Negative gross fair value [4] [5]	16	26	73	8	-	123
Amounts offset in the balance sheet	-	-	-	-	-	-
Stated balance of liabilities in respect of derivative instruments	16	26	73	8	-	123

1. Excluding foreign currency SWAP contracts (SPOT).
2. Derivatives constituting part of the bank's assets and liabilities management system that have not been designated for hedging relationships.
3. Including Interest Rate SWAP contracts amounting to NIS 757 million, in which the Bank has agreed to pay a fixed interest rate:
4. Of which gross positive fair value of assets in respect of embedded derivative instruments amounting to NIS 4 million, and negative gross fair value of NIS 1 million.
5. Of which NIS 55 million constitutes the balance of the liabilities in respect of foreign currency contracts not subject to a net settlement agreement (as of December 31,2015, the Bank had no assets in respect of derivative instruments not subject to a net settlement agreement).

Note 26 - Derivative Instruments (cont'd)

C. Derivative instrument credit risk, based on contract counterparty – consolidated (in NIS millions)

	December 31, 2016				
	Stock markets	Banks	Governments and central Banks	Others	Total
Stated balance of assets in respect of derivative instruments	**2**	**15**	**-**	**12**	**29**
Gross amounts that are not offset in the balance sheet:					
Reduction in credit risk in respect of derivative instruments	**(1)**	**(5)**	**-**	**(5)**	**(11)**
Reduction in credit risk in respect of cash collateral received	**-**	**(4)**	**-**	**-**	**(4)**
Assets in respect of derivative instruments, net	**1**	**6**	**-**	**7**	**14**
Off-balance sheet credit risk in respect of derivative instruments(1)	**-**	**7**	**-**	**12**	**19**
Total credit risk in respect of derivative instruments	**1**	**13**	**-**	**19**	**33**
Stated balance of liabilities in respect of derivative instruments	**2**	**11**	**-**	**67**	**80**
Gross amounts that are not offset in the balance sheet:					
Financial instruments	**(1)**	**(5)**	**-**	**(5)**	**(11)**
Pledged cash security	**-**	**(1)**	**-**	**-**	**(1)**
Liabilities for derivative instrument, net	**1**	**5**	**-**	**62**	**68**

	December 31, 2015				
	Stock markets	Banks	Governments and central banks	Others	Total
Stated balance of assets in respect of derivative instruments	4	21	-	10	35
Gross amounts that are not offset in the balance sheet:					
Reduction in credit risk in respect of derivative instruments	(1)	(14)	-	(1)	(16)
Reduction in credit risk in respect of cash collateral received	-	-	-	-	-
Assets in respect of derivative instruments, net	3	7	-	9	19
Off-balance sheet credit risk in respect of derivative instruments(1)	-	6	-	13	19
Total credit risk in respect of derivative instruments	3	13	-	22	38
Stated balance of liabilities in respect of derivative instruments	4	56	-	63	123
Gross amounts that are not offset in the balance sheet:					
Financial instruments	(1)	(14)	-	(1)	(16)
Pledged cash security	-	(9)	-	-	(9)
Liabilities for derivative instrument, net	3	33	-	62	98

1. The difference, if positive, between amounts in respect of derivative instruments included I the borrower indebtedness, as computed for borrower indebtedness limitations, before deduction of the credit risk, and the stated balance of assets in respect of derivative instruments.

Note 26 - Derivative Instruments (cont'd)

D. Maturity dates (stated value amounts) – consolidated (NIS millions)

	December 31, 2016				
	Up to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Total
Interest rate contracts:					
Shekel/CPI	**3**	**200**	**407**	**-**	**610**
Other	**-**	**264**	**22**	**342**	**628**
Foreign currency contracts	**931**	**622**	**7**	**108**	**1,668**
Contracts on shares	**1,574**	**-**	**-**	**-**	**1,574**
Commodities and other contracts	**-**	**-**	**-**	**-**	**-**
Total	**2,508**	**1,086**	**436**	**450**	**4,480**
December 31, 2015	5,764	1,896	315	532	8,507

Note 27 - Regulatory operating segments

A. General

The data contained in this note reflect he distribution of credit and deposits from the public by "regulatory segments of operations", in accordance with definitions determined by Bank of Israel in an amendment to the public reporting instructions in this matter, published on November 3, 2014, as follows:

- **Households –** Private customers the volume of their financial asset portfolio is typical to that of households (lower than NIS 3 million).
- **Private banking -** Private customers the volume of their financial asset portfolio exceeds NIS 3 million.
- **Tiny businesses** – Business customers the annual turnover of their operations is less than NIS 10 million.
- **Small businesses -** Business customers the annual turnover of their operations is between NIS 10 million and NIS 50 million.
- **Middle market businesses -** Business customers the annual turnover of their operations is between NIS 50 million and NIS 250 million.
- **Corporate banking –** Business customers the annual turnover of their operations exceeds NIS 250 million.
- **Financial management –** Principally includes banking activity not attributed to the other segments of operation, including:
  - Trading activity – such as investment in trading securities and derivative instrument activity not intended for hedge purposes and which does not comprise a part of the asset and liability management setup of the Bank.
  - Asset and liability management activity – Financial instrument activity comprising a part of risk management and of management of the active capital not for trading purposes, such as: investment in available-for-sale securities and in bonds held to maturity, derivative instrument activity being part of the asset and liability management and activity with banks and governments.
  - Investment activity – Investment in shares of affiliated companies and in available-for-sale shares.

Note 27 - Regulatory operating segments

A. General (Cont'd)

Measurement of the business results and their classification to the different segments of operations, as stated above, is based upon the methodology determined by the Bank as regards this matter, as described below:

Interest income – each segment of operation is allotted an "interest spread" comprising a total of the following components:
- The difference between the interest income attributable to the particular segment (from credit operations) and the cost of interest computed on the basis of the "transfer cost".
- The difference between the cost of interest (in deposit operations) and the interest income in respect of such deposits, such income computed on the basis of the "transfer cost".

"Transfer cost" – determined on the basis of quoted deposit prices on the institutional market (being an indication of the marginal cost of raising deposits by the Bank).

In accordance with this methodology, whereby a specific transfer cost is adapted for each credit or deposit product, in each of the segments of operation, these segments are not subject to market risk, but only to credit risk.

Financing operation profits or losses stemming from changes in market conditions, are recognized in the asset and liability management center (ALM), where the income from the management of the active capital of the Bank is also recognized.

The said profits and losses have been classified to the "financial management" segment.

Credit loss expenses – are allocated to the different segments of operation in accordance with the allocation of the customer in respect of whom the expenses had been recognized.

Operating income – commission fees and other operating income are allocated to the different segments of operation in accordance with the allocation of the customer in respect of whom the income had been recognized.

Operating expenses – Whereas the distribution of operations by "regulatory segments of operation", is not in agreement with the organizational structure of the Bank, the allocation of operating expenses to the said segments is based on the distribution of costs by segments of operation according to "Management's approach", adjusted to the "regulatory" distribution of operations, by use of an "income distribution" key.

For additional information regarding the methodology used by the Bank for the allocation of operating expenses by "segments of operation according to Management's approach" – see Note 28, below).

Note 27 - Regulatory operating segments (cont'd)

B. Financial data – Summary (in NIS millions)

	For the year ended December 31, 2016							
	Household	Private Banking	Small Business[(1)]	Medium Business	Large Business	Institutional Business	Financial management	Total
Interest income - outsiders	324	-	541	98	53	2	40	1,058
Interest expense – outsiders	(50)	(12)	(23)	(3)	(4)	(11)	(21)	(124)
Interest income (expense) from outsiders, net	274	(12)	518	95	49	(9)	19	934
Inter-segment interest	9	15	(6)	(10)	(7)	15	(16)	-
Net interest income	283	3	512	85	42	6	3	934
Non-interest income	114	4	145	32	10	-	44	349
Total income	397	7	657	117	52	6	47	1,283
Credit loss expenses (income)	11	-	17	10	(3)	-	1	36
Operating expenses	353	17	431	55	24	3	27	910
Total operating and other expenses	364	17	448	65	21	3	28	946
Pre-tax profit (loss)	33	(10)	209	52	31	3	19	337
Taxes on income	22	(3)	88	21	12	1	5	146
After tax profit (loss)	11	(7)	121	31	19	2	14	191
Share of the Bank in profit of an affiliated company	-	-	-	-	-	-	2	2
Net profit (loss)	11	(7)	121	31	19	2	16	193
Average balance of assets	7,456	25	9,687	2,756	1,767	40	8,951	30,682
Of which: - Affiliates	-	-	-	-	-	-	9	9
- Credit to public[(2)]	7,282	13	9,564	2,784	1,788	38	-	21,469
Credit to the public at end of year[(2)]:								
- Impaired debts	19	-	223	43	37	-	-	322
- 90 days in arrear	49	-	12	2	-	-	-	63
- Other	7,683	18	9,931	2,745	1,567	20	-	21,964
Total credit to the public	7,751	18	10,166	2,790	1,604	20	-	22,349
Average balance of liabilities								
- Deposits from the public	10,136	1,412	6,870	1,224	1,929	4,359	-	25,930
- Other	230	11	281	35	16	2	2,038	28,543
Total liabilities	10,366	1,423	7,151	1,259	1,945	4,361	2,038	28,543
Balance of deposits at end of year	10,361	1,568	6,996	1,307	2,852	4,115	-	27,199
Risk assets – average balance	5,490	10	9,115	3,352	2,131	54	583	20,735
Balance at end of year	5,873	10	9,248	3,473	1,964	33	515	21,116
Managed assets – average balance	3,536	1,412	1,970	848	2,186	864	-	10,816
Components of interest income:								
- Spread from credit operations	248	-	488	82	39	-		
- Spread from deposit operations	35	3	24	3	3	6		
Total interest income	283	3	512	85	42	6		

(1) Including minute businesses.
(2) The data relates to the stated balance of credit to the public.

Note 27 - Regulatory operating segments (cont'd)

B. Financial data - Summary (cont'd) (in NIS millions)

	For the year ended December 31, 2015							
	Household	Private Banking	Small Business [1]	Medium Business	Large Business	Institutional Business	Financial management	Total
Interest income - outsiders	287	-	507	92	60	2	26	974
Interest expense – outsiders	(53)	(12)	(22)	(2)	(4)	(11)	2	(102)
Interest income (expense) from outsiders, net	234	(12)	485	90	56	(9)	28	872
Inter-segment interest	12	15	(5)	(9)	(15)	13	(11)	-
Net interest income	246	3	480	81	41	4	17	872
Non-interest income	127	6	146	28	8	-	65	380
Total income	373	9	626	109	49	4	82	1,252
Credit loss expenses (income)	9	-	36	24	(2)	-	-	67
Operating expenses	338	11	396	47	21	2	26	841
Total operating and other expenses	347	11	432	71	19	2	26	908
Pre-tax profit (loss)	26	(2)	194	38	30	2	56	344
Taxes on income	14	(1)	78	15	13	1	16	136
After tax profit (loss)	12	(1)	116	23	17	1	40	208
Share of the Bank in profit of an affiliated company	-	-	-	-	-	-	2	2
Net profit (loss)	12	(1)	116	23	17	1	42	210
Average balance of assets	6,493	17	9,255	2,587	1,880	62	7,692	27,986
Of which: - Affiliates	-	-	-	-	-	-	7	7
- Credit to public[2]	6,289	8	9,109	2,591	1,907	61	-	19,965
Credit to the public at end of year[2]:								
- Impaired debts	26	-	206	59	41	-	-	332
- 90 days in arrear	32	-	-	-	-	-	-	32
- Other	6,764	13	9,205	2,582	1,770	56	-	20,390
Total credit to the public	6,822	13	9,411	2,641	1,811	56	-	20,754
Average balance of liabilities								
- Deposits from the public	9,859	1,602	6,572	913	1,333	3,224	-	23,503
- Other	222	7	260	30	14	1	1,973	2,507
Total liabilities	10,081	1,609	6,832	943	1,347	3,225	1,973	26,010
Balance of deposits at end of year	9,947	1,783	6,638	1,019	1,512	4,489	-	25,388
Risk assets – average balance	4,641	10	8,525	3,346	2,250	67	742	19,581
Balance at end of year	4,942	11	8,858	3,330	2,205	56	610	20,012
Managed assets – average balance	3,737	1,428	[3] 2,042	[3] 810	2,328	1,290	-	11,635
Components of interest income:								
- Spread from credit operations	212	-	454	79	40	1		
- Spread from deposit operations	34	3	26	2	1	3		
Total interest income	246	3	480	81	41	4		

(1) Including minute businesses.
(2) The data relates to the stated balance of credit to the public.

(3) Reclassified

Note 27 - Regulatory operating segments (cont'd)

C. Financial data – Private individuals (in NIS millions):

	For the year ended December 31, 2016								
	Household segment				Private banking segment				Total
	Housing loans	Credit cards	Other	Total	Housing loans	Credit cards	Other	Total	Private individuals
Interest income - outsiders	96	10	218	324	-	-	-	-	324
Interest expense – outsiders	-	-	(50)	(50)	-	-	(12)	(12)	(62)
Interest income (expense) from outsiders, net	96	10	168	274	-	-	(12)	(12)	262
Inter-segment interest	(55)	(3)	67	9	-	-	15	15	24
Net interest income	41	7	235	283	-	-	3	3	286
Non-interest income	2	21	91	114	-	-	4	4	118
Total income	43	28	326	397	-	-	7	7	404
Credit loss expenses (income)	1	-	10	11	-	-	-	-	11
Operating expenses	42	25	286	353	-	-	17	17	370
Total operating and other expenses	43	25	296	364	-	-	17	17	381
Pre-tax profit (loss)	-	3	30	33	-	-	(10)	(10)	23
Taxes on income	2	2	18	22	-	-	(3)	(3)	19
Net profit (loss)	(2)	1	12	11	-	-	(7)	(7)	4
Average balance of assets	3,546	356	3,554	7,456	8	2	15	25	7,481
Of which: - Credit to public(1)	3,535	346	3,401	7,282	8	2	3	13	7,295
Credit to the public at end of year(1):									
- Impaired debts	-	-	19	19	-	-	-	-	19
- 90 days in arrear	34	-	15	49	-	-	-	-	49
- Other	3,697	453	3,533	7,683	13	2	3	18	7,701
Total credit to the public	3,731	453	3,567	7,751	13	2	3	18	7,769
Average balance of liabilities:									
- Deposits from the public	-	-	10,136	10,136	-	-	1,412	1,412	11,789
- Other	-	16	214	230	-	-	11	11	241
Total liabilities	-	16	10,350	10,366	-	-	1,423	1,423	11,789
Balance of deposits at End of year	-	-	10,361	10,361	-	-	1,568	1,568	11,929
Risk assets – average balance	2,293	412	2,785	5,490	4	3	3	10	5,500
Balance at end of year	2,506	451	2,916	5,873	4	2	4	10	5,883
Managed assets – average balance	-	-	3,536	3,536	-	-	1,412	1,412	4,948
Components of interest income:									
- Spread from credit operations	41	7	200	248	-	-	-	-	248
- Spread from deposit operations	-	-	35	35	-	-	3	3	38
Total interest income	41	7	235	283	-	-	3	3	286

(1) The data relates to the stated balance of credit to the public.

Note 27 - Regulatory operating segments (cont'd)

C. Financial data – Private individuals (in NIS millions) (cont'd):

	For the year ended December 31, 2015								
	Household segment				**Private banking segment**				**Total**
	Housing loans	**Credit cards**	**Others**	**Total**	**Housing loans**	**Credit cards**	**Others**	**Total**	**Private individuals**
Interest income - outsiders	89	10	188	287	-	-	-	-	287
Interest expense – outsiders	-	-	(53)	(53)	-	-	(12)	(12)	(65)
Interest income (expense) from outsiders, net	89	10	135	234	-	-	(12)	(12)	222
Inter-segment interest	(56)	(2)	70	12	-	-	15	15	27
Net interest income	33	8	205	246	-	-	3	3	249
Non-interest income	3	20	104	127	-	-	6	6	133
Total income	36	28	309	373	-	-	9	9	382
Credit loss expenses (income)	3	-	6	9	-	-	-	-	9
Operating expenses	37	25	276	338	-	-	11	11	349
Total operating and other expenses	40	25	282	347	-	-	11	11	349
Pre-tax profit (loss)	(4)	3	27	26	-	-	(2)	(2)	24
Taxes on income	(1)	1	14	14	-	-	(1)	(1)	13
Net profit (loss)	(3)	2	13	12	-	-	(1)	(1)	11
Average balance of assets	3,131	355	3,007	6,493	6	2	9	17	6,510
Of which: - Credit to public(1)	3,117	335	2,837	6,289	6	2	-	8	6,297
Credit to the public at end of year(1):									
- Impaired debts	-	-	26	26	-	-	-	-	26
- 90 days in arrear	25	-	7	32	-	-	-	-	32
- Other	3,277	424	3,063	6,764	8	2	3	13	6,777
Total credit to the public	3,302	424	3,096	6,822	8	2	3	13	6,835
Average balance of liabilities:									
- Deposits from the public	-	-	9,859	9,859	-	-	1,602	1,602	11,461
- Other	-	16	206	222	-	-	7	7	229
Total liabilities	-	16	10,065	10,081	-	-	1,609	1,609	11,690
Balance of deposits at End of year	-	-	9,947	9,947	-	-	1,783	1,783	11,730
Risk assets – average balance	1,930	333	2,378	4,641	4	3	3	10	4,651
Balance at end of year	2,055	355	2,532	4,942	5	3	3	11	4,953
Managed assets – average balance	-	-	3,737	3,737	-	-	1,428	1,428	5,165
Components of interest income:									
- Spread from credit operations	33	8	171	212	-	-	-	-	212
- Spread from deposit operations	-	-	34	34	-	-	3	3	37
Total interest income	33	8	205	246	-	-	3	3	249

(1) The data relates to the stated balance of credit to the public.

Note 27 - Regulatory operating segments (cont'd)

D. Financial data – business activity (in NIS millions)

	For the year ended December 31, 2016									
	Small and minute business			**Middle-market business**			**Large businesses**			**Total**
	Construction Real estate	**Other**	**Total**	Construction Real estate	**Other**	**Total**	Construction Real estate	**Other**	**Total**	Business operations
Interest income - outsiders	**140**	**401**	**541**	**23**	**75**	**98**	**10**	**43**	**53**	**692**
Interest expense – outsiders	**(4)**	**(19)**	**(23)**	**(1)**	**(2)**	**(3)**	**-**	**(4)**	**(4)**	**(30)**
Interest income from outsiders, net	**136**	**382**	**518**	**22**	**73**	**95**	**10**	**39**	**49**	**662**
Inter-segment interest	**(8)**	**2**	**(6)**	**(1)**	**(9)**	**(10)**	**(3)**	**-**	**(7)**	**(23)**
Net interest income	**128**	**384**	**512**	**21**	**64**	**85**	**7**	**35**	**42**	**639**
Non-interest income	**23**	**122**	**145**	**16**	**16**	**32**	**2**	**8**	**10**	**187**
Total income	**151**	**506**	**657**	**37**	**80**	**117**	**9**	**43**	**52**	**826**
Credit loss expenses (income)	**(1)**	**18**	**17**	**(8)**	**18**	**10**	**-**	**(3)**	**(3)**	**24**
Operating expenses	**81**	**350**	**431**	**16**	**39**	**55**	**1**	**23**	**24**	**510**
Total operating and other expenses	**80**	**368**	**448**	**8**	**57**	**65**	**1**	**20**	**21**	**534**
Pre-tax profit	**71**	**138**	**209**	**29**	**23**	**52**	**8**	**23**	**31**	**291**
Taxes on income	**27**	**61**	**88**	**10**	**11**	**21**	**3**	**9**	**12**	**121**
Net profit	**44**	**77**	**121**	**19**	**12**	**31**	**5**	**14**	**19**	**171**
Average balance of assets	**2,837**	**6,850**	**9,687**	**641**	**2,115**	**2,756**	**354**	**1,413**	**1,767**	**14,210**
Of which: - Credit to public[(1)]	**2,815**	**6,749**	**9,564**	**642**	**2,142**	**2,784**	**356**	**1,432**	**1,788**	**14,136**
Credit to the public at end of year[(1)]:										
- Impaired debts	**76**	**147**	**223**	**13**	**30**	**43**	**-**	**37**	**37**	**303**
- 90 days in arrear	**1**	**11**	**12**	**1**	**1**	**2**	**-**	**-**	**-**	**14**
- Other	**2,875**	**7,056**	**9,931**	**568**	**2,177**	**2,745**	**372**	**1,195**	**1,567**	**14,243**
Total credit to the public	**2,952**	**7,214**	**10,166**	**582**	**2,208**	**2,790**	**372**	**1,232**	**1,604**	**14,560**
Average balance of liabilities:										
- Deposits from the public	**1,261**	**5,609**	**6,870**	**364**	**860**	**1,224**	**92**	**1,837**	**1,929**	**10,023**
- Other	**52**	**229**	**281**	**10**	**25**	**35**	**-**	**16**	**16**	**332**
Total liabilities	**1,313**	**5,838**	**7,151**	**374**	**885**	**1,259**	**92**	**1,853**	**1,945**	**10,355**
Balance of deposits at End of year	**1,315**	**5,681**	**6,996**	**316**	**991**	**1,307**	**86**	**2,766**	**2,582**	**11,155**
Risk assets – average balance	**2,775**	**6,340**	**9,115**	**656**	**2,696**	**3,352**	**377**	**1,754**	**2,131**	**14,598**
Balance at end of year	**2,600**	**6,648**	**9,248**	**740**	**2,733**	**3,473**	**441**	**1,523**	**1,964**	**14,685**
Managed assets – average balance	**263**	**1,707**	**1,970**	**574**	**274**	**848**	**84**	**2,102**	**2,186**	**5,004**
Components of interest income:										
- Spread from credit operations	**123**	**365**	**488**	**20**	**62**	**82**	**7**	**32**	**39**	**609**
- Spread from deposit operations	**5**	**19**	**24**	**1**	**2**	**3**	**-**	**3**	**3**	**30**
Total interest income	**128**	**384**	**512**	**21**	**64**	**85**	**7**	**35**	**42**	**639**

(1) The data relates to the stated balance of credit to the public.

Note 27 - Regulatory operating segments (cont'd)

D. Financial data – business activity (in NIS millions) (cont'd)

	For the year ended December 31, 2015									
	Small and minute business			**Middle-market business**			**Large businesses**			**Total**
	Construction Real estate	**Other**	**Total**	Construction Real estate	**Other**	**Total**	Construction Real estate	**Other**	**Total**	**פעילות עסקית**
Interest income - outsiders	133	374	507	23	69	92	9	51	60	659
Interest expense – outsiders	(4)	(18)	(22)	-	(2)	(2)	-	(4)	(4)	(28)
Interest income from outsiders, net	129	356	485	23	67	90	9	47	56	631
Inter-segment interest	(10)	5	(5)	(2)	(7)	(9)	(3)	(12)	(15)	(29)
Net interest income	119	361	480	21	60	81	6	35	41	602
Non-interest income	24	122	146	11	17	28	1	7	8	182
Total income	143	483	626	32	77	109	7	42	49	784
Credit loss expenses (income)	9	27	36	(1)	25	24	(1)	(1)	(2)	58
Operating expenses	74	322	396	11	36	47	2	19	21	464
Total operating and other expenses	83	349	432	10	61	71	1	18	19	522
Pre-tax profit	60	134	194	22	16	38	6	24	30	262
Taxes on income	24	54	78	8	7	15	4	9	13	106
Net profit	36	80	116	14	9	23	2	15	17	156
Average balance of assets	2,687	6,568	9,255	633	1,954	2,587	268	1,612	1,880	13,722
Of which: - Credit to public(2)	2,662	6,447	9,109	631	1,960	2,591	269	1,638	1,907	13,607
Credit to the public at end of year(2):										
- Impaired debts	58	148	206	8	51	59	-	41	41	306
- 90 days in arrear	-	-	-	-	-	-	-	-	-	-
- Other	2,724	6,481	9,205	614	1,968	2,582	240	1,530	1,770	13,557
Total credit to the public	2,782	6,629	9,411	622	2,019	2,641	240	1,571	1,811	13,863
Average balance of liabilities:										
- Deposits from the public	1,206	5,366	6,572	218	695	913	100	1,233	1,333	8,818
- Other	49	211	260	7	23	30	1	13	14	304
Total liabilities	1,255	5,577	6,832	225	718	943	101	1,246	1,347	9,122
Balance of deposits at End of year	1,205	5,433	6,638	279	740	1,019	122	1,390	1,512	9,169
Risk assets – average balance	2,645	5,880	8,525	631	2,715	3,346	377	1,873	2,250	14,121
Balance at end of year	2,746	6,112	8,858	627	2,703	3,330	369	1,836	2,205	14,393
Managed assets – average balance	(1) 282	1,760	2,042	(1) 522	288	810	147	2,181	2,328	5,180
Components of interest income:										
- Spread from credit operations	115	339	454	20	59	79	6	34	40	573
- Spread from deposit operations	4	22	26	1	1	2	-	1	1	29
Total interest income	119	361	480	21	60	81	6	35	41	602

(1) Reclassified
(2) The data relates to the stated balance of credit to the public.

Note 28 – Operating segments according to Management's approach

A. General

In accordance with the amendment to Bank of Israel rules in the matter of "business segment reporting", published on November 3, 2014 (hereinafter – "the amendment"), banking corporations are required to present their assets and liabilities and the results of their operations by "regulatory business segments" (see Note 1D (3), and Note 27 above)

In addition, banking corporations whose business segments are materially different from those defined in the amendment, as stated, are required to present additional disclosure as to the distribution of their business results by business segments, based on specific definitions determined for such segments in respect of each bank (hereinafter – "reporting in accordance with Management's approach).

The Bank's business operations have been classified into six segments of operation, compatible with the organizational structure of the Bank, as detailed hereunder:

- **Segments being the responsibility of the Retail Division**

  Households – This includes banking services granted to private customers whose nature of activity is typical of households, including credit facilities not exceeding NIS 3 million.

  Until December 31, 2015, this segment included private customers, whose credit facility limit did not exceed NIS 300 thousand and deposits made by them did not exceed NIS 500 thousand.
  Following the publication of the amendment, which includes a new definition for customers included in the household segment, Management of the Bank decided to adjust, as from January 1, 2016, the definition of the household segment in accordance with Management's approach to that stated in the amendment. The comparative data has been reclassified and adjusted to the new definitions (see Note 1F).

  Small businesses – This includes banking services granted to business customers (individuals and companies), the credit facilities granted to them by the Bank does not usually exceed NIS 7 million.

  Private banking - This includes services provided by the Bank in the banking and capital market fields to private customers having medium financial wealth (financial assets exceeding NIS 3 million).

  Until December 31, 2015, this segment included private customers (as well as corporations) whose financial assets held with the Bank exceeded NIS 500 thousand.

  Following the publication of the amendment, which includes a new definition for customers included in the private banking segment, Management of the Bank decided to adjust, as from January 1, 2016, the definition of the private banking segment in accordance with Management's approach to that stated in the amendment. The comparative data has been reclassified and adjusted to the new definitions (see Note 1F).

- **Segments being the responsibility of the Corporate-Commercial Division**

  Commercial banking – This includes banking services provided by the Bank to business customers (individuals and corporations) having a medium volume of operations and a credit facility limit, which in general does not exceed NIS 7 million, and who do not belong to the corporate banking segment.

  Corporate banking - This includes banking services provided to the Bank's large customers (the credit facilities granted to such corporations generally exceeds NIS 40 million) and to public

Note 28 – Operating segments according to Management's approach (cont'd)

A. General (cont'd)

companies. The segment includes also the operations of the Bank in the real estate field (construction and income producing properties) with customers, the credit facilities granted to them usually exceed NIS 7 million, and also operations in "closed construction finance" field (including the financing of "acquisition group projects" that exceed ten housing units).

- **Other operations**

Financial management – This includes financial activity with other than the Bank's regular customers (such as: the results of the Bank's securities portfolio management).

Whereas the definition of certain business segments, such as: "small businesses", "commercial banking" and "corporate banking", materially differs from the definitions contained in the amendment, the Bank presents in this Note information regarding the results of its operations by operating segments in accordance with Management's approach.

B. Composition (in NIS millions)

	For the year ended December 31, 2016						
	Household	Small Business	Commercial Banking	Corporate Banking	Private Banking	Financial management	Total consolidated
Net interest income							
• From outsiders	274	430	91	132	(12)	19	934
• Inter-segment	9	3	(5)	(6)	15	(16)	-
Total interest income	283	433	86	126	3	3	943
Non-interest financial income	-	-	-	-	-	36	36
Total financial income	283	433	86	126	3	39	970
Commission and other income	114	134	18	35	4	8	313
Total income	397	567	104	161	7	47	1,283
Income (expense) from credit losses	11	24	8	(6)	-	(1)	36
Operating and other expenses, excluding depreciation	353	383	55	73	17	29	910
Depreciation	364	407	63	67	17	28	946
Profit (loss) before taxes	33	160	41	94	(10)	19	337
Provision for taxes on income	22	68	17	37	(3)	5	146
Profit (loss) after taxes	11	92	24	57	(7)	14	191
Bank's share in net profits of equity-basis investee	-	-	-	-	-	2	2
Net profit (loss) for the year	11	92	42	57	(7)	16	193
Average balance of assets	7,428	7,214	2,656	4,408	25	8,951	30,682
Average balance of credit to the public	7,184	6,949	2,617	4,357	13	-	21,120
Average balance of deposits	10,136	6,104	1,468	6,881	1,342	-	25,931
credit to the public, net	7,669	7,347	2,667	4,309	9	-	22,001
Components of interest income:							
Margin from credit granting activity	248	411	81	117	-		
Margin from deposit receipt activity	35	22	5	9	3		
Total interest income	283	433	86	126	3		

Note 28 – Operating Segments According to Management approach (cont'd)

B. Composition (in NIS millions) (cont'd)

	For the year ended December 31, 2015						
	Household	Small Business	Commercial Banking	Corporate Banking	Private Banking	Financial management	Total consolidated
Net interest income							
• From outsiders	(1) 234	(1) 403	85	135	(1) (13)	28	872
• Inter-segment	(1) 12	(1) (3)	(2)	(12)	(1) 16	(11)	-
Total interest income	246	400	83	123	3	17	872
Non-interest financial income	1	-	-	3	1	32	.37
Total financial income	247	400	83	126	4	49	909
Commission and other income	(2)126	(2)130	19	30	(1) 5	33	343
Total income	373	530	102	156	9	82	1,252
Income (expense) from credit losses	9	37	15	6	-	-	67
Operating and other expenses, excluding depreciation	(1)338	(1)348	52	66	(1)11	26	841
Depreciation	347	385	67	72	11	26	908
Profit (loss) before taxes	26	145	35	84	(2)	56	344
Provision for taxes on income	(1)14	(1)59	14	34	(1) (1)	16	136
Profit (loss) after taxes	12	86	21	50	(1)	40	208
Bank's share in net profits of equity-basis investee	-	-	-	-	-	2	2
Net profit (loss) for the year	12	86	21	50	(1)	42	210
Average balance of assets	(1) 6,582	(1) 6,655	(1) 2,539	4,501	(1) 17	7,692	27,986
Average balance of credit to the public	(1) 6,316	(1) 6,381	2,496	4,449	(1) 9	-	19,651
Average balance of deposits	(1) 9,859	(1) 5,278	(1) 1,628	5,136	(1) 1,602	-	23,503
credit to the public, net	6,842	6,378	2,654	4,530	13	-	20,417
Components of interest income:							
Margin from credit granting activity	(1) 212	(1) 379	77	117	(1) -		
Margin from deposit receipt activity	34	(1) 21	6	6	(1) 3		
Total interest income	246	400	83	123	3		

(1) Reclassified - see Notes 1 E.

Note 28 – Operating segments According to Management Approach (cont'd)

B. Composition (in NIS millions) (cont'd)

For the year ended December 31, 2014

Profit after taxes	Retail banking	Commercial banking	Corporate banking	Financial management	Total consolidated
Net interest income					
• From outsiders	537	80	116	67	800
• Inter-segment	66	(6)	1	(61)	-
Total interest income	603	74	117	6	800
Non-interest financial income	1	1	1	39	42
Total financial income	604	75	118	45	842
Commissions and other income	267	18	28	1	314
Total income	871	93	146	46	1,156
Income (expense) from credit losses	(24)	14	25	-	15
	744	[(1)]56	[(1)]72	30	902
Operating and other expenses					
Total operating and other expenses	720	70	97	30	917
Profit before taxes	151	[(1)]23	49	16	239
Provision for taxes on income	59	9	19	7	94
Profit after taxes	92	14	30	9	145
Bank's share in net profits of equity-basis investee	-	-	-	2	2
Net profit for the year	92	14	30	11	147
Average balance of assets	11,787	2,376	4,261	[(1)] 8,986	27,410
Average balance of credit to the public	11,444	2,350	4,228	-	18,022
Average balance of liabilities	16,804	1,307	4,973	2,514	25,598
Credit to the public at year-end	12,109	2,513	4,293	-	18,915
Components of interest income:					
Margin from credit granting activity	516	70	109		
Margin from deposit activity	87	4	8		
Total interest income	603	74	117		

(1) Reclassified

Note 29 – Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses

A. Debts [(1)] and off-balance sheet credit instruments

1. Change in the balance of the allowance for credit losses (in NIS millions)

	Year ended December 31, 2016					
	Provision for credit losses					
	Credit to public					
		Private individuals				
	Commercial	Housing loans	Other	Total	Banks and Governments	Total
Balance of allowance for credit losses, at beginning of year	**295**	**16**	**55**	**366**	**1**	**367**
Credit loss expense (income)	**26**	**1**	**10**	**37**	**(1)**	**36**
Accounting write offs	**(80)**	-	**(57)**	**(137)**	-	**(137)**
Collection of debts written off in previous years	**59**	-	**51**	**110**	-	**110**
Net accounting write-offs	**(21)**	-	**(6)**	**(27)**	-	**(27)**
Balance of allowance for credit losses at end of year*	**300**	**17**	**59**	**376**	**-**	**376**
* Of which – in respect of off balance sheet credit instruments	**26**	-	**2**	**28**	-	**28**

	Year ended December 31, 2015					
	Provision for credit losses					
	Credit to public					
		Private individuals				
	Commercial	Housing loans	Other	Total	Banks and Governments	Total
Balance of allowance for credit losses, at beginning of year	267	13	54	334	1	335
Credit loss expense (income)	58	3	6	67	-	67
Accounting write offs	(84)	-	(53)	(137)	-	(137)
Collection of debts written off in previous years	54	-	48	102	-	102
Net accounting write-offs	(30)	-	(5)	(35)	-	(35)
Balance of allowance for credit losses at end of year*	295	16	55	366	1	367
* Of which – in respect of off balance sheet credit instruments	27	-	2	29	-	29

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

A. Debts [(1)] and off-balance sheet credit instruments (cont'd)

1. Change in the balance of the allowance for credit losses (in NIS millions) (cont'd)

	Year ended December 31, 2014					
	Provision for credit losses					
	Credit to public					
		Private individuals			Banks and	
	Commercial	Housing loans	Other	Total	Governments	Total
Balance of allowance for credit losses, at beginning of year	300	14	67	381	1	382
Credit loss expense (income)	24	(1)	(8)	15	-	15
Accounting write offs	(117)	-	(50)	(167)	-	(167)
Collection of debts written off in previous years	60	-	45	105	-	105
Net accounting write-offs	(57)	-	(5)	(62)	-	(62)
Balance of allowance for credit losses at end of year*	267	13	54	334	1	335
* Of which – in respect of off balance sheet credit instruments	13	-	2	15	-	15

(1) Credit to the public, credit to governments, deposits with banks and other debts (excluding bonds).

2. Additional information regarding the mode of computing the allowance for credit losses in respect of debts[(1)] and regarding the debts[(1)] for which the allowance is computed (in NIS millions)

	Year ended December 31, 2016					
	Credit to public					
		Private individuals			Banks and	
	Commercial	Housing loans	Other	Total	Governments	Total
Stated balance of debts[(1)]						
- Examined on a specific basis[(3)]	**11,751**	**-**	**40**	**11,791**	**646**	**12,437**
- Examined on a collective basis:						
by extent of default period	**91**	**3,744**	**-**	**3,835**	**-**	**3,835**
other	**2,829**	**-**	**3,894**	**6,723**	**-**	**6,723**
Total debts[(1)]	**14,671**	**3,744**	**3,934**	**22,349**	**646**	**22,995**
Provision for credit loss in respect of debts[(1)]						
- Examined on a specific basis	**227**	**-**	**1**	**228**	**-**	**228**
- Examined on a collective basis:						
by extent of default period	**-**	**4**	**-**	**4**	**-**	**4**
other	**47**	**13**	**56**	**116**	**-**	**116**
Total provisions for credit loss	**274**	[(1)] **17**	**57**	**348**	**-**	**348**

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

A. Debts [1] and off-balance sheet credit instruments (cont'd)

2. (cont'd)

	Year ended December 31, 2015					
	Credit to public					
		Private individuals			Banks and	
	Commercial	**Housing loans**	**Other**	**Total**	**Governments**	**Total**
Stated balance of debts[1]						
- Examined on a specific basis[3]	13,779	-	2,337	16,116	416	16,532
- Examined on a collective basis:						
by extent of default period	88	3,310	-	3,398	-	3,398
other	52	-	1,188	1,240	-	1,240
Total debts[1]	13,919	3,310	3,525	20,754	416	21,170
Provision for credit loss in respect of debts[1]						
- Examined on a specific basis	266	-	36	302	1	303
- Examined on a collective basis:						
by extent of default period	-	4	-	4	-	4
other	2	12	17	31	-	31
Total provisions for credit loss	268	[2] 16	53	337	1	338

(1) Credit to the public, credit to governments, deposits with banks and other debts (excluding bonds).

(2) Including the balance of provision for credit loss in excess of the provision based on the computation by the "extent of default period" method, computed on a specific basis, in an amount of NIS 1 million (December 31, 2015 – identical), and which computed on a collective basis amounts to NIS13 million (December 31, 2015– NIS 12 million).

(3) Including credit examined on a specific basis and found to be performing in the amount of NIS 12,115 million (December 31, 2015– NIS 16,200 million).

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts (1)

1. Credit quality and arrears (in NIS millions)

	December 31, 2016					
		Troubled (2)			Unimpaired Debts	
	Performing	Impaired (3)	Other	Total	In Arrears of 90 days or more (4)	In Arrears of 30 to 89 days(5)
Lending activity in Israel						
Public - commercial:						
construction and real-estate:						
Construction	**1,804**	**28**	**21**	**1,853**	**3**	**10**
Real estate	**1,972**	**61**	**1**	**2,034**	**-**	**5**
Financial services	**273**	**3**	**-**	**276**	**-**	**-**
Other	**9,916**	**179**	**91**	**10,186**	**11**	**48**
Total commercial	**13,965**	**271**	**113**	**14,349**	**14**	**63**
Private individuals:						
Housing loans	**3,651**	**-**	(6)**62**	**3,713**	**34**	**16**
Other loans	**3,879**	**19**	**33**	**3,931**	**15**	**39**
Total public in Israel	**21,495**	**290**	**208**	**21,993**	**63**	**118**
Banks in Israel	**334**	**-**	**-**	**334**	**-**	**-**
Total lending activity in Israel	**21,829**	**290**	**208**	**22,327**	**63**	**118**
Lending activity outside of Israel						
Public – commercial:						
Construction and real-estate	**16**	**-**	**-**	**16**	**-**	**-**
Commercial - other	**258**	**32**	**16**	**306**	**-**	**-**
Total commercial	**274**	**32**	**16**	**332**	**-**	**-**
Private individuals:						
Housing loans	**30**	**-**	**1**	**31**	**-**	**1**
Other loans	**3**	**-**	**-**	**3**	**-**	**-**
Total public outside of Israel	**307**	**32**	**17**	**356**	**-**	**1**
Banks outside of Israel	**312**	**-**	**-**	**312**	**-**	**-**
Total lending activity outside of Israel	**619**	**32**	**17**	**668**	**-**	**1**
Total public	**21,802**	**322**	**225**	**22,349**	**63**	**119**
Total Banks	**646**	**-**	**-**	**646**	**-**	**-**
Total	**22,448**	**322**	**225**	**22,995**	**63**	**119**

(1) Credit to the public, credit to governments, deposits with banks and other debts (excluding bonds).
(2) Risk concerning credit impaired, inferior, or under special supervision, including in respect of housing loans for which an allowance based on the extent of arrears exists, and other housing loans in arrears of 90 days or over.
(3) In general, impaired debts do not accrue interest income. For information regarding certain restructured impaired debts, see Note 29 (b)(3)(c) below.
(4) Classified as unimpaired troubled debts, accruing interest income.
(5) Accruing interest income. Debts in arrears of 30 to 89 days, in the amount of NIS 29 million were classified as unimpaired problematic debts.
(6) Includes housing loans of NIS 1 million with an allowance based on the extent of arrears, for which an arrangement has been signed with the borrower for the repayment of the amounts in arrears, which includes a change in the repayment schedule of the outstanding balance of the loan.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts [(1)] (cont'd)

1. Credit quality and arrears (in NIS millions) (cont'd)

	December 31, 2015					
		Troubled [(2)]			Unimpaired Debts	
	Performing	Impaired [(3)]	Other	Total	In Arrears of 90 days or more [(4)]	In Arrears of 30 to 89 days[(5)]
Lending activity in Israel						
Public - commercial:						
construction and real-estate:						
Construction	1,623	31	24	1,678	-	[(7)] 9
Real estate	1,842	36	-	1,878	-	[(7)] 2
Financial services	333	6	-	339	-	-
Other	9,313	202	94	9,609	1	[(7)] 31
Total commercial	13,111	275	118	13,504	1	42
Private individuals:						
Housing loans	3,214	-	[(6)]57	3,271	24	20
Other loans	3,453	26	42	3,521	7	[(7)] 31
Total public in Israel	19,778	301	217	20,296	32	93
Banks in Israel	106	-	-	106	-	-
Total lending activity in Israel	19,884	301	217	20,402	32	93
Lending activity outside of Israel						
Public – commercial:						
Construction and real-estate	19	-	63	82	-	-
Commercial - other	302	31	-	333	-	-
Total commercial	321	31	63	415	-	-
Private individuals:						
Housing loans	39	-	-	39	-	-
Other loans	4	-	-	4	-	-
Total public outside of Israel	364	31	63	458	-	-
Banks outside of Israel	310	-	-	310	-	-
Total lending activity outside of Israel	674	31	63	768	-	-
Total public	20,142	332	280	20,754	32	93
Total Banks	416	-	-	416	-	-
Total	20,558	332	280	21,170	32	93

(1) Credit to the public, credit to governments, deposits with banks and other debts (excluding bonds).
(2) Risk concerning credit impaired, inferior, or under special supervision, including in respect of housing loans for which an allowance based on the extent of arrears exists, and other housing loans in arrears of 90 days or over.
(3) In general, impaired debts do not accrue interest income. For information regarding certain restructured impaired debts, see Note 29 (b)(3)(c) below.
(4) Classified as unimpaired troubled debts, accruing interest income.
(5) Accruing interest income. Debts in arrears of 30 to 89 days, in the amount of NIS 28 million were classified as unimpaired problematic debts.
(6) Includes housing loans of NIS 1 million with an allowance based on the extent of arrears, for which an arrangement has been signed with the borrower for the repayment of the amounts in arrears, which includes a change in the repayment schedule of the outstanding balance of the loan.
(7) Restated.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts [(1)] (cont'd)

2. Quality of the credit portfolio

(a) General

Instructions published by Bank of Israel require banks to include in their financial statements qualitative and quantitative information constituting indication as to the quality of their credit portfolio.

The Bank maintains a credit control system comprising a central factor in the process of preserving the quality of its credit portfolio and the monitoring of credit defaults.

Within this framework, the Bank has developed credit rating models comprising a "decision support" system and is maintaining current monitoring for the identification and location of signals for a possible deterioration in the repayment ability of borrowers, among other means, by monitoring on a daily basis the default periods of debts.

(b) Quantitative data

Following are data with respect to certain financial indices used in the assessment of the quality of the credit portfolio, by classes of credit:

	December 31, 2016			
		Private individuals		
	Commercial	Housing loans	Other	Total
	%	%	%	%
Ratio of the allowance to credit losses in respect to the balance of credit to public	**0.2**	**-**	**0.3**	**0.2**
Ratio of impaired debts to the balance of credit to public	**2.1**	**-**	**0.5**	**1.4**
Ratio of troubled debts to the balance of credit to public	**2.9**	**1.7**	**1.3**	**2.4**
Ratio of debts in arrears for over 30 days to the balance of credit to public	**0.5**	**1.3**	**1.4**	**0.8**

	December 31, 2015			
		Private individuals		
	Commercial	Housing loans	Other	Total
	%	%	%	%
Ratio of the allowance to credit losses in respect to the balance of credit to public	0.4	0.1	0.2	0.3
Ratio of impaired debts to the balance of credit to public	2.2	-	0.7	1.6
Ratio of troubled debts to the balance of credit to public	3.5	1.7	1.9	2.9
Ratio of debts in arrears for over 30 days to the balance of credit to public	0.1	1.3	0.6	0.4

Management of the Bank follows developments in these indicators at quarterly intervals and examines the significance of the results, both in relation to prior periods and in relation to parallel data in the banking sector. A reduction was recorded in 2016 in the rate of credit loss expenses, from 0.3% in 2015 to 0.2% in 2016. Accordingly, and whereas other parameters (such as: the rate of troubled debts, including impaired debts) also indicate improvement or stability in quality indices, Management of the Bank estimates that the quality of the Bank's credit portfolio did not deteriorate in the reported period.

(1) Credit to the public, credit to governments, deposits in banks and other debts excluding bonds.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts [(1)] (cont'd)

3. Additional information regarding impaired debts

A. Impaired debts and specific allowance (in NIS millions)

	December 31, 2016				
	Impaired debts and credit loss allowance therefor				Contractual
	Balance of impaired debts	Balance of specific allowance[(2)]	Other impaired debts	Total	balance of impaired debts
Lending activity in Israel					
Public – commercial:					
Construction and real estate:					
Construction	**18**	**8**	**10**	**28**	**214**
Real estate	**22**	**4**	**39**	**61**	**76**
Financial services	**3**	**3**	**-**	**3**	**9**
Other	**132**	**50**	**47**	**179**	**577**
Total commercial	**175**	**65**	**96**	**271**	**876**
Private individuals					
Housing loans	**-**	**-**	**-**	**-**	**-**
Other loans	**2**	**-**	**17**	**19**	**193**
Total public in Israel	**177**	**65**	**113**	**290**	**1,069**
Banks in Israel	**-**	**-**	**-**	**-**	**-**
Total leading activity in Israel	**177**	**65**	**113**	**290**	**1,069**
Lending activity outside of Israel					
Public – commercial:					
Construction and real estate	**-**	**-**	**-**	**-**	**-**
Other	**27**	**12**	**5**	**32**	**32**
Total public lending activity outside of Israel	**27**	**12**	**5**	**32**	**32**
Foreign banks	**-**	**-**	**-**	**-**	**-**
Total lending activity outside of Israel	**27**	**12**	**5**	**32**	**32**
Total public [(1)]	**204**	**77**	**118**	**322**	**1,101**
Total banks	**-**	**-**	**-**	**-**	**-**
Total [(1)]	**204**	**77**	**118**	**322**	**1,101**
Of which:					
Measured according to present value of cash flows	**174**	**68**	**83**	**257**	**315**
Restructured debts	**44**	**6**	**78**	**122**	**146**

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Allowance for credit losses on an individual basis.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts[(1)](cont'd)

3. Additional information regarding impaired debts (cont'd)

A. Impaired debts and specific allowance (in NIS millions) (cont'd)

	December 31, 2015				
	Impaired debts and credit loss allowance therefor				Contractual
	Balance of impaired debts	Balance of specific allowance[(2)]	Other impaired debts	Total	balance of impaired debts
Lending activity in Israel					
Public – commercial:					
Construction and real estate:					
Construction	17	8	14	31	223
Real estate	-	-	36	36	43
Financial services	5	5	1	6	10
Other	128	45	74	202	660
Total commercial	150	58	125	275	936
Private individuals					
Housing loans	-	-	-	-	-
Other loans	5	2	21	26	215
Total public in Israel	155	60	146	301	1,151
Banks in Israel	-	-	-	-	-
Total leading activity in Israel	155	60	146	301	1,151
Lending activity outside of Israel					
Public – commercial:					
Construction and real estate	-	-	-	-	-
Other	25	12	6	31	31
Total public lending activity outside of Israel	25	12	6	31	31
Foreign banks	-	-	-	-	-
Total lending activity outside of Israel	25	12	6	31	31
Total public	180	72	152	332	1,182
Total banks	-	-	-	-	-
Total [(3)]	180	72	152	332	1,182
(3) Of which:					
Measured according to present value of cash flows	169	66	115	284	387
Restructured debts	49	8	84	133	156

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Allowance for credit losses on an individual basis.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts [1](cont'd)

3. Additional information regarding impaired debts (cont'd)

B. Average balance and interest income (in NIS millions)

	For the Years Ended December 31, 2016			For the Years Ended December 31, 2015		
		Interest income recorded[4] [3]			Interest income recorded[4] [3]	
	Average balance of impaired debts[2]	On a cash basis	Other	Average balance of impaired debts[2]	On a cash basis	Other
Lending activity in Israel						
Public - commercial						
Construction and real estate:						
- Construction	**37**	**-**	**-**	42	-	-
- Real estate	**73**	**1**	**1**	45	1	1
Financial services	**5**	**-**	**-**	6	-	-
Other	**216**	**3**	**3**	268	3	3
Total commercial	**331**	**4**	**4**	361	4	4
Private individuals						
- Housing loans	**-**	**-**	**-**	-	-	-
- Other loans	**27**	**-**	**-**	42	-	-
Total public in Israel	**358**	**4**	**4**	403	4	4
Banks in Israel	**-**	**-**	**-**	-	-	-
Total lending activity in Israel	**358**	**4**	**4**	403	4	4
Lending activity outside of Israel						
Public - commercial:						
- Construction and real estate	**-**	**-**	**-**	-	-	-
- other	**32**	**-**	**-**	31	-	-
Total commercial	**32**	**-**	**-**	31	-	-
Foreign banks	**-**	**-**	**-**	-	-	-
Total lending activity outside of Israel	**32**	**-**	**-**	31	-	-
Total public	**390**	**4**	**4**	434	4	4
Total Banks	**-**	**-**	**-**	-	-	-
Total	**390**	**4**	**4**	434	4	4

Note:

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).

(2) Average recorded debt balance of impaired debts in the reported period

(3) The contractual interest income that would have been recognized had the impaired debts accrued interest according to the original terms, amounted in 2016 to NIS 17 million (2015 – NIS 18 million).

(4) Interest income recognized in the reported period in respect of the average balance of impaired debts, in the period in which they were classified as impaired.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts[1](cont'd)

3. Additional information regarding impaired debts (cont'd)

B. Average balance and interest income (in NIS millions)

	For the year ended December 31, 2014		
	Average balance of impaired debts[2]	On a cash basis	Other
Lending Activity in Israel:			
Public - commercial:			
Construction and real estate:			
- Construction	41	-	-
- Real estate	24	-	1
Financial services	1	-	-
Other	186	3	2
Total commercial	252	3	3
Private individuals			
- Housing loans	-	-	-
- Other loans	42	-	1
Total public in Israel	294	3	4
Banks in Israel	-	-	-
Total lending activity in Israel	294	3	4
Lending activity outside of Israel			
Public - commercial:			
- Construction and real estate	-	-	-
- other	52	1	-
Total lending activity outside of Israel	52	1	-
Foreign banks	-	-	-
Total lending activity outside of Israel	52	1	-
Total public	346	4	4
Total Banks	-	-	-
Total	346	4	4

Note:

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).

(2) Average recorded debt balance of impaired debts in the reported period

(3) The contractual interest income that would have been recognized had the impaired debts accrued interest according to the original terms, amounted in 2014 to NIS 20 million.

(4) Interest income recognized in the reported period in respect of the average balance of impaired debts, in the period in which they were classified as impaired.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts[1] (cont'd)

3. Additional information regarding impaired debts (cont'd)

C. Restructured troubled debts[2] (in NIS millions):

	December 31, 2016				
		Performing debts			
		Arrears for			
	Non performing	90 days or more	30 to 89 days	Not in arrears	Total[2]
Lending activity in Israel					
Public - commercial					
Construction and real-estate					
- Construction	4	-	-	3	7
- Real estate	7	-	2	7	16
Financial services	-	-	-	1	1
Other	37	-	-	37	74
Total commercial	48	-	2	47	97
Private individuals - other	9	-	-	9	18
Total public lending activity in Israel	57	-	2	56	115
Banks	-	-	-	-	-
Total lending activity in Israel	57	-	2	56	115
Leading activity outside of Israel					
Public - commercial:					
- Construction and real-estate	-	-	-	-	-
- other	2	-	-	5	7
Total public outside of Israel	2	-	-	5	7
Total Banks	-	-	-	-	-
Total lending activity outside of Israel	2	-	-	5	7
Total public	59	-	2	61	122
Total Banks	-	-	-	-	-
Total	59	-	2	61	122

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Included in impaired debts.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts[1] (cont'd)

3. Additional information regarding impaired debts (cont'd)

C. Restructured troubled debts[2] (in NIS millions) (cont'd):

	December 31, 2015				
		Performing debts			
		Arrears for			
	Non performing	90 days or more	30 to 89 days	Not in arrears	Total[2]
Lending activity in Israel					
Public - commercial					
Construction and real-estate					
- Construction	5	-	-	4	9
- Real estate	3	-	-	8	11
Financial services	-	-	-	1	1
Other	27	-	1	58	86
Total commercial	35	-	1	71	107
Private individuals - other	9	-	-	11	20
Total public lending activity in Israel	44	-	1	82	127
Banks	-	-	-	-	-
Total lending activity in Israel	44	-	1	82	127
Leading activity outside of Israel					
Public - commercial:					
- Construction and real-estate	-	-	-	-	-
- other	-	-	-	6	6
Total public outside of Israel	-	-	-	6	6
Total Banks	-	-	-	-	-
Total lending activity outside of Israel	-	-	-	6	6
Total public	44	-	1	88	133
Total Banks	-	-	-	-	-
Total	44	-	1	88	133

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Included in impaired debts.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts[(1)] (cont'd)

3. Additional information regarding impaired debts (cont'd)

D. Restructured troubled debts[(2)] (in NIS millions) (cont'd):

	Restructuring of debts during the year ended December 31, 2016			Restructuring of debts during the year ended December 31, 2015		
		Recorded debt balance			Recorded debt balance	
	Number of contracts	Before restructuring	After restructuring	Number of contracts	Before restructuring	After restructuring
Lending activity in Israel						
Public - commercial:						
Construction and real estate:						
Construction	**92**	**6**	**6**	68	9	5
Real estate	**8**	**3**	**3**	6	3	3
Financial services	**2**	**-**	**-**	1	-	-
Other	**310**	**49**	**47**	315	60	58
Total commercial	**412**	**58**	**56**	390	72	66
Private individuals:						
Housing loans	**-**	**-**	**-**	-	-	-
Other loans	**969**	**18**	**14**	1,000	16	15
Total public in Israel	**1,381**	**76**	**70**	1,390	88	81
Banks in Israel	**-**	**-**	**-**	-	-	-
Total lending activity in Israel	**1,381**	**76**	**70**	1,390	88	81
Lending activity outside of Israel						
Public - commercial:						
- Construction and real estate	**-**	**-**	**-**	-	-	-
- other	**4**	**2**	**2**	-	-	-
Total public outside of Israel	**4**	**2**	**2**	-	-	-
Foreign banks	**-**	**-**	**-**	-	-	-
Total lending activity outside of Israel	**4**	**2**	**2**	-	-	-
Total public	**1,385**	**78**	**72**	1,390	88	81
Total Banks	**-**	**-**	**-**	-	-	-
Total	**1,385**	**78**	**72**	1,390	88	81

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Included in impaired debts.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts [1] (cont'd)

3. Additional information regarding impaired debts (cont'd)

D. Restructured troubled debts [2] (in NIS millions) (cont'd):

	Restructuring of debts during the year ended December 31, 2014		
		Recorded debt balance	
	Number of contracts	Before restructuring	After restructuring
Lending activity in Israel			
Public - commercial			
Construction and real-estate			
- Construction	78	10	7
- Real estate	6	7	7
Financial services	5	-	-
Other	396	90	60
Total commercial	485	107	74
Private individuals:			
Housing loans	-	-	-
- Other	1,211	23	22
Total public lending activity in Israel	1,696	130	96
Banks	-	-	-
Total lending activity in Israel	1,696	130	96
Leading activity outside of Israel			
Public - commercial:			
- Construction and real-estate	-	-	-
- other	2	7	7
Total public outside of Israel	2	7	7
Total Banks	-	-	-
Total lending activity outside of Israel	2	7	7
Total public	1,698	137	103
Total Banks	-	-	-
Total	1,698	137	103

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Included in impaired debts.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts[(1)] (cont'd)

3. Additional information regarding impaired debts (cont'd)

D. Restructured troubled debts [(2)] (in NIS millions) (cont'd):

	Failed restructured debts [(3)] during the year ended December 31, 2016		Failed restructured debts [(3)] during the year ended December 31, 2015	
	Number of contracts	Recorded debt balance	Number of contracts	Recorded debt balance
Lending activity in Israel				
Public - commercial				
Construction and real estate:				
- Construction	**12**	**1**	9	-
- Real estate	**1**	**-**	1	-
Financial services	**1**	**-**	1	-
Other	**63**	**5**	72	3
Total commercial	**77**	**6**	83	3
Private individuals:				
- Housing loans	**-**	**-**	-	-
- Other loans	**182**	**1**	261	2
Total public in Israel	**259**	**7**	344	5
Banks in Israel	**-**	**-**	-	-
Total lending activity in Israel	**259**	**7**	344	5
Lending activity outside of Israel				
Public - commercial:				
- Construction and real estate	**-**	**-**	-	-
- Commercial – other	**-**	**-**	-	-
Total public outside of Israel	**-**	**-**	-	-
Foreign banks	**-**	**-**	-	-
Total lending activity outside of Israel	**-**	**-**	-	-
Total public	**259**	**7**	344	5
Total Banks	**-**	**-**	-	-
Total	**259**	**7**	**344**	**5**

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Included in impaired debt.
(3) Debts, which during the reported period, have turned into debts in arrear for 30 days and over, which had been restructured during the year preceding the date of their classification as "debts in arrear".

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts[(1)] (cont'd)

3. Additional information regarding impaired debts (cont'd)

D. Restructured troubled debts[(2)] (in NIS millions) (cont'd):

	Failed restructured debts[(3)] during the year ended December 31, 2014	
	Number of contracts	Recorded debt balance
Lending activity in Israel		
Public - commercial		
Construction and real-estate		
- Construction	9	-
- Real estate	1	-
Financial services	2	-
Other	78	4
Total commercial	90	4
Private individuals:		
Housing loans	-	-
- Other	231	2
Total public lending activity in Israel	321	6
Banks	-	-
Total lending activity in Israel	321	6
Leading activity outside of Israel		
Public - commercial:		
- Construction and real-estate	-	-
- other	-	-
Total public outside of Israel	-	-
Total Banks	-	-
Total lending activity outside of Israel	-	-
Total public	321	6
Total Banks	-	-
Total	321	6

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Included in impaired debt.
(3) Debts, which during the reported period, have turned into debts in arrear for 30 days and over, which had been restructured during the year preceding the date of their classification as "debts in arrear".

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts[(1)] (cont'd)

4. Additional disclosure regarding housing loans:

December 31, 2016

	Financing ratio[(2)]	Balance of housing loans: With no balloon terms	With balloon terms	Total	Of which: Variable interest	Off-balance sheet credit risk
First degree pledge	Up to 60%	**2,660**	**78**	**2,738**	**1,925**	**148**
	Over 60%	**949**	**10**	**959**	**660**	**46**
Second degree pledge or without pledge		**46**	**1**	**47**	**2**	**-**
Total		**3,655**	**89**	**3,744**	**2,587**	**194**

December 31, 2015

	Financing ratio[(2)]	Balance of housing loans: With no balloon terms	With balloon terms	Total	Of which: Variable interest	Off-balance sheet credit risk
First degree pledge	Up to 60%	2,449	74	2,523	1,844	147
	Over 60%	728	12	740	542	80
Second degree pledge or without pledge		47	-	47	-	-
Total		3,224	86	3,310	2,386	227

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) The ratio of the approved credit facility to the asset value at date of approval of the credit.

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

C. Classification of credit to the public and off-balance sheet credit risk according to the size of credit per borrower:

Credit level (NIS thousands)		December 31, 2016		
From	**to**	**Number of borrowers**[4]	**Credit**[1][2]	**Credit risk**[3]
-	10	**71,877**	**133**	**42**
10	20	**35,674**	**325**	**208**
20	40	**34,809**	**716**	**298**
40	80	**29,526**	**1,330**	**356**
80	150	**18,362**	**1,686**	**305**
150	300	**10,262**	**1,875**	**269**
300	600	**6,249**	**2,415**	**265**
600	1,200	**3,700**	**2,771**	**297**
1,200	2,000	**1,120**	**1,486**	**225**
2,000	4,000	**759**	**1,857**	**248**
4,000	8,000	**349**	**1,675**	**243**
8,000	20,000	**218**	**2,298**	**393**
20,000	40,000	**90**	**1,707**	**784**
40,000	200,000	**54**	**2,175**	**1,336**
200,000	400,000	**1**	**211**	**1**
		213,050	**22,660**	**5,270**

Credit level (NIS thousands)		December 31, 2015		
From	**to**	**Number of borrowers**[4]	**Credit**[1][2]	**Credit risk**[2][3]
			NIS millions	
-	10	**69,272**	**149**	**37**
10	20	**34,455**	**336**	**203**
20	40	**31,747**	**664**	**282**
40	80	**26,380**	**1,206**	**323**
80	150	**15,529**	**1,435**	**268**
150	300	**8,660**	**1,614**	**236**
300	600	**5,717**	**2,215**	**256**
600	1,200	**3,328**	**2,433**	**316**
1,200	2,000	**999**	**1,331**	**187**
2,000	4,000	**720**	**1,776**	**221**
4,000	8,000	**320**	**1,530**	**222**
8,000	20,000	**202**	**2,158**	**365**
20,000	40,000	**85**	**1,708**	**633**
40,000	200,000	**57**	**2,559**	**1,081**
200,000	400,000	**1**	**220**	**1**
		197,472	**21,334**	**4,631**

(1) Including investments in corporate bonds and assets relating to transactions in derivative financial instruments of the public.
(2) The credit and off-balance sheet credit risk are reflected prior to the effect of provisions for credit losses and prior to the effect of deductible qualified collateral, as applies for determining indebtedness of a borrower or a borrower group.
(3) Credit risk relating to off-balance sheet financial instruments, as computed for the limitation on indebtedness of a borrower.
(4) Number of borrowers according to total credit and credit risk.

The maximum credit at the highest credit level amounts to NIS 211 million (December 31, 2015 – NIS 220 million).

Note 29 - Additional Information Regarding Credit risk, Credit to the Public and Provision for Credit Losses (cont'd)

D. Off-Balance Sheet Financial Instruments

The balance of contracts or their stated amounts at the end of the year (in NIS millions)

	December 31, 2016		December 31, 2015	
	Balance (1)	Provision (2)	Balance (1)	Provision (2)
Transactions in which the balance represents credit risk:				
Letters of credit	**77**	**1**	68	-
Credit guarantees	**311**	**6**	299	10
Guarantees for home purchasers	**1,241**	**1**	984	2
Other guarantees and obligations	**832**	**10**	677	5
Unutilized credit line facilities for credit cards *	**798**	**2**	686	1
Unutilized revolving credit account facilities and other credit facilities in on-call accounts	**1,350**	**4**	1,229	4
Commitment to issue guarantees	**881**	**-**	753	-
Irrevocable commitments to extend credit approved but not yet granted (3)	**982**	**4**	945	7

***** Credit facilities of credit cards, which may be unconditionally revoked at any time.

(1) Contract balance or their stated amounts at year end, before the effect of allowance for credit loss.

(2) Balance of allowance for credit losses.

(3) Includes commitment in principle to extend housing loans.

Note 30 - Assets and Liabilities - According to Linkage Basis

Consolidated (in NIS millions)

	December 31, 2016					
	Israeli currency		Foreign currency*			
	Unlinked	Linked to the CPI	$	Other	Non-monetary Items**	Total
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Assets						
Cash and deposits with banks	2,720	327	252	123	-	3,422
Securities	3,487	1,604	774	124	13	6,002
Net credit to the public	19,534	1,736	523	208	-	22,001
Investment in Affiliates	-	2	-	-	7	9
Buildings and equipment	-	-	-	-	358	358
Assets in respect of derivative instruments	3	3	14	2	4	26
Other assets	325	7	3	-	11	346
Total assets	26,069	3,679	1,566	457	393	32,164
Liabilities						
Deposits from the public	22,101	2,500	1,984	614	-	27,199
Deposits from banks	170	-	77	12	-	259
Deposits from the government	122	-	27	-	-	149
Bonds and deferred debt notes	257	669	-	-	-	926
Liabilities in respect of derivative instruments	8	57	8	2	4	79
Other liabilities	1,259	13	2	2	32	1,308
Total liabilities	23,917	3,239	2,098	630	36	29,920
Difference	2,152	440	(532)	(173)	357	2,244
Non Hedging Derivative Instruments:						
Derivative instruments (excluding options)	(1,026)	319	531	176	-	-
Options in the money, net (in terms of underlying asset)	-	-	-	-	-	-
Options out of the, money net (in terms of underlying asset)	9	-	(9)	-	-	-
Total	1,135	759	(10)	3	357	2,244
Options in the money, net (present value of nominal amount)	9	-	(9)	-	-	-
Options out of the money, net (present value of nominal amount)	-	-	-	-	-	-

* Including amounts linked to foreign currency.

** Including balances in respect of derivative instruments whose underlying asset is a non-monetary item.

Note 30 - Assets and Liabilities - According to Linkage Basis (cont'd)

Consolidated (NIS millions)

	December 31, 2015					
	Israeli currency		Foreign currency*			
	Unlinked	Linked to the CPI	$	Other	Non-monetary Items**	Total
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Assets						
Cash and deposits with banks	5,015	100	218	169	-	5,502
Securities	1,967	923	519	11	12	3,432
Net credit to the public	17,694	1,832	606	285	-	20,417
Investment in Associates	-	2	-	-	5	7
Buildings and equipment	-	-	-	-	346	346
Assets in respect of	2					
derivative instruments	2	-	20	1	8	31
Other assets	324	8	-	-	9	341
Total assets	25,002	2,865	1,363	466	380	30,076
Liabilities						
Deposits from the public	19,800	2,854	2,075	659	-	25,388
Deposits from banks	406	-	48	5	-	459
Deposits from the government	122	-	29	-		151
Bonds and deferred debt notes	-	672	-	-		672
Liabilities in respect of derivative instruments	26	55	15	18	8	122
Other liabilities	1,136	10	5	2	28	1,181
Total liabilities	21,490	3,591	2,172	684	36	27,973
Difference	3,512	(726)	(809)	(218)	344	2,103
Non Hedging Derivative Instruments:						
Derivative instruments (excluding options)	(2,183)	1,155	825	203	-	-
Options in the money, net (in terms of underlying asset)	10	-	(10)	-	-	-
Options out of the, money net (in terms of underlying asset)	-	-	-	-	-	-
Total	1,339	429	6	(15)	344	2,103
Options in the money, net (present value of nominal amount)	11	-	(11)	-	-	-
Options out of the money, net (present value of nominal amount)	-	-	-	-	-	-

* Including amounts linked to foreign currency.

** Including balances in respect of derivative instruments whose underlying asset is a non-monetary item.

.

Note 31 - Assets and Liabilities - According to Maturity Periods and Linkage Basis

Consolidated (NIS millions)

	December 31, 2016													
	Future expected contractual cash flows (1)											Stated balance (4)		
	On demand and up to 1 month	1 month up to 3 months	3 months up to 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	5 to 10 years	10 to 20 years	Over 20 years	Total Cash-flows	Without fixed maturity(2)	Total	Contract yield rate (5)
Israeli currency - unlinked (3)														
Assets	6,197	3,432	5,050	4,511	2,565	3,392	2,190	2,927	1,942	476	32,682	522	29,986	3.61
Liabilities	16,799	3,077	4,311	1,324	354	401	194	694	308	101	27,563	-	27,189	0.57
Difference	(10,602)	355	739	3,187	2,211	2,991	1,996	2,233	1,634	375	5,119	522	2,797	3.04
Derivative instruments (excluding options)	(148)	(59)	(432)	(4)	(29)	(27)	(34)	-	-	-	(733)	-	(734)	
Difference including derivatives	(10,750)	296	307	3,183	2,182	2,964	1,962	2,233	1,634	375	4,386	522	2,063	
Foreign currency(6)														
Assets	646	42	106	184	345	64	178	296	11	-	1,872	25	1,783	1.63
Liabilities	1,996	280	387	14	4	4	4	17	4	-	2,710	-	2,694	0.39
Difference*	(1,350)	(238)	(281)	170	341	60	174	279	7	-	(838)	25	(911)	1.24
Derivative instruments (excluding options)	148	59	432	4	29	27	34	-	-	-	733	-	734	
Difference including derivatives	(1,202)	(179)	151	174	370	87	208	279	7	-	(105)	-	(177)	
Thereof – difference in dollars*	(1,014)	(230)	(266)	150	322	27	170	191	3	-	(647)	25	(706)	
Total														
Assets (8)	6,843	3,474	5,156	4,695	2,910	3,456	2,368	3,223	1,953	476	34,554	547	(7) 31,769	3.50
Liabilities(9)	18,795	3,357	4,698	1,338	358	405	198	711	312	101	30,273	-	29,883	0.55
Difference	(11,952)	117	458	3,357	2,552	3,051	2,170	2,512	1,641	375	4,281	547	1,886	2.95
8. Including - credit to the public	3,647	3,456	4,029	3,243	2,394	1,947	1,151	2,479	1,953	476	24,775	298	(7) 22,001	4.72
9. Including - Deposits from the public	17,725	3,219	4,607	1,181	284	107	52	61	100	-	27,336	-	27,199	0.46

(1) The amounts in this note are presented based on future expected contractual cash flows in respect of assets and liabilities according to linkage bases, in accordance with the remaining periods of each cash flow. The data is presented net of provisions for doubtful debts.
(2) Includes past due assets in the amount of NIS 74 million.
(3) Including amount linked to foreign currency.
(4) As included in Note 30 “Assets and Liabilities - According to Linkage Basis”, including off - balance sheet amounts in respect of derivatives.
(5) The contractual rate of return is the interest rate used in discounting the expected contractual future cash flows presented in this Note in respect of a financial item, to the stated balance thereof.
(6) Excluding Israeli currency linked to foreign currency.
(7) The item includes credit granted under revolving credit facility terms in the amount of NIS 2,135 million, of which NIS 163 million comprising credit under terms relating to deviation from revolving credit facility (classified in the reported period as "with no repayment period").

Note 31 - Assets and Liabilities - According to Maturity Periods and Linkage Basis (cont'd)

Consolidated (NIS millions)

	December 31, 2015													
	Future expected contractual cash flows [1]											Stated balance [4]		
	On demand and up to 1 month	1 month up to 3 months	3 months up to 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	5 to 10 years	10 to 20 years	Over 20 years	Total Cash-flows	Without fixed maturity[2]	Total	Contract yield rate [5]
Israeli currency - unlinked [3]														
Assets	8,227	3,356	4,583	3,228	2,491	1,878	1,727	2,757	1,661	325	30,233	563	28,181	3.64
Liabilities	16,064	2,340	4,026	1,101	450	239	358	523	299	97	25,497	-	25,118	0.63
Difference	(7,837)	1,016	557	2,127	2,041	1,639	1,369	2,234	1,362	228	4,736	563	3,063	3.01
Derivative instruments (excluding options)	(482)	8	(478)	(5)	(5)	(30)	(29)	(36)	-	-	(1,057)	-	(1,057)	
Difference including derivatives	(8,319)	1,024	79	2,122	2,036	1,609	1,340	2,198	1,362	228	3,679	-	2,006	
Foreign currency[6]														
Assets	666	83	172	146	52	335	44	75	14	-	1,587	2	1,515	1.72
Liabilities	2,096	185	498	11	9	7	6	19	7	-	2,838	-	2,819	0.23
Difference*	(1,430)	(102)	(326)	135	43	328	38	56	7	-	(1,251)	2	(1,304)	1.49
Derivative instruments (excluding options)	482	(8)	478	5	5	30	29	36	-	-	1,057	-	1,057	
Difference including derivatives	(948)	(110)	152	140	48	358	67	91	7	-	(194)	2	(247)	
Thereof – difference in dollars*	(1,187)	(72)	(304)	127	43	324	30	49	6	-	(984)	-	(1,033)	
Total														
Assets [8]	8,893	3,439	4,755	3,374	2,543	2,213	1,771	2,832	1,675	325	31,820	565	[7] 29,696	3.54
Liabilities[9]	18,160	2,525	4,524	1,112	459	246	364	542	306	97	28,335	-	27,937	0.59
Difference	(9,267)	914	231	2,262	2,084	1,967	1,407	2,290	1,369	228	3,485	565	1,759	2.95
8. Including - credit to the public	3,415	3,420	3,887	2,944	2,137	1,495	1,218	2,144	1,609	324	22,593	300	[7] 20,417	4.88
9. Including - Deposits from the public	17,229	2,191	4,385	1,041	307	179	72	23	108	-	25,535	-	25,388	0.50

(1) The amounts in this note are presented based on future expected contractual cash flows in respect of assets and liabilities according to linkage bases, in accordance with the remaining periods of each cash flow. The data is presented net of provisions for doubtful debts.
(2) Includes past due assets in the amount of NIS 85 million.
(3) Including amount linked to foreign currency.
(4) As included in Note 30 "Assets and Liabilities - According to Linkage Basis", including off - balance sheet amounts in respect of derivatives.
(5) The contractual rate of return is the interest rate used in discounting the expected contractual future cash flows presented in this Note in respect of a financial item, to the stated balance thereof.
(6) Excluding Israeli currency linked to foreign currency.
(7) The item includes credit granted under revolving credit facility terms in the amount of NIS 2,090 million, of which NIS 214 million comprising credit under terms relating to deviation from revolving credit facility (classified in the reported period as "with no repayment period").

Note 32 - Balances and Fair Value Estimates of Financial Instruments

A. Fair value of financial instruments

This note includes information regarding the determination of the fair value of financial instruments.

Most of the financial instruments of the Bank do not have a market value because they do not have an active trading market. Their fair value is therefore determined on the basis of accepted costing models, such as the present value of future cash flows, discounted at an interest rate which reflects the level of risk inherent in the financial instrument, according to Management evaluation.

The assessment of the fair value by means of estimating future cash flows and the determination of the discount rate are subjective. Therefore, in respect of most financial instruments, the estimated fair value does not necessarily indicate the realizable value of the financial instrument on the reporting date. The estimate of fair value is made on the basis of interest rates in effect on the reporting date and does not take into account interest rate fluctuations. Under different interest rates the fair value calculated may be significantly different. This is true especially in respect of financial instruments bearing interest at fixed rates or which do not bear any interest.

Furthermore, the determination of fair value does not take into account commissions that will be received or paid over the course of business nor do they take into account any tax effect. Furthermore, the difference between the balance sheet value and the fair value may not be realized because in most cases the Bank may hold the financial instrument until maturity.

Therefore, it should be emphasized that the data included in this Note does not purport to reflect the value of the Bank. Moreover, because of the wide range of valuation techniques and estimates that may be applied in the calculation of fair value, caution must be exercised when comparing fair values of different banks.

B. Principal methods and assumptions used in estimating fair value of financial instruments

(1) Marketable financial instruments: Securities and subordinate debt notes – the fair value is determined on the basis of market value.

(2) Non marketable financial instruments (other than off-balance sheet financial instruments):

The fair value of non-marketable financial instruments at fixed interest rates is generally determined by discounting the future cash flows, at interest rates by which the Bank effected or would effect similar transactions on the reporting date, as stated below:

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

B. Principal methods and assumptions used in the estimating fair value of financial instruments (cont'd)

Credit to the public - the fair value of credit to the public is determined on the basis of the present value of future cash flows discounted at an appropriate discount rate. The present value is measured for the future receipts flow (principal and interest) for each loan separately, at an interest rate which reflects the level of risk inherent in the loan. The determination of the said risk level is based on a model used by the Bank for rating customers, which evaluates the risk level of the customer based on financial, management and industry parameters. In general, the interest rates which are used for the purpose of discounting the cash flows were fixed according to the interest rates which the Bank uses for similar transactions on the reporting date.

The fair value of troubled debts was calculated by using discount rates which reflect the credit risk inherent therein. In any case, such discount rates are not less than the highest interest rate which the Bank uses for transactions on reporting date. The cash flows for troubled debts were calculated net of specific provisions for credit losses.

Cash flows in respect of housing loans which may be prematurely repaid without an early repayment charge, have been valued according to a forecast taking into account the possibility of early repayment and based on a statistical model. The discounting of such cash flows based on the anticipated repayment dates instead of on the contractual repayment dates of the said loans, reduced the fair value of such loans by approximately NIS 9 million.

Deposits and subordinate debt notes – The value is calculated according to the method of discounting future cash flows at the interest rate used by the Bank, as at balance sheet date, for obtaining similar deposits or similar subordinate debt notes, based on parameters such as: the period of the deposit, the type of linkage and the amount of the deposit. In calculating the fair value of Shekel deposits optionally linked to the CPI, consideration was also given to the possible changes in the fair value of the deposit considering the length of the period of the option and the anticipated changes in the CPI until the repayment date of the deposit.

Deposits of the public include also savings deposits having a relatively long repayment period. As experienced by the Bank in the past, in practice, a part of the depositors redeem the deposits prior to their contractual repayment date at the contractual value of the deposit less an "early redemption charge". The expected future cash flows in respect of the savings deposits are based on statistical data that include a forecast of early redemption of such deposits.

The discounting of future cash flows of savings deposits, taking into consideration early redemption forecast, reduced the fair value of such deposits by an amount of NIS 55 million.

(3) Off-balance sheet financial instruments:

The fair value of off-balance sheet financial instruments the balance of which reflects a credit risk, as well as of contingent liabilities and special commitments, is calculated according to the commissions in similar transactions at the reporting date, after taking into consideration the remaining period of the transaction and the quality of the credit of the counterparty.

The assessment of the fair value of "irrevocable commitments to grant credit which has been approved but not yet granted" includes consideration of the difference between the interest rate fixed in the agreement and the interest rate of similar transactions on the reporting date.

Derivative instruments - derivative instruments that have an active market were valued at market value. Derivative instruments that are not traded on an active market were valued on the basis of models which the Bank uses in its current operations that take into account the risks inherent in the financial instrument, including the credit risk of the counterparty (CVA). The credit risk of a counterparty is based on credit spreads of marketable CDS contracts of the counterparty to the transaction (where these exist), or on spreads based on the credit rating of the customer.

Notes to the Financial Statements as at December 31, 2016

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

C. Composition on a consolidated basis

		December 31, 2016			
		Fair value			
	Balance Sheet	Level 1[1]	Level 2[2]	Level 3[3]	Total
	NIS millions	NIS millions			
Financial assets					
Cash and deposits with banks	3,422	3,024	-	414	3,438
Securities[4]	6,002	5,036	980	13	6,029
Credit to the public	22,001	21	1	21,891	21,913
Assets in respect of derivative instruments	26	4	12	10	26
Loan to affiliated company	2	-	-	2	2
Other financial assets	62	-	5	57	62
Total financial assets	(5) 31,515	8,085	998	22,387	31,470
Financial liabilities					
Deposits from the public	27,199	-	20,833	6,564	27,397
Deposits from banks	259	-	259	-	259
Deposits from the Government	149	-	122	33	155
Bonds and deferred debt notes	926	260	12	735	1,007
Liabilities in respect of derivative instruments	79	4	18	57	79
Other financial liabilities	782	-	1	781	782
Total financial liabilities	(5) 29,394	264	21,245	8,170	29,679
Off balance financial instruments:					
Transaction balances representing credit risk	19	-	-	19	19

Notes:
1. The data are based on quoted market prices in active market.
2. The data are based on other significant observable information.
3. The data are based on unobservable significant information.
4. For additional information regarding balance sheet value and fair value - see Note 12.
5. Including assets in the amount of NIS 8,933 million and liabilities in the amount of NIS 8,990 million, the stated balance of which is equal or proximate to their fair value.

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

C. Composition on a consolidated basis (cont'd)

	December 31, 2015				
		Fair value			
	Balance Sheet	Level 1[1]	Level 2[2]	Level 3[3]	Total
	NIS millions	NIS millions			
Financial assets					
Cash and deposits with banks	5,502	5,091	-	431	5,522
Securities[4]	3,432	2,835	617	12	3,464
Credit to the public	20,417	22	2	20,572	20,596
Assets in respect of derivative instruments	31	8	22	1	31
Loan to affiliated company	2	-	-	2	2
Other financial assets	66	-	7	59	66
Total financial assets	(5) 29,450	7,956	648	21,077	29,681
Financial liabilities					
Deposits from the public	25,388	-	19,639	6,032	25,671
Deposits from banks	459	-	433	25	458
Deposits from the Government	151	-	121	36	157
Bonds and deferred debt notes	672	-	6	755	761
Liabilities in respect of derivative instruments	122	8	43	71	122
Other financial liabilities	662	-	1	661	662
Total financial liabilities	(5) 27,454	8	20,243	7,580	27,831
Off balance financial instruments:					
Transaction balances representing credit risk	16	-	-	16	16

Notes:
1. The data are based on quoted market prices in active market.
2. The data are based on other significant observable information.
3. The data are based on unobservable significant information.
4. For additional information regarding balance sheet value and fair value - see Note 12.
5. Including assets in the amount of NIS 8,431 million and liabilities in the amount of NIS 8,095 million, the stated balance of which is equal or proximate to their fair value.

Notes to the Financial Statements as at December 31, 2016

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

D. Financial instruments measured at fair value on a recurring basis

	December 31, 2016				
	Fair value measurements based on				
	Prices quoted on active market (Level 1)	Other observable data (Level 2)	Unobservable data (Level 3)	Effect of setoff agreements	Stated balance
	NIS millions				
Assets					
Cash and deposits with banks	**248**	**-**	**-**	**-**	**248**
Available-for-sale securities:					
- Bonds – Israel government	**4,610**	**561**	**-**	**-**	**5,171**
– Foreign government	**-**	**295**	**-**	**-**	**295**
- Israel financial institutions	**-**	**-**	**-**	**-**	**-**
- other	**110**	**95**	**-**	**-**	**205**
Trading securities:					
- Bonds – Government	**2**	**-**	**-**	**-**	**2**
- other	**-**	**10**	**-**	**-**	**10**
Total securities	**4,722**	**961**	**-**	**-**	**5,683**
Credit to the public:					
Securities lending	**21**	**-**	**-**	**-**	**21**
Embedded derivatives	**-**	**1**	**-**	**-**	**1**
Total credit to the public	**21**	**1**	**-**	**-**	**22**
Other financial assets	**-**	**5**	**-**	**-**	**5**
Assets regarding derivative Instruments:					
- Interest contracts					
- Shekel/ CPI	**-**	**-**	**4**	**-**	**4**
- Other	**-**	**-**	**-**	**-**	**-**
- Foreign currency contracts	**-**	**12**	**6**	**-**	**18**
- Share contracts	**4**	**-**	**-**	**-**	**4**
Total assets regarding derivative instruments	**4**	**12**	**10**	**-**	**26**
Total assets	**4,995**	**979**	**10**	**-**	**5,984**
Liabilities					
Liabilities regarding derivative instruments:	**-**	**1**	**-**	**-**	**1**
- Interest contracts					
- Shekel/ CPI	**-**	**-**	**-**	**-**	**-**
- Other	**-**	**9**	**-**	**-**	**9**
- Foreign currency contracts	**-**	**9**	**57**	**-**	**66**
- Share contracts	**4**	**-**	**-**	**-**	**4**
Total liabilities regarding derivative instruments	**4**	**18**	**57**	**-**	**79**
Total liabilities	**4**	**19**	**57**	**-**	**80**

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

D. Financial instruments measured at fair value on a recurring basis (cont'd)

	December 31, 2015				
	Fair value measurements based on				
	Prices quoted on active market (Level 1)	Other observable data (Level 2)	Unobservable data (Level 3)	Effect of setoff agreements	Stated balance
			NIS millions		
Assets					
Cash and deposits with banks	5	-	-	-	5
Available-for-sale securities:					
- Bonds – Israel government	2,169	340	-	-	2,509
– Foreign government	-	78	-	-	78
- Israel financial institutions	204	-	-	-	204
- other	139	168	-	-	307
Trading securities:					
- Bonds – Government	-	-	-	-	-
- other	-	12	-	-	12
Total securities	2,512	598	-	-	3,110
Credit to the public:					
Securities lending	22	-	-	-	22
Embedded derivatives	-	2	-	-	2
Total credit to the public	22	2	-	-	24
Other financial assets	-	7	-	-	7
Assets regarding derivative Instruments:					
- Shekel/ CPI	-	-	-	-	-
- Other	-	-	-	-	-
- Foreign currency contracts	-	22	1	-	23
- Share contracts	8	-	-	-	8
Total assets regarding derivative instruments	8	22	1	-	31
Total assets	2,547	629	1	-	3,117
Liabilities					
Liabilities regarding derivative instruments:	-	1	-	-	1
- Interest contracts					
- Shekel/ CPI	-	-	16	-	16
- Other	-	26	-	-	26
- Foreign currency contracts	-	17	55	-	72
- Share contracts	8	-	-	-	8
Total liabilities regarding derivative instruments	8	43	71	-	122
Total liabilities	8	44	71	-	123

Notes to the Financial Statements as at December 31, 2016

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

E. Changes in financial instruments measured at fair value on a recurring basis included in Level 3

	December 31, 2016				
	Fair value at beginning of year	Profits (losses) realized and unrealized	Settlements	Fair value at end of year	Balance of unrealized profits (losses)(1)(2)
			NIS millions		
Liabilities, net, in respect of derivative instruments:					
- Interest contracts	**(16)**	**3**	**17**	**4**	**3**
- Foreign currency contracts	**(54)**	**9**	**(6)**	**(51)**	**1**
Total	**(70)**	**12**	**11**	**(47)**	**4**

	December 31, 2015				
	Fair value at beginning of year	Profits (losses) realized and unrealized	Settlements	Fair value at end of year	Balance of unrealized profits (losses)(1)(2)
			NIS millions		
Liabilities, net, in respect of derivative instruments:					
- Interest contracts	(7)	(21)	(16)	(16)	(16)
- Foreign currency contracts	(44)	-	(10)	(54)	(12)
Total	(51)	(21)	2	(70)	(28)

(1) For instruments held at end of period.
(2) Included in the statements of Profit and Loss in the item "Non-interest financing income".

F. Items measured at fair value on a nonrecurring basis (in NIS millions)

	December 31, 2016				
	Fair value based on:				
	"Level 1"	"Level 2"	"Level 3"	Total	Profit(loss)
Impaired credit where collection depends on collateral	**-**	**-**	**64**	**64**	**(10)**
Securities	**-**	**-**	**13**	**13**	**-**
Total	**-**	**-**	**77**	**77**	**(10)**

	December 31, 2015				
	Fair value based on:				
	"Level 1"	"Level 2"	"Level 3"	Total	Profit(loss)
Impaired credit where collection depends on collateral	-	-	47	47	(25)
Securities	-	-	12	12	-
Total	-	-	59	59	(25)

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

G. Additional information regarding significant unobservable data and evaluation techniques used in the measurement of fair value of items classified to "Level 3"

1. Quantitative information

December 31, 2016

	Fair value NIS millions	Valuation technique	Unobservable data	Quantitative information Range (%)	Quantitative information Average (%)
Impaired credit where collection depends on collateral	**64**	Quoted fair value	Estimated value of collateral		
Securities	**13**	valuation	Company value		
Liabilities in respect of derivative instruments:					
Shekel/CPI interest contracts	**4**	Discounted cash flows	Inflationary expectations	**(1.1)-0.9**	**0.0**
Foreign currency contracts	**(51)**	Discounted cash flows	Inflationary expectations(2)	**(1.7)-(1.7)**	**(1.7)**
		Rating model	Counterparty credit risk	**0.0-0.4**	**0.1**

December 31, 2015

	Fair value NIS millions	Valuation technique	Unobservable data	Quantitative information Range (%)	Quantitative information Average (%)
Impaired credit where collection depends on collateral	47	Quoted fair value	Estimated value of collateral		
Securities	12	valuation	Company value		
Liabilities in respect of derivative instruments:					
Shekel/CPI interest contracts	(16)	Discounted cash flows	Inflationary expectations(2)	0.0-(4.4)	(2.2)
Foreign currency contracts	(54)	Discounted cash flows	Inflationary expectations(2)	(3.9)-(3.9)	(3.9)
		Rating model	Counterparty credit risk	0.0-0.9	0.1

1. Weighted average
2. Up to one year

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

G. Additional information regarding significant unobservable data and evaluation techniques used in the measurement of fair value of items classified to "Level 3" (cont'd)

2. Qualitative information

- The "anticipated inflation" graph for the coming year forms a significant unobservable data used in the measurement of fair value of derivative financial instruments.

  A rise in anticipated inflation leads to a decline in the fair value of a liability linked to the CPI in respect of a derivative financial instrument (and to an increase in the fair value of an asset linked to the CPI) – and vice versa.

- "The counterparty credit risk" coefficient reflects the probability of a credit default of the counterparty for the transaction. An increase in the probability for default reduces the fair value of the transaction, and vice versa.

Note 33 - Interested and Related Parties

Consolidated

A. Balances (in NIS millions)

	December 31, 2016							
	Shareholders		Other interested parties					
	Parent company		Directors and executives		Others*		Other related parties	
	Balance at year end	Highest balance during the year	Balance at year end	Highest balance during the year	Balance at year end	Highest balance during the year	Balance at year end	Highest balance during the year
1. The balance sheet items include balances with related parties as follows:								
Assets								
Deposits with Banks	293	363	-	-	6	9	-	-
Credit to the public	-	-	1	2	110	110	-	-
Allowance to the credit losses	-	-	-	-	(2)	(2)	-	-
Net credit to the public	-	-	1	2	108	108	-	-
Other assets	2	4	-	-	3	12	-	-
Investment in affiliated companies	-	-	-	-	9	9	-	-
Shares	-	-	-	-	-	-	10	10
Liabilities								
Deposits from the public	-	-	8	8	5	10	6	20
Deposits from Banks	103	468	-	-	-	-	-	-
Other liabilities	23	48	17	17	551	570	-	-
Subordinated debt notes	84	85	-	-	-	-	-	-
Shares (included in shareholders' equity)	2,244	2,244	-	-	-	-	-	-
2. Contingent liabilities include balances with related parties in respect of:								
Guarantees given	-	-	-	-	13	13	-	-
Unutilized credit facilities	-	-	1	1	1	1	-	-
Off-balance sheet credit risk regarding transactions in derivatives	-	-	-	-	2	3	-	-
3. Letters of guarantee received in respect of credit to customers	50	50	-	-	-	-	-	-

* Balances as of December 31, 2016, in respect of interested parties, as defined in the Securities Act, include assets amounting to NIS 18 million, and liabilities amounting to NIS 552 million, relating to corporations held by those interested parties at a rate of 25% or over of their issued share capital or of the voting therein, or where the said interested parties are entitled to appoint 25% or over of the members of their boards of directors.

Note 33 - Interested and Related Parties (cont'd)

Consolidated

A. Balances (cont'd) (in NIS millions)

	December 31, 2015							
	Shareholders		Other interested parties					
	Parent company		Directors and executives		Others*		Other related parties	
	Balance at year end	Highest balance during the year	Balance at year end	Highest balance during the year	Balance at year end	Highest balance during the year	Balance at year end	Highest balance during the year
1. The balance sheet items include balances with related parties as follows:								
Assets								
Deposits with Banks	55	196	-	-	7	8	-	-
Credit to the public	-	-	2	3	109	109	-	-
Allowance to the credit losses	-	-	-	-	(2)	(2)	-	-
Net credit to the public	-	-	2	3	107	107	-	-
Other assets	1	5	-	-	12	14	-	-
Investment in affiliated companies	-	-	-	-	7	11	-	-
Shares	-	-	-	-	-	4	10	10
Liabilities								
Deposits from the public	-	-	7	8	13	15	20	23
Deposits from Banks	318	593	-	-	-	-	-	-
Other liabilities	39	46	15	15	511	511	-	-
Subordinated debt notes	84	85	-	-	-	-	-	-
Shares (included in shareholders' equity)	2,103	2,103						
2. Contingent liabilities include balances with related parties in respect of:								
Guarantees given	-	-	-	-	10	10	-	-
Unutilized credit facilities	-	-	1	3	1	1	-	-
Off-balance sheet credit risk regarding transactions in derivatives	-	1	-	-	2	2	-	-
3. Letters of guarantee received in respect of credit to customers	24	24	-	-	-	-	-	-

* Balances as of December 31, 2015, in respect of interested parties, as defined in the Securities Act, include assets amounting to NIS 26 million, and liabilities amounting to NIS 511 million, relating to corporations held by those interested parties at a rate of 25% or over of their issued share capital or of the voting therein, or where the said interested parties are entitled to appoint 25% or over of the members of their boards of directors.

Note 33 - Interested and Related Parties (cont'd)

B. Summary of results of transactions with interested and related parties (in NIS millions) **(cont'd):**

	Year ended December 31, 2016			
	Shareholders	Other interested parties		
	Parent company	Directors and executives	Others	Other related parties
1. Interest income, net				
Deriving from assets				
Deposits with banks	4	-	-	-
Credit to the public	-	-	2	-
Total interest income	4	-	2	-
Deriving from liabilities				
Deposits from the public	-	-	-	-
Deposits from banks	(1)	-	-	-
Subordinated debt notes	(3)	-	-	-
Total interest expense	(4)	-	-	-
Total net interest income	-	-	2	-
Non-interest financing expenses	(12)	-	-	-
Total financing income (expenses), net	(12)	-	2	-
2. Commission income	4	-	33	-
3. Operating and other expenses* (See also "C" below)	(31)	(18)	(22)	-
Profit (loss) before taxes	(39)	(18)	13	-
4. Bank's share in profits after taxes of equity-basis investees	-	-	2	-
* Including - computer expenses	(26)	-	(19)	-

Note 33 - Interested and Related Parties (cont'd)

B. Summary of results of transactions with interested and related parties (cont'd):

	Year ended December 31, 2015			
	Shareholders	Other interested parties		
	Parent company	Directors and executives	Others	Other related parties
1. Interest income, net				
Deriving from assets				
Deposits with banks	1	-	-	-
Credit to the public	-	-	2	-
Total interest income	1	-	2	-
Deriving from liabilities				
Deposits from the public	-	-	-	-
Deposits from banks	-	-	-	-
Subordinated debt notes	(3)	-	-	-
Total interest expense	(3)	-	-	-
Total net interest income (expense)	(2)	-	2	-
Non-interest financing expenses	(12)	-	-	-
Total financing income (expenses), net	(14)	-	2	-
2. Commission income	4	-	31	-
3. Operating and other expenses* (See also "C" below)	(32)	(20)	(19)	-
Profit (loss) before taxes	(42)	(20)	14	-
4. Bank's share in profits after taxes of equity-basis investees	-	-	2	-
* Including - computer expenses	(29)	-	(19)	-

Note 33 - Interested and Related Parties (cont'd)

B. Summary of results of transactions with interested and related parties (cont'd):

	Year ended December 31, 2014			
	Shareholders		Other interested parties	
	Parent company	Others	Directors and executives	Others
1. Interest income, net				
Deriving from assets				
Deposits with banks	4	-	-	-
Credit to the public	-	-	-	1
Total interest income	4	-	-	1
Deriving from liabilities				
Deposits from the public	-	(4)	-	-
Deposits from banks	-	-	-	-
Subordinated debt notes	(3)	-	-	-
Total interest expense	(3)	(4)	-	-
Total net interest income (expense)	1	(4)	-	1
Non-interest financing expenses	(6)	-	-	(6)
Total financing expenses, net	(5)	(4)	-	(5)
2. Commission income	4	-	-	29
3. Operating and other expenses* (See "C" below)	**(26)	-	(16)	(19)
Profit (loss) before taxes	(27)	(4)	(16)	5
4. Bank's share in profits after taxes of equity-basis investee	-	-	-	2
* Including - computer expenses	(22)	-	-	(19)

** Restated.

Note 33 - Interested and Related Parties (cont'd)

C. Operating and other expenses included benefits to interested parties, as follows:

	Year ended December 31, 2016			
	Parent company		Directors and Executives	
	Number of Beneficiaries	Total benefits NIS millions	Number of Beneficiaries	Total benefits NIS millions
Management fees to parent company	**-**	**2**	**-**	**-**
Remuneration to an interested party employed by the Bank	**-**	**-**	**10**	***15**
Remuneration of Directors not employed by the Bank Group	**3**	**-**	**13**	**3**

	Year ended December 31, 2015			
	Parent company		Directors and Executives	
	Number of Beneficiaries	Total benefits NIS millions	Number of Beneficiaries	Total benefits NIS millions
Management fees to parent company	-	2	-	-
Remuneration to an interested party employed by the Bank	-	-	11	*17
Remuneration of Directors not employed by the Bank Group	3	-	11	3

	Year ended December 31, 2014			
	Parent company		Directors and Executives	
	Number of Beneficiaries	Total benefits NIS millions	Number of Beneficiaries	Total benefits NIS millions
Management fees to parent company	-	2	-	-
Remuneration to an interested party employed by the Bank	-	-	9	*13
Remuneration of Directors not employed by the Bank Group	4	-	9	3

* Of which, short-term employee benefits of NIS 14 million, postretirement benefits of NIS 1 million and long-term employee benefits of a negligible amount, (2015 – NIS 14 million, NIS 2 million and NIS 1 million: 2014– NIS 12million, NIS 1 million and negligible amount respectively, respectively)

D. Transactions with related parties

- Transactions with related parties have been carried out in the ordinary course of business and at the same terms as transactions with other entities not related to the Bank. The income and expenses relating to such transactions are included in the appropriate items in the Statement of Profit and Loss.
- See Note 24B (10) regarding the engagement with the parent company relating to computer services.
- See Note 24B (11) regarding the commitment of the Bank to grant exemption in advance and to indemnify Directors and Officers of the Bank.
- The General Manager is engaged for a specified period of five years.
  In accordance with his engagement terms, the General Manager would be entitled upon retirement to the amounts accumulated in his favour in the severance compensation fund and to an adaptation award in an amount equal to four monthly salaries. The financial statements include adequate provisions to cover the Bank's liabilities in respect of these rights.

Note 34 – Financial Statements of the Bank

A. **Statements of profit and loss**

	2016	2015	2014
	NIS millions	NIS millions	NIS millions
Interest income	**1,058**	974	1,011
Interest expenses	**124**	102	211
Interest income, net	**934**	872	800
Allowance for credit losses	**36**	67	15
Net interest income after allowance for	**898**	805	785
Non-interest income			
Non- interest financing income (expenses)	**36**	37	42
Commissions	**303**	308	312
Other income	**9**	33	1
Total non-interest income	**348**	378	355
Operating and other expenses			
Payroll and related expenses	**581**	518	585
Maintenance and depreciation of buildings and equipment	**154**	152	150
Other expenses	**175**	171	166
Total operating and other expenses	**910**	841	901
Profit before taxes	**336**	342	239
Provision for taxes	**146**	135	94
Profit after taxes	**190**	207	145
Bank's equity in the results of investee companies, net	**3**	3	2
Net profit for the year	**193**	210	147
Earnings per share (in NIS thousands)			
Stock per share of NIS 0.1	**1.55**	1.69	1.18
Stock per share of NIS 0.01	**0.15**	0.17	0.12

Note 34 - Financial Statements of the Bank (cont'd)

B. Balance sheets

	December 31 2016 NIS millions	December 31 2015 NIS millions
Assets		
Cash and deposits with banks	**3,422**	5,502
Securities	**6,000**	3,432
Credit to the public	**22,349**	20,754
Allowance for the credit losses	**(348)**	(337)
Credit to the public, net	**22,001**	20,417
Buildings and equipment	**20**	17
Buildings and equipment	**358**	346
Assets in respect of derivative instruments	**26**	31
Other assets	**345**	340
Total assets	**32,172**	30,085
Liabilities and shareholders' equity		
Deposits from the public	**27,207**	25,397
Deposits from banks	**259**	459
Deposits from the Government	**149**	151
Bonds and deferred debt notes	**926**	672
Liabilities in respect of derivative instruments	**79**	122
Other liabilities	**1,308**	1,181
Total liabilities	**29,928**	27,982
Shareholders' equity	**2,244**	2,103
Total liabilities and shareholders' equity	**32,172**	30,085

Mercantile Discount Bank - Corporate Governance Report 2016

General

This report contains information with respect to corporate governance and audit at the Bank, as well as additional details regarding the business of the Bank and the manner of management thereof. The report forms an integral part of the annual report of the Bank.

Part "A" – Corporate governance and audit

1. The Board of Directors and Management

A. The Board of Directors

(1) Information regarding the members of the Board

Mr. Yair Avidan

Acts as member of the Board of Directors since January 12, 2016, and as Chairman of the Board as from July 16, 2016.

In addition, serves as senior VP, Chief Risk Manager and Head of the Subsidiaries Division of Israel Discount Bank Ltd.; Chairman of the Board of Discount Trusteeship Ltd. (since July 21, 2016); Director of Discount Bankcorp Inc. and of Israel discount Bank New York (since September 20, 2016). Between the years 2010-2016 acted as Chief Risk Manager and Head of the risk management group of Israel Discount Bank Group; between the years 2008-2010 acted as Head of the Corporate Division of Israel Discount Bank Ltd.; between the years 2006-2008 acted as Manager of the foreign extensions group and of management information of Israel Discount Bank Ltd. and between the years 1998-2010 acted as Director of Discount Mortgage Bank Ltd. Holds a Bachelor Degree in Economics and Statistics and a Master Degree in Business Administration and in Education from the Tel Aviv University, graduate of the advanced management program (AMP) of the Harvard Business School.
Has financial and accounting skills (see Section "B" below) and has "banking experience", as defined in Bank of Israel instructions.

Mr. Avi Eckstein (*)

Serves as member of the Board of the Bank since March 15, 2009. Member of the credit committee, risk management committee, audit committee, compensation and administration committee (Chairman) and Chairman of the *ad-hoc* committee for board of directors' procedures. In addition acts as President and CEO of ALHB Company Ltd.

During the period from 1983 to 2007 served in various capacities with Bank of Israel, his last position was Deputy Supervisor of Banks in charge of bank evaluation and licensing. Holds a Bachelor Degree in Economics and a Master Degree in Business Administration (finance and banking) from the Hebrew University, Jerusalem. During his tenure of office with Bank of Israel participated in a large number of professional training courses in Israel and abroad.
Has financial and accounting skills (see Section "B" below) and has "banking experience", as defined in Bank of Israel instructions.

Ms. Leah Banay (*)

Serves as member of the Board of the Bank since October 30, 2008. Member of the audit committee and of the compensation and administration committee.

In addition, served in the years 2008 and 2009 as member of the Board and Chairperson of the audit committee of Altschuler Shacham Provident Funds. In the period from 2000 to 2006 served as member of the Board and Chairperson of the audit committee of Discount Mortgage Bank Ltd. Holds a Bachelor Degree in Economics and Sociology from the Hebrew University in Jerusalem and a Diploma in Internal Auditing from the Haifa University.

(*) External Director

Mr. Joseph Beressi

Acts as member of the Board of the Bank since July 2, 2012, and as member of the Audit Committee.

In addition, serves as Senior VP and member of Management of Israel Discount Bank Ltd., acting as Chief Accounting Officer and Head of the Accounting Group.
Serves as director of BDL Computer Services and Administration Ltd., of Nidbach Real Estate and Investment Ltd., of Diners Club Israel Ltd. and of Discount Reinsurance International Limited, Guernsey.

Until 2008 served as Chairman of the Board of Discount Provident Funds Ltd; in the years 2010-2011 served as director of Israel Credit Cards Ltd.; in the years 2011-2015 served as director of and in Diners Club Israel Ltd. and the years 1999-2012 served as director of Discount Israel Capital Markets Ltd. Holds a Bachelor degree in Economics and Accounting from the Tel Aviv University.
Has accounting and financial skills (see Section "B" below) and has "banking experience", as defined in Bank of Israel instructions.

Mr. Shaul DeAngelli*

Acts as member of the Board of the Bank since June 1. 2016. Member of the compensation and administration committee.
Acts as Director of the Haifa Theatre; member of the administration committee of the Haifa University and of the Haifa Entrepreneurship Development Center (MATTI). In the years 2009-2012 acted as Director of Chod Assaf Ltd.; in 2011 acted as internal auditor and as member of management of RAPHAEL; in the years 2003-2006 served as a senior partner in Ernst & Young Israel, Public Accountants; in the years 2007-2012 served as economic and business development consultant for hi-tech incubators and the Haifa Municipality, and in the years 2008-2016 acted as lecturer in accounting and finance at the Carmel Academic Center. Holds a Bachelor degree in Economics and Accounting from the Tel Aviv University and a Master Degree in Marine Civilizations from the Haifa University.
Has accounting and financial skills (see Section "B" below).

Mr. Eyal Hayardeni [(*)]

Acts as member of the Board of the Bank since August 9, 2009. Member of the audit committee, the credit committee, the risk management committee (Chairman), and of the *ad-hoc* committee for board of directors' procedures.

In addition, serves as Director of Lardan Consultants Ltd.; Lardan Economic and Financial Consultants Ltd.; Lardan Holdings Ltd., Reblaze Technologies Ltd., New Trends (1998) Economic Consulting Ltd., Paamei Tikvah Ltd. and of Paamei Tikvah Israel (2014) Ltd. Between the years 2004 to 2009 served in various capacities in Shamir Optical Industries Ltd. (SHMR). Between the years 1991 to 1994 served as budget officer in the unit of the Financial Advisor to the Chief of Staff of the armed forces/budget group of the Ministry of Defense. Since 1994 lectures on accounting, economics, capital market and business administration at several academic institutions. Holds a Bachelor Degree in Economics and Accounting and a Master Degree in Business Administration (Finance) from the Bar-Ilan University.
Has financial and accounting skills (see Section "B" below).

Mr. Hanan Zalinger[(*)]

Acts as member of the Board of the Bank since February 19, 2012. Member of the audit committee (Chairman), risk management committee and of the compensation and administration committee.
Since the second half of 2016, serves as an outside consultant to Konfino, Leuchtenstein, Levi, a private law office engaged in commercial and corporate law, established upon his retirement from the Law Office of Zalinger, Konfino, Ben-Tzvi, Leuchtenstein & Co., which he headed. Moreover, since his retirement, he is engaged in various consulting services to corporations and other entities; in the period from 1993 to 2014 served as head of Zalinger & Co. Law Offices. In addition, serves on the boards of foundations engaged in social and cultural fields – the Howard Gillman Foundation for Israeli Culture, the Donation Foundation and the Betty and Walter Arzt Foundation; serves also on the executive board of Kolot Association. Holds a Bachelor Degree in Law from the Tel Aviv University and a Master Degree in Law from the New York University.

(*) External Director

Mr. Eli Khoter

Acts as member of the Board of the Bank since July 25 2006. Member of the risk management committee, the compensation and administration committee and of the *ad-hoc* committee for board of directors' procedures.

In addition, serves as member of the Board of Kali Insurance Agencies Group, and on the Board of Trustees and the Executive Board of the Beit Berl Academic College
In the years 2001 – 2009 held various positions at Israel Discount Bank Ltd. including Head of the Human Resources Division and Head of the Marketing and Strategic Planning Division. Holds a Bachelor Degree in Psychology from the Haifa University and a Master Degree in Business Administration from the Tel Aviv University.

Has "banking experience", as defined in Bank of Israel instructions.

Mr. Riad Khouri

Acts as member of the Board since October 30, 2008, and is a member of the compensation and administration committee.

In the years 2004-2008, as Senior Assistant General Manager, acted as the Nazareth Regional Manager of the Bank. In the years 1994-2004 acted as Manager of the Acre Region. Holds a Banking Diploma from the Clerks Institute in Haifa.

Mr. Shauki Khatib

Acts as member of the Board of the Bank since May 26, 2015. Member of the credit committee.

General Manager of Shauki Khatib Consulting, Management and Promotion Ltd.; Chairman of the Board of "Alphanar" – Promoting Employment for Arabs Ltd., and of "Injaz" – Professional Center for the Promotion of Local Authorities; in the years 1999-2008 served in senior public positions, including: Head of the Yafia Local Authority, Chairman if the Committee of heads of Arab Local Authorities, and Chairman of the Supreme Follow-up Committee of the Arab Population in Israel. Holds a Bachelor Degree in Civil Engineering from the Haifa Technion.

Ms. Tamar Selemnik

Acts as member of the Board of the Bank since April 1, 2016. Member of the credit committee (Chairperson).

In the period from 1999 to2011 served as manager of the properties and infrastructure group at Israel Discount Bank Ltd. and in the years 2011-2016 acted as manager of the London Branch of Discount Bank. Holds a Bachelor Degree in Law from the Hebrew University in Jerusalem and a Master Degree in Law from the Tel Aviv University in conjunction with Berkley University, California.

Has "banking experience", as defined in Bank of Israel instructions.

Mr. Yossi Peretz

Acts as member of the Board of the Bank since April 1, 2016. Member of the audit committee.

In addition acts as Director of Diners Club Israel Ltd. In the years 2011-2014 served as VP Human Resources at Israel Discount Bank Ltd. In the years 2005-2011 served as Head of Human Resources Group at the Prime Minister's Office. Holds a Bachelor Degree in Social Sciences from the Tel Aviv University, a Master Degree in Political Science from the Haifa University and a master Degree in Business Administration from the Thames Valley University (the London extension in Israel).

Has "banking experience", as defined in Bank of Israel instructions.

(2) Changes in membership of the Board of Directors

(a) Change in chairmanship of the Board of Directors

- Ms. Lilach Asher Topilsky informed on June 28, 2016 of her decision to terminate her office as Chairperson of the Board of the Bank. Her retirement took effect on July 20, 2016.
- The Board of Directors decided on June 28, 2016 to appoint Mr. Yair Avidan to the office of Chairman of the Board of the Bank. The appointment took effect of July 21, 2016.

(b) Other changes in Board membership

- Mr. Shmuel Messenberg terminated his office as Director on March 31, 2016.
- Mr. Nachum Langental terminated his office as Director on June 22, 2016.
- Mr. Shlomo Avidan terminated his office as Director on May 31, 2016.
- Ms. Tamar Selemnik was appointed Director of the bank on April 1, 2016.
- Mr. Yossi Peretz was appointed Director of the bank on April 1, 2016.
- Mr. Shaul DeAngeli was appointed Director of the Bank on June 1, 2016.

B. Report on Directors possessing accounting and financial skills

According to Bank of Israel instructions included in Proper Management of Banking Business Directive No. 301 in the matter of "the board of directors", banking corporations have to determine, among other things, the appropriate minimum number of directors who possess "accounting and financial skills", at a rate of at least one fifth of the total number of Board members. In addition, the Directive requires that at least two Directors who have "accounting and financial skills" shall serve on the Audit Committee. The Bank complies with the guidelines regarding this matter.

Those members of the Board of Directors who are defined as possessing accounting and financial skills, together with details of the career background that qualifies them to be so defined, are as follows:

Mr. Yair Avidan - Holds a Bachelor Degree in Economics and Statistics and a Master Degree in Business Administration and in Education from the Tel Aviv University, graduate of the advanced management program (AMP) of the Harvard Business School.

Served in business and control positions at discount Bank. In the years 1998-2010 acted as Director of Discount Mortgage Bank Ltd; since 2010 serves as member of Management of Discount Bank; since 2016 acts as Chairman of the Board of Discount Trusteeship Ltd., and as Director of Discount Bankcorp Inc. and of Israel discount Bank New York.

Acts as Chairman of the Board of Directors of the Bank.

Mr. Avi Eckstein

Holds a Bachelor Degree in Economics and a Master Degree in Business Administration (finance and banking) from the Hebrew University, Jerusalem. Since 1983 served in various capacities with Bank of Israel. In his last position and until December 31, 2007, he served as Deputy Supervisor of Banks in charge of bank evaluation and licensing. Serves as President and CEO of ALHAB Company Ltd., which is engaged in economic and financial consulting, and acts as consultant on banking and capital market issues. Among other things, serves as a member of the credit committee, audit committee, compensation and administration committee and the risk management committee of the Board of the Bank.

Joseph Beressi

A certified public accountant by profession. Holds a Bachelor Degree in Economics and Accounting from the Tel Aviv University. Acts as Director of BDL Computer and Administration Services Ltd., of Nidbach Real Estate and Investments Ltd., and of Discount Reinsurance International Limited, Guernsey. He also serves as Chief Accounting Officer and senior member of Management of Israel Discount Bank Ltd. Until 2008 served as Chairman of the Board of Discount Provident Funds Ltd.; in the years 2011-2015 served as Director of Diners Club Israel Ltd.; in the years 2010-2011 served as Director of Israel Credit Cards Ltd. and in the years 1999-2012 served as Director of Discount Israel Capital Markets and Investments Ltd.. Among other things serves as member of the audit committee of the Board of the Bank.

Mr. Shaul DeAngelli*

A certified public accountant by profession; holds a Bachelor degree in Economics and Accounting from the Tel Aviv University. In the years 1989-2003 was a partner in Luboshitz Kassierer &Co., Public Accountants, and in the years 2003-2006 served as a senior partner in Ernst & Young Israel, Public Accountants; in the years 2007-2012 served as economic and business development consultant for hi-tech incubators and the Haifa Municipality; in the years 2008-2016 acted as lecturer in accounting and finance at the Carmel Academic Center. In the years 2009-2012 acted as Director of Chod Assaf Ltd.; in 2011 acted as internal auditor and as member of management of RAPHAEL. Member of the administration committee of the Haifa University and of the Haifa Entrepreneurship Development Center (MATTI). Member of the executive Board of several public associations, including the Haifa Theater and the Yanko Dada Museum. Acts as director of the Haifa Theatre; serves as member of the compensation and administration committee of the Board of the Bank.

Mr. Eyal Hayardeni

A certified public accountant by profession. Holds a Bachelor Degree in Economics and Accounting and a Master Degree in Business Administration (finance) from the Bar-Ilan University. Between the years 2004 to 2009 served in various capacities in Shamir Optical Industries Ltd. (SHMR), including President and CEO of the company, chairman of the boards of all its subsidiary companies, Deputy President and VP Business Development. Since 1998 serves as President and owner of Lardan Consultants Ltd., engaged in economic and financial consulting services, mergers and acquisitions, public offerings, business development, etc. Between the years 1991 to

1994 served as budget officer in the unit of the Financial Advisor to the Chief of Staff of the armed forces/budget group of the Ministry of Defense. Since 1994 lectures on accounting, economics, capital market and business administration at several academic institutions. Among other things, serves as chairman of the risk management committee and as member of the audit committee and the credit committee of the Board of the Bank.

C. Information regarding meetings of the Board of Directors

In the year 2016, the Board of Directors held seventeen meetings. In addition, committees of the Board of Directors held sixty-five meetings during this year.

D. Management of the Bank

(1) Information regarding Senior Officers of the Bank

Mr. Joshua Burstein

Serves as General Manager of the Bank since August 17, 2015.

Holds a Bachelor Degree in Mathematics from the Hebrew University, Jerusalem. In the years 1989-2008 acted in various capacities in Bank Leumi Le-Israel Ltd., including Manager of the Tel Aviv Main Branch, Deputy Head of the Corporate Division and Deputy Head of the Capital Markets Division; in the years 2008-2012 acted as General Manager of Leumi Mortgage Bank Ltd. and in the years 2013-2015 acted as General Manager of Clal Financial Management Ltd., as the Chief Investment Manager and as Chairman of Clal Credit Insurance Ltd.

Mr. Avi Rishpan

Senior Vice General Manager and Chief Accounting Officer of the Bank. Serves in this role since March 15, 1999. He is a Certified Public Accountant and holds a Bachelor Degree in Economics and Accounting from the Haifa University.

Gilad Alyagon

Vice General Manager, serves since May 1, 2012, as Head of the Risk Management Division and Chief Risk Officer (CRO) of the Bank. He is a Certified Public Accountant and holds a Bachelor Degree in Economics and Accounting from the Bar-Ilan University and a Master Degree in Public Administration (Management of Financial Systems) from the Israel College-Clark University. Between the years 2002-2012 served as the internal auditor of the Bank and its subsidiaries.

Mr. Zion Becker

Vice General Manager and Head of the Finance Division. Serves in this role since January 9, 2009. Holds a Bachelor and Master Degree in Law from the Tel Aviv University. In the period 2005-2008 served as joint CEO of Excellence-Nessua, Stock Exchange Services Ltd. and served as Director of the Stock Exchange Clearing House Ltd. and as an alternate Director of the Tel Aviv Stock Exchange Ltd.

Between the years 2006-2007 served as director in Ma'alot S&P – the Israeli Rating Company, ESOP Trust Company Ltd., and since 2009 to date serves as chairman and director in a number of subsidiaries of the Bank.

Mr. Shmuel Berman

Vice General Manager and Head of the Strategy Division. Serves in this role since February1, 2007, and as member of Management since June 1, 2015.

Holds a Bachelor Degree in Economics and Administration from the Tel Aviv Academic College and a Master Degree in Business Administration from the Derby University. In the years 1998-2003 served in various banking capacities at Bank Hapoalim, inter alia, as Manager of the corporate department and as a branch manager; in the years 2003-2007 served as senior manager at Delloites Consultants.

Ms. Michal Haner-Deutsch

Vice General Manager, Chief Legal Advisor, acts in this position since November 1, 2013. Holds a Bachelor Degree in Law from the Inter-disciplinary Center for Business, Law and Technology Studies in Herzliyah. In the years 2011-2013 managed the significant subsidiary companies and taxation group at Israel Discount Bank Ltd., where she acted as administratively responsible for significant subsidiaries in the Group on behalf of the President and CEO of the Discount Bank Group ("ICC", "Mercantile" and "IDBNY"). In the years 2006-2011 served as legal advisor on legislation matters at the Israel Tax Authority.

Ms. Ziona Cohen

Vice General Manager and Chief Internal Auditor. Serves in this position since August 1, 2012. Has a Bachelor Degree in Law from the Sha'arei Mishpat College and a Master Degree in Law and Bachelor degree in Economics from the Bar Ilan University. Between the years 2006-2012 served as manager of the internal audit group of Otzar Hachayal Bank Ltd. and between the years 2008-2012 served as manager of the internal audit group of Massad Bank Ltd.

Ms. Ronnie Lars

Vice General Manager and head of the Human Resources and Administration Division. Serves in this position since January 1, 2015.

Has a Bachelor degree in Social Sciences from the Open University and a Master Degree in Labor Studies from the Tel Aviv University. In the period from 2009 to 2014 served as head of the human resources group of the Weitzman Institute of Science; in the period from 2004 to 2009 served as human resources manager of various divisions of the Strauss Group Ltd., and in the years 2008-2009 served as human resources manager of the business divisions of this group.

Mr. David Maimon

Vice General Manager and head of the Retail Division. Serves in this position since September 1, 2016; holds a Bachelor Degree in Economics from the Tel Aviv University and a Master Degree in Business Administration from the Derby University.

In the years 2008-2014 served as manager of the Jerusalem and Southern region and in the years 1997-2008 managed several branches of the Bank.

Mr. Yair Feldman

Vice General Manager, Head of the Operation and Information Group. Serves in this position since November 1, 2013. Holds a Bachelor Degree in Economics-Business Administration (extended) from the Bar-Ilan University. In the years 2009-2013 served as manager of the risk management control group of the Bank. In the years 2005-2009 served as owner-manager of Kiribty Management Company Ltd., and in the years 2001-2004 acted as general manager and shareholder of Malal Software and Computer Industries Ltd.

Mr. Amir Klivanov

Vice General Manager and Head of the Commercial Division, serving in this position since May 1, 2012. Has a Bachelor Degree in Political Science and General Studies from the Tel Aviv University and a Master Degree in Business Administration from the Tel Aviv University. Between the years 2007-2012 served as senior assistant to the General Manager, as head of the credit and economic group and deputy head of the Retail Banking Division.

(2) Changes in Management membership of the Bank.

The meeting of the Board of Directors of the Bank held on July 26, 2016, decided to appoint Mr. David Maimon to the office of Head of the Retail Division with the title of Vice General Manager and member of Management. The appointment took effect on September 1, 2016.

2. The Internal Auditor

A. Details regarding the Internal Auditor

The Internal Auditor of the Bank is Ms. Tziona Cohen, acting in this position since August 1, 2012. The internal auditor is neither an interested party in the Bank, nor a next of kin of such party. She is also not the independent auditor of the Bank or their representative.

The internal auditor and the staff of the internal audit department comply with the provisions of Section 146(b) of the Companies Act, with Section 8 of the Internal Audit Act and with Proper banking Management Directive No. 307 in the matter of "the internal audit function".

The internal auditor is an employee of the Bank. In addition to her duties as internal auditor she is in charge of public complaints and approaches.

B. Mode of appointment

The appointment of the internal auditor was approved by the Audit Committee on April 22, 2012, and by the Board of Directors on April 24, 2012. The appointment was approved based on the qualifications, experience and education of Ms. Tziona Cohen, who has a Bachelor Degree in Economics and a Bachelor and Masters Degree in Law. Prior to her appointment she had been in charge of the internal audit of Otzar Hachayal Bank Ltd. and of Massad Bank Ltd.

C. Identity of the entity in charge of the internal auditor

The Chairman of the Board of Directors is the organizational entity in charge of the internal auditor.

D. Audit program

The internal audit department operates in accordance with an annual work plan, being part of a multi-annual plan for five years.

The annual work plan of the audit department, and the extended work plan covering more than one year (hereinafter – “the work plans”) are determined based on a risk evaluation review performed by the internal auditor in accordance with accepted methodologies and based upon the guidelines included in Proper Management of Banking Business Directive No. 307 in the matter of "the internal audit function".

The work plans do not include the audit of the computer systems managed by the parent company. This audit is being performed by the internal auditor of the parent company.

The draft work plans have been submitted for review of the Chairman of the Board of Directors, the General Manager, the internal auditor of the parent company and the independent auditors of the Bank. The work plans were discussed by the Audit Committee of the Board and with its recommendations they were submitted for discussion by the Board and were approved by the Chairman of the Board.

The work plans do not refer to the discretion of the internal auditor as to deviations from the plans, however the internal audit procedures require that the cancellation of an assignment included in the audit plan is to be approved by the Chairman of the Board and reported to the Audit Committee. Also any significant deviations from the plan are reported by the internal auditor to the Chairman of the Board and to the Chairman of the Audit Committee.

The audit plan for 2016 included the examination of a material transaction (as defined by Bank of Israel directives) as regards "attainment of the goals for the establishment of the Expert Center".

E. Audit of investee companies

The work plan of the internal audit covers also principal investee companies of the Bank. The Bank and its investees do not have operations outside Israel.

F. Internal audit department staff

The internal auditor and the staff working under him are engaged in full-time positions.
During the year 2016, the average number of employees engaged in internal audit (including the internal auditor herself) totaled 18.0 positions (2015 – 17.6 positions). The average number of positions relating to the internal audit staff operating under the internal auditor, and which were engaged in attending to approaches by customers, numbered in 2016 1.9 positions (2015 – identical).

In addition to the above, several audits have been performed at the Bank by the internal auditor of the parent company, and by an external auditor engaged by way of "outsourcing" (comprising approximately 0.3 of a position).

G. Performance of the audit

The internal audit program is, inter alia, prepared in accordance with Proper Management of Banking Business Directive No. 307 in the matter of "the internal audit function", the Internal Audit Act, Proper Management of Banking business Directives, guidelines of the Supervisor of Banks and professional standards of the Institute of Internal Auditors.

The Board of Directors and the Audit Committee, discuss, inter-alia, the work plans of the internal audit department, review the annual operations of the department, and discuss the audit reports issued by external bodies (such as the independent auditors) and the Supervisor of Banks. The Audit Committee discussed also the reports of the internal auditor and the reports of the internal auditor of the parent company.

Members of the Board and of the Audit Committee obtained in such discussions information as to the mode of operation of the internal auditor, and they were satisfied that he had acted in accordance with the said Acts, directives and standards.

H. **Access to information**

The internal auditor has been provided with all information and documentation required by her, as stated in Section 9 to the Internal Audit Act. She has also been granted access to information mentioned in the said Section, including constant and direct access to the information systems of the Bank, including financial data. The above was also assured as regards investee companies, by the internal audit operating procedures.

I. Internal audit reports

All the internal audit reports are in writing and are presented to the Chairman of the Board of Directors, the Chairman of the Audit Committee of the Board of Directors, to the General Manager, to the internal auditor of the parent company and to the external auditors. The Audit Committee discusses summarized reports on an ongoing basis, while reports involving material issues are being discussed in full. The Audit Committee and the Board of Directors also discuss the semi-annual summary report by the internal auditor, which includes also a list of reports that had been issued by her, as follows:

- Report summarizing the activities of the internal audit group for 2015, was discussed by the Audit Committee on February 17, 2016 and by the Board of Directors on February 25, 2016.

- Report summarizing the activities of the internal audit group for the first half of 2016, was discussed by the Audit Committee on September 4, 2015 and by the Board of Directors on September 25, 2015.

J. Evaluation of the operations of the internal auditor by the Board of Directors

The Board of Directors and the Audit Committee are of the opinion that the extent, the nature and the continuity of the activities and the program of the internal auditor are reasonable in the circumstances, and are also satisfactory for the purposes of meeting the internal audit goals set by the Bank.

K. Remuneration

The remuneration paid to the internal auditor, was as follows:

	2016	2015
	NIS thousands	
Salary	**794**	798
Awards	**232**	234
Related benefits	**227**	254
Total payroll expense	**1,253**	1,286

In the opinion of the Board of Directors, the above remuneration does not affect the professional judgment of the internal auditor.

3. Auditors' remuneration

The Bank's joint independent auditors are KPMG Somekh Chaikin and Ziv Haft. Details of the remuneration paid to the joint auditors in respect of professional services rendered to the Bank and to its consolidated subsidiaries, are as follows:

	Consolidated		The Bank	
	2016	2015	2016	2015
	NIS thousands			
Audit of the financial statements	**2,051**	1,633	**2,030**	1,578
Audit-related services [(1)]	**253**	95	**253**	95
Tax services	**65**	100	**65**	100
Total professional fees	**2,369**	1,828	**2,348**	1,773

(1) Relates mainly to audit of specific matters and audit for the purpose of rendering special confirmations.

4. Remuneration and benefits to senior officers (in thousands of shekels):

2016

Name of Officer [4]	Position	Remuneration for service [1] Salary [1]	Awards [1]	Social Benefits [2]	Other benefits	Total	Loans granted on benefitial terms [3] Outstanding loans	Repayment period	Annual benefit
Joshua Burstien	General Manager	**1,232**	**437**	**274**	**95**	**2,038**	**-**	**-**	**-**
Avi Rishpan	Chief Accounting Officer	**1,066**	**315**	**257**	**77**	**1,715**	**130**	**1.87**	**6**
Zion Becker	Head of Finance Division	**886**	**321**	**76**	**71**	**1,354**	**-**	**-**	**-**
Cohen Tziona	Internal Auditor	**794**	**232**	**152**	**75**	**1,253**	**-**	**-**	**-**
Haner-Deutsch Mical	Chief Legal Counsel	**757**	**252**	**154**	**69**	**1,232**	**36**	**2.30**	**2**
Amir Klibanov	Head of Commercial Division	**779**	**271**	**110**	**63**	**1,223**	**-**	**-**	**-**

2015

Name of Officer [4]	Position	Remuneration for service [1] Salary [1]	Awards [1]	Social Benefits [2]	Other benefits	Total	Loans granted on benefit terms [3] Outstanding loans	Repayment period	Annual benefit
Joshua Burstien*	General Manager	491	-	539	37	1,067	-	-	-
Uri Baruch**	Former General Manager	1,141	578	315	98	2,132	-	-	-
Avi Rishpan	Chief Accounting Officer	1,074	320	211	76	1,681	188	2.28	6
Zion Becker	Head of Finance Division	845	281	235	68	1,429	-	-	-
Shmuel Berman	Manager Strategy Group	739	203	366	62	1,370	189	2.92	6
Tziona Cohen	Internal Auditor	798	234	178	76	1,286	-	-	-
Amir Klibanov	Head of Corporate-Commercial Division	764	276	166	64	1,270	-	-	-

* As from August 17, 2015.
** Terminated his office on August 16, 2015

(1) Remuneration is presented in terms of cost to the Bank and do not include payroll tax.
(2) Social benefits include provisions for severance compensation, provident fund, further education fund, vacation pay, long service award, National Insurance contribution as well as adjustments of the said provisions due to changes in salary in the reported year.
(3) The terms of loans are similar to those applying to all Bank employees. Amounts of loans are determined according to uniform criteria applying to all Bank employees.
(4) All senior officers are employed on the basis of a full time position (100%).

Notes:

a. Factors taken into account in determining the amounts of salaries and awards included the scope of the Bank's business, profitability, and the rate of return on capital.

b. The terms applying to the senior officers for bank services, including all banking operations, are similar to the terms granted to all Bank employees. In general, such terms are not preferable to the terms accorded to other customers of a similar banking profile. The total benefits granted to senior officers in respect of banking operations is not material.

c. Benefits of all kinds are stated in the statement of profit and loss under "Payroll and related benefits".

d. Directors of the Bank, excluding directors who act as officers of the parent company, are entitled to remuneration that is not in excess of accepted amounts, and is payable in accordance with the Companies Regulations (Rules regarding remuneration and reimbursement of expenses to an external director), 2000, as detailed in Note 33 to the financial statements.

e. For additional details as to a resolution to grant exemption and indemnification to Directors and officers of the bank, see Note 24B(11) to the financial statements.

f. For additional details regarding the remuneration plan for senior members of management - see disclosure in the risk report published on the Internet Website of the Bank under the address: https://www.mercantile.co.il/MB/private/about-mercantile/financial-reports/regulatory

Following are additional details regarding the "components of remuneration" (as defined in the Securities Regulations (Periodic and immediate reports), 1970, relating to the senior officers of the Bank:

1. **Mr. Joshua Burstein** – The Board of Directors approved on July 28, 2015, the employment terms of Mr. Joshua Burstein, officiating as General Manager of the Bank, for a specified period of five years. Notwithstanding the above, the parties are entitled to terminate the period of engagement giving a prior notice of three months.

   Upon termination of his engagement, the General Manager would be entitled to receive the amounts accumulated to his credit in the severance compensation fund and to a special award in an amount equal to four monthly salaries (one quarter of which to be considered a "variable award", as defined in the compensation policy of the Bank).

   Following the termination of his employment, the General Manager may not undertake any occupation which is in competition with the Bank for a period of four months.

   The salary of the General Manager is linked to the CPI, and in addition, he is entitled to vacation pay, sick pay, recreation pay, use of a company car, social benefits (including severance compensation, provident fund an further education fund contributions and loss of work ability insurance) as well as additional benefits.

2. **Mr. Avi Rishpan** – Senior Vice General Manager and Chief Accounting Officer of the Bank is employed according to a personal contract for a period ending August 3, 2018 (date on which he reaches retirement age). Notwithstanding the above, each of the parties may terminate the engagement giving a prior notice of three months.

At the end of his employment period, Mr. Rishpan will be entitled to severance pay and to a special award of nine monthly salaries. Subsequent to termination of office, Mr. Rishpan shall not be entitled to undertake any occupation which is in competition with the Bank for a period of three months.

The remuneration of Mr. Rishpan is linked to the CPI, and in addition he is entitled to paid vacation period, sick leave, recreation pay and to a motor vehicle at the expense of the Bank. He is also entitled to social benefits (including severance pay, provident fund, loss of work ability insurance and further education fund) as well as additional benefits.

3. **Mr. Zion Becker** – Vice General Manager and Head of the Finance Division, is employed according to a personal employment contract for an unspecified period. Notwithstanding the above, each of the parties may terminate the engagement giving a prior notice of three months.

   According to Mr. Becker's employment agreement he is entitled at the termination of his employment to the amount of the severance compensation accumulated to his credit and to a special award of six monthly salaries, and subsequent to termination of office, Mr. Becker shall not allowed to undertake any occupation which is in competition with the Bank for a period of three months. In consideration for honoring this commitment, Mr. Becker shall be entitled to an additional special award equal to three monthly salaries.

   Mr. Becker's salary is linked to the CPI, and in addition he is entitled to paid vacation period, sick leave, recreation pay and to a motor vehicle at the expense of the Bank. He was also entitled to social benefits (including severance pay, provident fund, loss of work ability insurance and further education fund) as well as additional benefits.

4. **Ms. Michal Haner Deutsch**

   Vice General Manager and Chief Legal Counsel, employed according to a personal contract for an unspecified period. In accordance with the contract, each of the parties may terminate the engagement giving a prior notice of four months.

   At the end of her employment period, Ms. Haner Deutsch will be entitled to the amount of severance compensation accumulated to her credit and to special award of four monthly salaries.

   The salary of Ms. Haner Deutsch is linked to the CPI, and in addition she is entitled to paid vacation period, sick leave, recreation pay and to a motor vehicle at the expense of the Bank. She is also entitled to social benefits (including severance pay, provident fund, loss of work ability insurance and further education fund) as well as additional benefits.

5. **Ms. Tziona Cohen**– Vice General Manager and Chief Internal Auditor, employed according to a personal contract for an unspecified period. In accordance with the contract, each of the parties may terminate the engagement giving a prior notice of three months.

At the end of her employment period, Ms. Cohen will be entitled to the amount of severance compensation accumulated to her credit and to special award of six monthly salaries. Subsequent to termination of office, Ms. Cohen shall not be entitled to undertake any occupation which is in competition with the Bank for a period of three months. In consideration for honoring this commitment, Ms. Cohen shall be entitled to an additional special award equal to three monthly salaries.

The salary of Ms. Cohen is linked to the CPI, and in addition she is entitled to paid vacation period, sick leave, recreation pay and to a motor vehicle at the expense of the Bank. She is also entitled to social benefits (including severance pay, provident fund, loss of work ability insurance and further education fund) as well as additional benefits.

6. **Mr. Amir Klibanov** – Vice General Manager and Head of the Corporate/Commercial Division, employed by the Bank according to a personal contract for an unspecified period. In accordance with the contract, each of the parties may terminate the engagement giving a prior notice of three months.

   At the end of his employment period, Mr. Klebanov will be entitled to the amount of severance compensation accumulated to his credit (or in the case of dismissal, to an amount equal to his last monthly salary multiplied by the number of years of service) and to special award of six monthly salaries. Subsequent to termination of office, Mr. Klibanov shall not be entitled to undertake any occupation which is in competition with the Bank for a period of three months. In consideration for honoring this commitment, Mr. Klebanov would be entitled to an additional special award equal to three monthly salaries.

   The salary of Mr. Klibanov is linked to the CPI, and in addition he is entitled to paid vacation period, sick leave, recreation pay and to a motor vehicle at the expense of the Bank. He is also entitled to social benefits (including severance pay, provident fund, loss of work ability insurance and further education fund) as well as additional benefits.

5. Transactions with controlling shareholders and related parties

A. Agreements concerning computer and operational services

The central computer systems of the Bank are based on the computer systems of the parent company, which operates and maintains them. The computer and operating services provided to the Bank by the parent company, under agreements signed by the parties, are based on economic principles.

In addition to that stated above, the Bank has entered into additional agreements for obtaining certain operating services from the parent company.

For additional details regarding the agreements for computer and operating services – see Chapter 9A below.

B. Exemption and indemnification of Directors and Officers

The Bank is committed to exempt in advance Directors and Officers of the Bank as well as Directors and other Officers of certain subsidiaries (as defined in the commitment document), from any responsibility for damage, which might be caused to the Bank (and to those subsidiaries), resulting from the violation of the duty of care on the part of the Director or Officer.

In addition, the Bank is committed to indemnify Directors and Officers in respect of a possible monetary liability, which might be imposed upon them, and in respect of reasonable legal expenses that might be incurred by them in respect of certain classes of events, as detailed in the document.

On January 31, 2016, the General Meeting of Shareholders of the Bank approved an amendment to the commitment document for indemnification and exemption of Officers of the Bank (as defined in the Companies Act), whereby, the maximum amounts of indemnification payable by the Bank to the Officers have been increased from 10% of the equity capital of the Bank to 25%, on condition that the realization of such indemnification shall no create a deviation from the limits of the indemnification as determined by the indemnification decision of the parent company (Israel Discount Bank Ltd.).

The commitment for indemnification of Officers, as stated above, shall apply in respect of actions made by them within the framework of their office at the Bank or at its investee companies. In addition, the General Meeting of Shareholders decided to extend the granting of the exemption from responsibility to Officers, and grant it to all Officers and Directors of the Bank, excluding those Directors who are engaged as Officers or as other employees of the Parent company.

C. For additional details regarding transactions entered into by the Bank in 2016 with controlling shareholders and related parties – see Note 33 to the financial statements.

Part "B" – Additional details regarding the business of the Bank

6. Structure of the Group and control of the Bank

A. Control of the Bank

As of date of publication of this report, Israel Discount Bank Ltd. (hereinafter – "Discount Bank") holds the full ownership and control of the Bank (100%). For additional details regarding material agreements between the Bank and Discount Bank – See Chapter 9A below.

During the reported period and in the previous year, no investments in shares of the Bank were made and no transactions were made in the shares of the Bank by the parent company.

B. Chart of the principal holdings at December 31, 2015.

Mercantile Discount Bank Ltd.		
Capital Market	**Financial Companies**	**Non-Banking Corporations**
Tafnit Discount Portfolio Management Ltd. (31%)	**Mercantile Issuances Ltd. (100%)**	**Golden Gate Bridge Fund (20%)**
		A.I. America Israel Investments Ltd. (14.8%)

7. Fixed assets and fixtures[(1)]

A. General

Investments of the Bank infixed assets and fixtures as of December 31, 2016, are as follows:

	Land and buildings[(2)]	Equipment furniture and vehicles	Software costs	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Cost	394	386	455	1,235
Accumulated Depreciation	195	302	380	877
Depreciated cost at December 31, 2016	199	84	75	358

1. For additional information regarding the Bank's rights in building and equipment – see Note 15 to the financial statements,
2. For additional information regarding engagements of the Bank for the sale of buildings and equipment – see Note 24B (12) to the financial statements.

B. Land and buildings

(1) General

The policy of the Bank is to hold only those assets required for the current operation of the Bank, or those assets expected to be needed by the bank in the future. Assets not falling within these premises are offered for sale by the Bank or are provisionally let, until conditions for their sale materialize.
The Bank's rights in land and buildings are freehold, leasehold or rent protected. In addition, the Bank uses seventy-three properties rented on the free rental market.

In accordance with International Accounting Standard No. 36, the Bank examines on an ongoing basis the differences between the fair value or the recoverable value of its freehold properties and their depreciated cost as stated in its books. In cases where the depreciated cost of these properties exceeds their fair value (or their recoverable value, as the case nay be), a provision for impairment is included in this respect.
No provisions in respect of impairment of properties intended for sale were recorded in 2016 (in 2015, the Bank recognized a provision for impairment in the amount of NIS 1 million).

Following are details of land and building in use by the Bank at December 31, 2016:

	Freehold or leasehold	Protected rental	Free rental	Total
	Square meters	Square meters	Square meters	Square meters
Branches(1)	6,029	396	19,728	26,203
Office premises(1)	6,439	-	6,816	13,255
Auxiliary space (storage etc.)	-	-	1,168	1,168
Area not in use by the Bank(2)	753	-	1,836	2,589
Total	13,221	396	29,598	43,215

1. For additional details regarding engagement by the Bank for the sale of buildings – see Note 24B (11) to the financial statements.
2. Vacant premises that are not in use by the Bank, intended for future use or for sale, are stated at cost which does not exceed their market value.

(2) Plan for the relocation of offices of the Bank's Management and of central Head Office units

Management of the Bank and the central Head Office units operate at present at three different locations. As part of the efficiency measures adopted by the Bank and in order to improve the work of Management, the Bank, together with the parent company and additional companies in the Discount Group, signed on June 27, 2016, an agreement for the purchase from the Rishon LeTzion Municipality of a plot of land in an area of twenty dunnums, on which it is planned to construct office buildings for Management, Head Office and operational units serving the purchasing companies.

The cost of purchase of the proportionate area allocated to the Bank (two dunnums) designated for the construction of a building that would house in the future the offices of Management, Head Office and operational units, amounts to NIS 10.5 million plus VAT.

8. Human capital

A. Developments in the organizational structure

(1) Changes in management of the Retail Division

On July 16, 2016, it was decided to appoint Mr. David Maimon, to the office of Head of the Retail Division with the title of Vice General Manager and member of Management of the Bank. The appointment took effect on September 1, 2016.

(2) Enlarging the operations of the back office operating unit

As part of the plan for business focusing and efficiency, the Bank continued in 2016 the implementation of the strategy changing the concept of operations at the Bank's branches and the operating Head Office units.

Within the framework of this plan, the Bank removed in 2016, from the branches and units, as above, additional operating activities, assembling them in designated back office operating units.

Implementation of the plan is followed by changes in work processes in the branches and in the back office operating units, and involves inputs required for the integration of the new concepts and work system (as well as the need to maintain dual work processes in the first stages of implementation of the plan).

(3) Reorganization of the corporate/commercial division

As a derivative of the implementation of the strategic program of the Bank, which, inter alia, includes outlines for the development of the retail and commercial activities, Management of the Bank decided on November 29, 2016, to reorganize the corporate/commercial division, whereby the activity of the corporate group of the division was divided into two commercial groups.

The change entered into effect on January 1, 2017, following which, the name of the division has been changed from the "corporate/commercial division" into the "commercial banking division".

(4) Organizational change in the retail division

In the last quarter of 2016, Management has approved organizational changes in the retail division, which include:

- An organizational change in the marketing group stemming from the implementation of the new strategic program, whereby special representatives would be appointed for the marketing of banking products and services to designated populations, modified to their special needs.

- Enlarging the operations of the credit and control group, including the appointment of representatives in the fields of operating risk management and compliance risk.

B. Workforce

(1) General

The number of employees engaged by the Bank and its consolidated subsidiaries in full-time positions, decreased by 53 employees totaling at the end of 2016, 1,550 employees in comparison with 1,603 employees at the end of 2015. On an average, the number of employees decreased by 21 positions totaling in 2016, 1579 positions, as compared with 1,600 positions in 2015.

	2016	2015
Number of positions at end of year	**1,550**	1,603
Average number of positions	**1,579**	1,600

This data shows that in 2016, the workforce of the Bank, employed on the basis of the average number of positions, decreased by 1.3%. This reduction in the number of positions stems, inter alia, from the voluntary retirement program introduced in the last quarter of 2016 (see Item C(3) below).

(2) Distribution of the workforce by segments of operation

Following are data regarding the distribution of the number of average employee positions at the Bank by segments of operation[(1)]:

	2016	2015
Households	699	[(2)]706
Small businesses	655	[(2)]665
Middle market banking	75	77
Corporate banking	88	89
Private banking	22	[(2)]24
Financial management	40	[(2)]39
Total	1,579	1600

(1) The distribution of the number of position by segments of operation is based on the organizational structure of operating segments at the Bank ("Management's approach").
(2) Reclassified.

C. Labor agreements at the Bank

(1) Labor Charter

Labor relations between the Bank and its employees, excluding employees engaged under a personal agreement, are mainly based on a collective labor agreement, known as the "Labor charter", and on complementary collective agreement. These agreements determine that the wage terms, employment terms and terms related to them will be linked to those prevailing at Bank Leumi Le-Israel Ltd. Apart from these agreements, the Bank and the representative committee of employees enter from time to time into agreements on specific issues.

The employment terms of members of Management are governed by personal employment agreements.

On May 22, 2005, the New Labor Federation, employee representatives and the Accountant-General at the Ministry of Finance put their signatures to an agreement, which stipulated that, inter alia, the validity of existing collective agreements would be extended until December 31, 2009. Subsequent to that date, the provisions of section 5 of the labor agreement dated May 17, 1968 would apply to the collective agreements. In other words, the validity of the agreement would be automatically extended for a further two years, unless one of the parties to the agreement announced his intention of introducing amendments thereto.

A special collective agreement was signed on April 28, 2016, between the Bank, the Federation of Labor and representatives of the employee (valid for the years 2015-2018), constituting an update of the previous wage agreement and adopts consents determined in the agreement signed at the beginning of 2015 between Bank Leumi and its employees, including:

- The rate of increase in the average annual wage would be decreased gradually from 5%, as follows:
  - In the years 2015-2016, to 4%.
  - In the years 2017-2018, to 3.5%.

- The maximum "seniority increment" was increased from 37 to 38 years.
- The "seniority awards" have been reduced at all seniority levels as from February 1, 2016 and thereafter (see extended discussion in Item (2) below).

(2) Revision of the wage agreement in the matter of "seniority awards"

As stated in (1) above, and according to wage agreements signed in the past, the terms of employment of Bank employees are linked to the terms prevailing at Bank Leumi (hereinafter – "Leumi"). It is noted, in this respect that on February 17, 2016, Bank Leumi signed a special collective agreement with its employees, whereby Leumi issued to its employees shares of this bank in consideration for the settlement in full of Leumi's liabilities for the payment to employees of "seniority awards" (including the vacation component included in such awards).

Following the signing of the above mentioned agreement and the principles established in the Labor Charter, the Bank signed on December 28, 2016, an agreement with its employees whereby the parties agreed to the settlement of the Bank's liabilities for the payment of "seniority awards" in consideration for the payment to employees of a one-off amount of NIS 61 million, computed on the basis of the actuarial provisions in respect of the said liabilities as of September 30, 2016, discounted to their present value at a discount rate of 3.5% (instead of the discount rate in effect on September 30, 2016).

The profit accruing to the Bank as a result of the settlement of this liability amounted to NIS 19 million, and was recognized in profit and loss in the reported period in the item "Payroll expenses".

In accordance with the agreement, the said one-off payment settles in full the Bank's liability for the payment of "seniority awards" to its employees, and accordingly, as from December 31, 2016, the Bank no longer records provisions for the payment of "seniority awards.

(3) Efficiency

The Board of Directors of the Bank approved on September 11, 2016, an efficiency program, which, inter alia, includes an employee voluntary retirement plan under beneficial terms. The cost of the plan, implemented by the Bank in the fourth quarter of 2016, amounted to NIS 43 million.

For further information regarding this plan and its implications on the liabilities of the Bank for the payment of severance compensation and on the payroll expenses in 2016, see Chapter 21A in the Report of the Board of Directors and Management.

D. Branches of the Bank

At the end of 2016, the Bank operates 78 branches (2015 – 79 branches). As part of the policy for an ongoing examination of the branch disposition, the Bank merged during the reported period, the operations of one of the Bank's branches with a nearby branch.

9. Material agreements

A. Agreements concerning computer and operating services

(1) Agreements concerning computer services

The central computer systems of the Bank are based on the computer systems of the parent company, which operates and maintains them. The computer and operating services provided to the Bank by the parent company, under agreements signed by the parties, are based on economic principles.

These agreements detail the scope, quality and availability of the computer services provided to the Bank and ensure their continuity, both during the present engagement terms and during the transitional period, if one of the parties wishes to terminate the existing engagement.

According to the agreement signed by the parties on November 11, 2004 (hereinafter – "the service agreement") , the parent company is committed to provide to the Bank computer services in the scope, and level of quality detailed in the agreement, for an unspecified period. Notwithstanding the above, the agreement entitles each of the parties to terminate it by prior notice, as follows:

- Mercantile Discount Bank Ltd. – two years
- Israel Discount Bank Ltd. – three years.

The price of the computer services provided to the Bank in terms of this agreement, is based on periodic pricing agreements renewable from time to time (hereinafter – "the pricing agreements").

The cost of the present computer services being provided to the Bank amounts to NIS 63 million per year, derived from the pricing agreement signed by the parties on June 17, 2010, for a period of seven years ended December 31, 2015.

On December 27, 2015, the parties agreed to extend the validity of the pricing agreement for one additional year, until December 31, 2016. In addition, the agreement states that the cost of the computer services will remain in effect also after December 31, 2016, if until December 31, 2016, the parties will not sign an additional agreement.

During December 2016, the parties agreed to extend the validity of the "pricing agreement" for one additional year until December 31, 2017.

The extension of the agreement was approved by the Audit Committee of the Board on January 22, 2017.

(2) Operating agreement

On November 11, 2004, the Bank and the parent company signed an agreement whereby the parent company is committed to provide to the Bank certain operating services, as detailed in the agreement, for an unspecified period. Notwithstanding the above, the agreement entitles each of the parties to terminate it by prior notice of periods identical to those applying to the computer services agreement (see (1) above).

The cost of the operating services provided by the parent company amounts to NIS 3 million per year, and derives from the proportionate cost of such services to the parent company.

(3) Agreement for the purchase of land

For further information regarding the agreement for the purchase of a plot of land designed for the future use by the Bank's Management and Head office units, see Chapter 7C above.

B. Loan agreements within the framework of the small business fund

For detailed information regarding the agreement for the granting of loans signed by the Bank (in participation with an institutional body) and by the "small business fund" – see Chapter 12B(7) below.

C. Issue of bonds

Within the framework of the steps adopted by the Bank for the management of risk exposure and with the aim of diversifying the mix of financial resources at the disposal of the Bank, the Bank issued on March 31, 2016, a series of marketable bonds in the amount of NIS 253 million.

The bonds are non-linked; carry interest at the rate of 2.07% (higher by 0.79 percentage points than the rate of return according to which government bonds were traded at date of the issue), and are redeemable at the end of six years from the date of issue.

D. Labor agreements

For information regarding the labor agreements in effect at the Bank and developments regarding this issue – See Chapter 8C above.

10. Legislative and regulatory restrictions

The Bank (like all banks in the Israeli banking sector) operates within a framework of laws, orders, and regulations applying to it, including, inter alia, the Banking Ordinance, Bank of Israel Act, The Banking Act (Licensing), the Banking Act (Customer service), as well as directives, rules and guidelines published from time to time by the Supervisor of Banks, Including, Proper Conduct of Banking Business Directives and the Banking Rules (Customer service).

Following is information regarding developments in legislation and regulations in 2016:

A. Legislation regarding competition in the banking sector

(1) Increase in Competition and Reduction Concentration and Conflict of Interests in the Banking Market in Israel Act (Legislation amendments), 2016

Following legislation and regulation actions taken to increase competition in the field of banking services, the Committee for the increase in competition in banking and in prevalent financial services ("the Strom Committee") was appointed on June 3, 2015. The Committee was asked to examine the possibility of allowing additional bodies into the market, which would provide banking services (including the possibility of separating credit card companies from banks) and to recommend action that would reduce barriers preventing competition in the banking sector.

The Strom Committee completed its work and published its recommendations on July 6, 2016.

In order to implement the recommendations of the Committee, the Knesset passed the Increase in Competition and Reduction Concentration and Conflict of Interests in the Banking Market in Israel Act (Legislation amendments), 2016, (hereinafter – "the Act"), which was formally published on January 31, 2017.

The Acts contains recommendations for structural changes in the field of financial services in the banking sector, including:

(a) Regulation of the structure of ownership and operation of credit card companies

- The two largest banks ("Hapoalim" and "Leumi") shall be obliged to sell their holdings in credit card companied owned by them within three to four years (depending on circumstances) from date of publication of the Act.
  Notwithstanding the above, the Act permits credit card companies, under certain conditions, to make use of the information gathered in their hands during a period of three to five years from date of publication of the Act.
  On the other hand, the Act permits the two banks, owners of Israel Credit Card Company Ltd. ("Discount" and the "First International") to maintain their holdings in the said company for an additional period of four years. At the end of this period, a re-examination would be made of the ownership structure of ICC.

- The Act permits the large banks (the volume of their stated assets exceeds 20% of total assets of the banking sector, hereinafter – "the large banks"), to continue the operation of credit card issuance during a transitional period of five years. However, these banks may approach customers with respect to the issue of a credit card within a limited time frame not exceeding 45 days prior to the expiration date of the credit card.

- With the aim of increasing competition in the credit card field, the Act requires banking corporations to offer customers the full range of credit cards with no discrimination.

  Moreover, the Act restricts the future market share of each of the credit companies of the large banks to a rate not to exceed 52% of the total of credit cards held by customers of that bank (depending on the number of credit card companies).

  These restrictions shall take effect after the end of two years from date of publication of the Act, and will apply during a transitional period of between three to five years.

- Within the framework of the Act, banking corporations shall be required to reduce by 50% the volume of their credit facilities (exceeding NIS 5,000) granted to their customers via credit cards.

These restrictions are expected to take effect after the end of a four year period from date of publication of the Act, and will apply for a period of seven years.

- The Supervisor of Banks shall continue to supervise credit card companies and regulate their operations.

(b) Increased competition in the field of clearing credit card transactions

- Mitigating terms would be granted to new entities applying for "clearing license", with the aim of increasing competition in the field of clearing credit card transactions.
- Small and medium sized businesses, the annual turnover of which does not exceed NIS 50 thousand, may have the option of incorporating together (within the framework of a "credit union") with a view of reducing clearing fees payable by them to credit card companies.
- Additional entities wishing to engage in clearing services will have the possibility of obtaining clearing services from existing clearing agents, who would be obliged to enter into a binding service agreement with the new clearing agents ("guest clearing agents").
- The ownership structure of Automatic Bank Services Company (hereinafter – "ABS"), which provides clearing services to credit card companies and to users thereof, has been changed so that the rate of ownership of each of the holders of means of control in ABS shall not exceed 10%.

(c) Entry of new competitors into the banking market

- Mitigated rules would be introduced by legislation and regulation allowing the establishment and operation of "credit associations" (the total volume of credit that may be provided by them would be restricted to a maximum of NIS 200 million), which would compete with the retail activity of the banking sector.

- Mitigated terms would be offered to institutional bodies wishing to grant retail loans out of their member funds or out of their equity resources, by way of a model to be examined by the Commissioner of the Capital Market at the Ministry of Finance.
- The activity of off-banking finance corporations would be regulated in a manner that would introduce competition with the banking sector in the field of granting retail credit.

(d) Increasing competition in the banking sector

- Banking corporations will be required, at the request of customers, to present to them the balances and transactions made by hem by means of a technological interface, which provides customers with updated information as to the cost of the banking services regarding their accounts, and would offer them competitive alternatives with other banks.
- With the aim of reducing barriers preventing the entry of new entities into the banking market due to the high investment required for the establishment of technological infrastructure, the Minister of Finance (in consultation with Bank of Israel) will, within nine months from date of publication of the Act, publish a public tender for the setting-up of a technological infrastructure that would provide computer services and their operation to financial bodies. Alternatively, the Minister of Finance would determine rules allowing the provision of computer services to financial corporations. In addition, subject to certain conditions, the Minister of Finance would be granted the authority to instruct banking corporations to provide computer services to other banking corporations at a price to be determined.

(e) Increasing the competitive ability of retail customers

- In order to allow retails customers access to additional sources of finance outside the banking sector, these customers would be given the possibility of creating additional pledge, inferior in degree, on assets already pledged to banks. Banks would be prohibited from objecting to the registration of such additional pledge, where such objection is not based on reasonable grounds. Notwithstanding the above, the other secured creditor would be entitled to realize the additional pledge only with the consent of the banking corporation (which may object to such realization only on reasonable grounds).

Moreover, additional recommendations exist, which were not reflected in the said Act, though additional legislation proceedings are being conducted, intended to allow or implement them, such as:

- Regulating the access of off-banking finance companies to the credit data base, which is to be established under the Credit Data Service Act, 2016 (see extended discussion in Item 6 below).
- The Insurance of Deposits with Banking Corporations Bill, 2015 (see extended discussion in Item F(2) below).
- The Supervision over Financial Services Act (Regulated financial services), 2016, dealing with the establishment of a new financial

regulator, who will supervise financial services , which at the present time are not under supervision or regulation.

- Chapter "I" of the Economic Program Act (Legislation amendments for the implementation of the economic policy for the budget years 2017 and 2018).
- The Supervision over Financial Services (Regulated financial services) (Amendment) (Non-interest bearing deposit and credit services Bill.

Certain of the above mentioned legislation proceedings are not yet in effect and it is unclear what would be the scope of financial services which might be offered by new potential competitors. Accordingly, it is not possible, at this stage, to estimate the implications which the above measures might have on the activity and financial results of the Bank in the future.

(2) Outline for the establishment of a new bank in Israel

As stated in Item 1 above, and as part of the regulatory action taken by Bank of Israel with a view of promoting competition in the banking sector, Bank of Israel published on June 14, 2016, a draft document in the matter of "an outline for the establishment of a new bank in Israel", which was attached as an annex to the recommendations of the Strom Committee.

The draft contains far reaching changes in Bank of Israel's policy, both as to the minimum conditions required from entities wishing to obtain a banking license, and as to the proposed changes in existing restrictions regarding infrastructure and regulation of such entities. These would cause the removal of barriers, which up to now prevented the establishment of new banks in Israel (the entry of which may contribute to increased competition as regards banking services involving the granting credit and acceptance of deposits and to the decrease in the cost of banking services to the retail sector, as a result of the expected expansion in the number of providers of such services).

In addition, the draft contains mitigation in matters of regulation and licensing, relating mainly to new entities wishing to provide banking services, including:

- Small banks (the cumulative total stated assets of which does not exceed 20% of stated assets of the banking sector as a whole) would be permitted to incorporate in order to establish a joint computer infrastructure by means of engagement with a technology supplier.
- Mitigating terms as regards "capital adequacy" would be granted to credit card companies applying for a banking license. Such companies would be required to maintain a minimal "core capital ratio" of only 8% (instead of the present 15% and the requirement for a minimal ratio of 9% in respect of medium and small banks), and a minimal comprehensive capital adequacy ratio of 11.5% (in contrast to the requirement for a minimal ratio of 12.5% in respect of medium and small banking corporations).

- The establishment of new retail banks would be positively considered, subject to the enactment of a legislative infrastructure, which is an essential condition for the licensing of such banks and for the supervision thereof, including:

    - Completion of the legislation regarding deposit insurance.
    - Establishment of a credit data base (serving as a source of information for the new banks).
    - Completion of legislation providing Bank of Israel with tools for dealing with banks in financial difficulties.

Within the framework of the proposed outline the minimum requirements for the licensing of new banks would be reduced, including:

- New banks would be required to produce a minimum equity capital of NIS 50 million only (instead of the present minimum amount of NIS 400 million). However, upon the volume of risk assets of a new bank reaching an amount of over NIS 600 million, the bank would be required to comply with a core capital adequacy requirement of 8% and with a comprehensive capital adequacy requirement of 11.5%.
- The procedure for the granting in principal of a banking license would be shortened to a period not exceeding three months for a credit card company and six months for another new entity.
- Relief would be granted allowing the expansion of banking services provided on-line, thus enabling, inter alia, the establishment of full service digital banks.
- It is the intention of Bank of Israel to allow such digital banks to engage also in the marketing of insurance, with a view of granting economic advantages to such banks enabling them to compete with existing banks (this relief is conditional upon obtaining the approval of the Commissioner of the Capital Market at the Ministry of Finance).
- Following the changes in licensing policy and in regulations, as detailed above, Bank of Israel would be required to develop new models for the supervision and regulation of new and small banks.

Within the framework of the new licensing policy, Bank of Israel has defined a new class of banks – "a retail bank" (operating under a specific licensing framework), which includes the following singular characteristics:

- The bank would provide credit to the retail sector only in amounts not to exceed NIS 4 million per single borrower and for a period not exceeding five years (thus limiting its exposure to credit and interest risks).
- The activity of the bank would be restricted to accepting deposits from and granting credit to individuals and businesses operating in Israel only.
- The bank's investments in securities would be restricted only to issuers having a low risk profile.
- The bank would be permitted to deal in derivative instruments only for the purpose of hedging against risk involved in its core business operations.
- The bank would not be permitted to accept exposure to foreign currency risks.

To date, a binding version of this document has not yet been published. Moreover, the implementation of the instructions stemming from the change in policy, as detailed in the document, involves the completion of legislative and regulatory proceedings.

Accordingly, it is not possible at this stage to estimate the implications of the proposed changes in policy of Bank of Israel on the banking sector as a whole, and on the operations of the Bank in particular.

(3) The Supervision over Financial Services Act (Regulated financial services), 2016

The Act was published on August 1, 2016, and is dealing with the regulation of activity of off-institutional suppliers of financial services ("suppliers of currency services") and of institutional suppliers of credit services.

In accordance with the provisions of the Act, a licensing duty is imposed on engagement in providing financial asset service and in providing credit. The licenses granted under this Act shall be graded in accordance with the scope of operation of the service supplier.

The financial services detailed in the ct would be supervised by a designated financial regulator.

(4) Legislation in the matter of financial services granted by cooperative societies and associations

- **Chapter "I" to the Economic Program Act (Legislation amendments for the implementation of the economic policy for the budget years 2017and 2018), 2016**

  The Act was published on December 29, 2016, and is dealing, inter alia, with the regulation of activities of cooperative societies granting to their members credit and deposit services alongside basic banking services.
  The Act provides for the regulation of the operations of cooperative societies the volume of credit or deposits managed by them does not exceed NIS 1.5 billion.
  The activities of such cooperative societies (engaged also in providing basic banking services) would require licensing and would be regulated by the designated regulator supervising financial services.
  Cooperative societies intending to operate at higher volumes would require a license from Bank of Israel.
  Moreover, the Act contains a legislative infrastructure permitting providers of credit services (as defined in the Act), to issue credit cards with no involvement by banking corporations.

- **The Supervision over Financial Services Bill (Regulated financial services) (Amendment) (Non-interest bearing deposit and credit services)**

The Bill, which passed its first reading by the Knesset on November 21, 2016, deals, inter alia, with the regulation of associations engaged in providing basic banking services (non-interest bearing loans and deposits).
The Bill proposes to regulate the activity of societies engaged in the granting of credit and in accepting deposits in a volume not exceeding NIS 1.5 billion.
The activity of such societies would require licensing and would also be supervised by the designated regulator supervising financial services.

(5) Supervision over Financial Services Act (Legislation amendments), 2016

Within the framework of the action taken by the Government to regulate the activities of financial corporations and to increase competition in the banking sector, the Supervision over Financial Services Act (Legislation amendments), 2016 was published on August 21, 2016, comprising an infrastructure for the formation of a new supervisory authority regarding the activity on the capital market and the financial sector, to be named "the capital market, insurance and savings authority".

This Authority is intended to operate as a separate governmental agency, under the responsibility of the Minister of Finance, acting to promote competition in the capital, insurance and savings markets and in the financial sector, while securing the interests of the insured the members and the customers of the supervised entities, and supervising their proper management, and financial stability of the supervised entities.

(6) Legislation in the matter of "credit data"

- **Credit Data Service Act, 2016**

- The Credit Data Service Act, 2016, which was published on April 12, 2016, implements in practice the recommendations of the Dorfman Committee and establishes a comprehensive arrangement for participation in credit data, within the framework of which financial bodies and public bodies would be required to gather information regarding credit, containing both positive and negative data.
  The collected data would be assembled in a central data base, which would include information regarding households and small businesses and would be under the responsibility of Bank of Israel.
  The guidelines contained in the Act take effect within thirty months from date of publication of the Act.
  The Bank is preparing to implement the guidelines of the Act on their effective date.

- **Draft Credit Data Regulations, 2016**

  The Minister of Justice published on July 17, 2016, a draft of the Credit Data Regulations, 2016, which includes supplementary instructions and specific arrangements not regulated within the framework of the Act

- **Provisional Directive No. 100 in the matter of "the safekeeping of information to be delivered to the credit data base"**

- Following the enactment of the Credit Data Act (hereinafter – "the Act"), Bank of Israel published on June 21, 2016, a provisional directive in the matter of "the safekeeping of information to be delivered to the credit data base", intended to implement the provisions of the Act by means of a central data base to be established and managed by Bank of Israel.

  The provisional directive requires banking corporations and credit card companies (hereinafter – "sources of information") to prepare for the gathering of information to be stored in the data base.
  In addition the sources of information are required to:

  - setup a professional team to take responsibility for the implementation of the guidelines of the Act and of the provisional directive, and for the definition of a plan of action for the collection of information, to be completed until June 30, 2017, at the latest.
  - report to Bank of Israel on a quarterly basis as from September 30, 2016, the progress made in applying the plan.

  The Bank is preparing for the implementation of the guidelines contained in the provisional directive.

B. Legislation regarding "housing loans".

Within the framework of the action taken by the Government intended to moderate the price increases in the housing market, the Ministry of Finance proclaimed an initiative for the construction of housing sites, within the framework of which, housing units are offered for sale at reduced prices (including housing sites under programs such as: "Target price" and " Purchaser price")

In order to enable banks to participate in this initiative, Bank of Israel published on May 1, 2016, an amendment to Proper Conduct of Banking Business Directive No. 329, in the matter of "restrictions of the granting of housing loans", which includes new guidelines intended to facilitate the granting of housing loans by banks in respects of apartments purchased within the framework of the said projects ("apartments at a reduced price" as defined in the amendment to the Directive), including:

- Banking corporations are allowed to base the value of the property on an assessor's valuation (instead on its sale price) subject to value restriction not to exceed NIS 1.8 million, and to the borrower equity restriction of not less than NIS 100 thousand.

- In the case of apartments of a value exceeding NIS 1.8 million, the value of the property would be based on the higher of the assessor's valuation or the sale price.

The guidelines contained in the Directive took effect on date of its publication.

At this stage, no loans have been granted by the Bank in respect of apartments purchased at a reduced price, as stated.

C. Legislation regarding taxes on Income

(1) Reduction in tax rates

The Income Tax Ordinance Amendment (No. 216) Act, 2016, was published on January 5, 2016, whereby the tax rates applying to corporations in Israel were reduced as from January 1, 2016 ("the determining date") from a rate of 26.5% to 25.0%. Accordingly, the statutory tax rate applying to the Bank was also reduced as from the determining date, from 37.18% to 35.90%.

Following he amendment of the Act, as stated, the Bank updated in the first quarter of 2016 the provisions for deferred taxes in accordance with the updated statutory tax rates applying to it in the future. The updating of the provisions for deferred taxes in respect of the said change in tax rates increased the tax expense of the Bank in the first quarter of 2016 by an amount of NIS 8 million.

In the wake of the said legislation proceedings, the Economic Efficiency Act (Legislation amendments for attaining the budgetary goals for the budget years 2017 and 2018), 2016, was published on December 29, 2016, whereby it had been decided to continue and reduce the rate of corporation tax by 1% in each of the years 2017 and 2018, down to a rate of 23% in 2018.

Following the publication of this Act, the Bank updated in the last quarter of 2016, the provisions for deferred taxes in accordance with the statutory tax rates expected to apply upon realization of the deferred taxes.

The update of the provisions for deferred taxes, as stated, increased the tax expense of the Bank in the fourth quarter of the 2016 by an amount of NIS 10 million. In total for 2016, as a result of the said changes in the tax rates, the tax expense of the Bank increased by an amount of NIS 18 million.

(2) Income Tax Ordinance Amendment (No. 227) Act, 2016

The amendment to the Ordinance, which was published on July 14, 2016, contains guidelines regarding the implementation of the FATCA agreement signed in June 2014 by the Government of Israel and the US Government, by which, the Government of Israel has, inter alia, committed to instruct financial institutions in Israel having reporting duties, to examine accounts being conducted with them and deliver to the Tax Authority information regarding customer accounts held directly or indirectly, by US citizens and residents. Moreover, the Government of Israel has committed that the information gathered by the Tax Authority would be delivered to the authorized US agencies. Likewise, the amendment includes provisions allowing the signing in the future of further agreements for the exchange of information.

(3) Income Tax Regulations (Application of the FATCA agreement), 2016

Regulations regarding the implementation of the FATCA agreement between the Government of Israel and the US Government were published on August 4, 2016.

The Regulations state the definitions and duties applying to financial institutions in Israel, including a series of actions that will have to be adopted, such as: the identification of account holders who are considered US citizens or residents for tax purposes, registration on the website of the US tax authorities, conducting due diligence reviews for accounts of individuals and entities and their classification, reporting of reportable accounts or their absence, and informing the customer regarding the delivery of information to the Israeli tax authorities and from them to the US tax authorities. The Regulations provide for exemption from the reporting of accounts of a low value (such as deposits of individuals the amounts thereof do not exceed $50,000). The Regulations took effect on date of their publication.

D. Permission to operate partial and mobile bank branches

A trend is noted in the banking sector in recent years regarding the increase in banking services provided on-line (Including: the use of automatic teller machines for the withdrawal of cash, use of the Internet, use of mobile phone applications, and more), as an alternative to services provided in the traditional manner through the branch layout. In the wake of this trend, a part of the banking corporations began to modify their branch layout by reducing the number of manned teller stations in some of the branches and replacing them by digital instruments.
As a general rule, Bank of Israel supports the transition to on-line banking services, inter alia, due to the potential of reduced costs involved in this format of service.

However, the said format is not suitable for a part of the customer population (such as elderly people) who continue to be in need of service in the traditional manner.

In order to enable banks to provide response to the needs of customers belonging to the said populations or of those living in remote areas in which banking services are not provided due to economic inadvisability, Bank of Israel published on February 28, 2016, a document permitting banks to operate partial branches in different areas, including the granting of banking services by mobile branches.

The permit for such change in the format of banking activity is subject to a preceding discussion by the board of directors of the possible implications arising from such change (including the special risks involved in operating a partial or mobile branch), securing proper conditions for the conduct of banking operations at this type of branches, and to the prior approval by Bank of Israel for the operation of branches in this format.

The Bank is studying the guidelines included in the document.

E. The closing down of branches and reduction in manned teller services

(1) Banking Act (Licensing (Amendment No. 22) (Closure of branches), 2016

A trend is noted in the banking sector in recent years regarding the increase in banking services provided on-line while modifying the branches layout to the changes occurring in the service format.

Following these trends, the Banking Act (Licensing (Amendment No. 22) (Closure of branches), 2016, was published on August 16, 2016, whereby the authority of the Supervisor of Banks has been extended to approve or object to the closure of a bank branch, and to include in his deliberations, upon receiving a request for approval of the closure of a bank branch, also the contribution of that branch to the services provided to the customers or to the business development of the Bank, the volume of its operations, its equity, profitability and the benefit of the public.

At the same time, a banking corporation wishing to close down one of its branches has to submit a reasoned application, to be responded to within 45 days from date of submission. The guidelines contained in the Act state that a banking corporation may close down a branch only after the approval by the Supervisor of Banks had been obtained, as stated, and only following a period of sixty days from date of delivery by the bank of a notice to customers regarding the intended shut down of the branch.

The Act took effect on date of publication thereof.

(2) Proper Conduct of Banking Business Directive No. 400 in the matter of "the closing down of bank branches and reducing teller services"

Following the changes occurring in recent years in the banking sector, including changes in the format of granting banking services, which, inter alia, include transition to on-line banking services and reduction in services granted in the traditional way (through service personnel) accompanied by a reduction in manned service stations and in the number of branches. Whereas these developments might cause difficulties to a part of the customer population (such as handicapped or elderly persons), Bank of Israel published on January 7, 2017, a new Proper Conduct of Banking Business Directive No. 400 in the matter of "the closing down of bank branches and reducing teller services".

The Directive establishes yardsticks to which banking corporations would have to adhere to as a precondition for the implementation of plans involving the reduction in the number of branches or in the number of manned service stations. These include the range of banking services that would be provided to customers following the closing down of a branch, requirements for fair disclosure and preceding action, including:

- The closure of a branch requires a prior application to the Supervisor of Banks and obtaining his approval;
  - The policy of a banking corporation as regards the maintenance of branches and the transition to on-line banking services, have to be established in a designated document being supervised by the board of directors;
  - Management of the bank shall be responsible for the formation and implementation of the policy in this respect;
  - Banking corporations are required to conduct preliminary examinations and form an alternative plan for the granting of banking services as a precondition for taking a decision regarding the shut down of a branch or the discontinuation of banking services by means of personal service. In making such a decision, banking corporations would be required to consider also the potential impact which such a move might have on the different customers of the bank (including customers with special needs, such as: elderly or handicapped persons);
  - Banks would have to verify that the mix and amount of cash available for automatic withdrawal would not differ due to the closure of the branch or reduction in teller services;
  - The transition to digital banking services would be accompanied by instruction provided to customers by designated service agents and the staff of the branch having had appropriate training in the matter;
  - Banking corporations would be required to provide customers with a prior notice of at least sixty days of their intention to reduce teller services or to close down a branch.

Most of the guidelines included in the Directive took effect on date of publication, while the remainder (relating to the format of the notice to customers) will take effect at the end of sixty days from date of publication of the Directive.
The Bank is preparing for the implementation of the provisions of the Directive.

F. Legislation regarding "bank/customer relations"

(1) Debt Execution Act (Amendment No. 50) (Non-charging of interest due to delay), 2016

The Act, which was published on April 7, 2016, establishes a mechanism preventing creditors from unfairly increasing the amounts due to them by intended delay in applying to the Collection and Enforcement Authority (with a view of increasing the amount of interest being accumulated on the debt).

(2) Bank Deposit Insurance Bill, 2015

The Ministers Committee on Legislation Matters approved on January 3, 2016, a private Bill in the matter of "insurance of deposits with a banking corporation", intended to secure bank deposits made by households and to increase competition in the banking sector by providing insurance cover financed by the State for deposits in amounts not exceeding NIS 250,000, deposited with banking corporations, the banking market share of which does not exceed 5%.

It is noted that this issue had also been discussed by the Strom Committee (see Section A(1) above), and it is expected that a Government Bill in the matter would replace the private Bill.

(3) Inclusion of Alert in Advertising and Marketing of Loans Bill (Legislation amendments), 2016

On July 4, 2016, the Knesset passed in first reading the Inclusion of Alert in Advertising and Marketing of Loans Bill (Legislation amendments), 2016.

The Bill proposes to prohibit the encouragement by banking corporations of loan acceptance through advertising or other marketing efforts, unless an alert notice is included warning potential borrowers of legal and other proceedings that might be instituted against them in case of default in repayment of the loan.

(4) Amendment to Proper Conduct of Banking Business Directive No. 403 in the matter of "non-banking benefits to customers"

As part of the regulatory measures adopted by Bank of Israel, which are intended to encourage competition in the banking sector, Bank of Israel published on July 11, 2016, an amendment to Proper Conduct of Banking Business Directive No. 403 in the matter of "non-banking benefits to customers".

The above Amendment includes several mitigating provisions with respect to the existing guidelines, including a guideline permitting banking corporation to grant to their customers non-banking benefits also during the current conduct of the account, with a focus on the encouragement and promotion of digital banking.

The said guidelines took effect on date of their publication.

It is noted in this respect, that on January 19, 2017, Bank of Israel published an amendment to the said Directive, by which it is proposed to require banking corporations to deliver to customers a prior notice regarding their intent to terminate or change an earlier benefit program offered to customers.

(5) Proper Conduct of Banking Business Directive No. 436 in the matter of "initiative for the identification of dormant deposits and accounts of deceased persons"

As part of the regulatory measures adopted by Bank of Israel with a view of setting proper standards in respect of the layout of relations between banking corporations and their customers, Bank of Israel published on September 12, 2016, a new Proper Conduct of Banking Business Directive No. 436 in the matter of "initiative for the identification of dormant deposits and accounts of deceased persons".

The guidelines contained in the Directive provide for the establishment, by means of the Internet, of a central data base accessible to the public, which would include information regarding deposits and accounts of deceased persons or regarding other dormant deposits together with the name of the bank with which such accounts are being held (defined in the Directive as "deposits in respect of which the bank, within a period of two months prior to their maturity date, was not successful in creating contact with the owners thereof". In this respect, a credit balance on current account shall be considered a "dormant deposit" after the passing of ten months from date of the last contact with the owner thereof). Additional information regarding a dormant deposit would be provided to the enquirer by the bank holding the account in question, only after verification of the right of the enquirer to receive such information.

Furthermore, banking corporations are required to include in their Internet website a link to the data base, as well as determine appropriate procedures for the handling of approaches by the public in this matter and appoint a designated function to deal with such approaches.

The guidelines contained in the Directive took effect on date of its publication, and were implemented by the Bank on that date. Within the framework of the implementation of the Directive, the Bank issued an internal procedure regarding guidelines for the handling of public approaches in respect of this initiative and in respect of the format for identification of customers and heirs for the purpose of providing information and the withdrawal of funds.

(6) Granting of capital market services using "technological means"

With a view of reducing barriers preventing customers active on the capital market from obtaining available services, The Securities Authority published on August 23, 2016, a Directive applying to "holders of a license to grant services by use of technological means".

In accordance with guidelines contained in the Directive, customers active on the capital market would be able to obtain on-line services, as follows:

- Engagement in investment consultation or in portfolio management agreements by use of the computer;
- Clarification of needs through an on-line questionnaire;
- Obtaining investment recommendations by use of the computer.

Implementation of the guidelines contained in the Directive is conditional upon the modification of the infrastructure systems of the bank to the new format.

(7) Proper Conduct of Banking Business Directive No. 436 in the matter of "on-line banking"

Bank of Israel published on July 21, 2016, a new Proper Conduct of Banking Business Directive in the matter of "on-line banking" replacing the existing Directive No. 435 in the matter of "telephonic instructions".

The new Directive contains guidelines intended to regulate the granting of banking services through on-line communication with a view of integration of banking services through technological and on-line means. The Directive requires banks to determine operating principles and to update their risk management policies. Moreover, the Directive refers also to the duties of the board of directors and management with respect to the formation of a policy and appropriate risk management principles in this respect.

The guidelines contained in the Directive took effect on January 1, 2017.

Further to these guidelines, Bank of Israel published a draft amendment to the Directive, whereby it is proposed to determine rules allowing a customer to instruct the closure of his accounts by means of the telephone where the outstanding balance is not material.

Moreover, Bank of Israel published on December 20, 2016, an additional draft amendment to this Directive, proposing additional relief to customers wishing to conduct transactions by on-line communication, such as: requesting information or conducting transactions in deposit accounts having balances of less than NIS 1,000.

The draft amendment further proposes to allow banking corporations to open "child long-term savings" accounts under the National Insurance Act, based of identification details delivered to it by the National Insurance Institute using digital means.

(8) Amendment to Proper Conduct of Banking Business Directive No. 420 in the matter of "delivery of information by electronic means"

As part of the regulatory measures adopted by Bank of Israel intended to expand banking services provided on-line, Bank of Israel published on July 27, 2016 an amendment to Proper Conduct of Banking Business Directive No. 420, which enlarges the possibility of delivering information to customers by electronic means instead of by regular mail. In addition, Banking corporations are permitted to send warning notes to customers by SMS or electronic mail.

The majority of the guidelines contained in the amended Directive took effect on date of publication (and were implemented by the Bank on this date), except for items dealing with the delivery of special notices that will take effect on April 1, 2017 and on July 1, 2017.

(9) Waiver of customer signature in certain cases

With a view of increasing competition in the banking sector by reducing barriers that impede customer mobility from bank to bank, Bank of Israel published a document on August 7, 2016, permitting banking corporations to enter into certain agreements with customers (as detailed below), without requiring the physical signature of the customer, but making do instead with obtaining approval by the customer using the Internet website, including:

- General business terms agreement or agreement for the opening of a current account;
- On-line banking agreement;
- Agreement for the deposit of funds fore a determinate period not exceeding one year;
- Securities safekeeping deposit agreement;
- Authorization for the granting of service by telephonic instructions.

On the other hand, Bank of Israel updated the Proper Conduct of Banking Business Directive No. 435 in the matter of "telephonic instructions", adding a guideline requiring banking corporations to establish procedures enabling banking corporations to identify their customers, both upon receiving by means of the telephone a request for the granting of banking services, and upon receiving of the telephonic instruction itself.

The guidelines contained in the document took effect on date of publication thereof (excluding the guidelines relating to engagement in an agreement for instructions received by telephone, which took effect of January 1, 2017). The Bank applies the guidelines as from their effective date.

Following the said guidelines, the Supervisor of Banks issued on December 26, 2016, a draft amendment to the said document, in which it is proposed to allow banking corporations to open a "child long-term savings" account with no requirement for the customer's signature, provided that the request for the opening of the account was received through the National Insurance Institute.

(10) Proper Conduct of Banking Business Directive No. 450 in the matter of "debt collection proceedings"

In the ordinary course of banking business, banking corporations from time to time take steps for the collection of debts of customers being in default of their debt repayments (including legal proceedings).

Within the framework of regulatory measures applied by bank of Israel with a view of introducing appropriate standards regarding relations between banks and their customers, Bank of Israel published on February 1, 2017, a new Proper Conduct of Banking Business Directive No. 450 in the matter of "debt collection proceedings", which states rules and yardsticks for the conduct of banks in this respect, including:

- Banking corporations are required to appoint a designated function for the handling of debt collection, which would carry-out the necessary actions in this respect, while maintaining fair relations between the parties. The activity of this function would be subject to the supervision of management and the board of directors.

- Loan agreements signed by a bank and its customer should include a formula for the computation of interest on arrears that might be charged to the loan.
- The maximum rate determined for interest on arrears may not exceed the maximum rate of interest charged on deviations from approved credit facilities
- Banking corporations are required to send warning letters to all customers who are in default regarding loan repayment as soon as the default arises and prior to instituting legal proceedings against these customers.
- A uniform and simple format is to be established for interest tables submitted by banks to the Debt Execution Office.
- Banking corporations are required to supervise external bodies representing them with respect to debt collection proceedings against their customers ("the representatives") and control their actions.

The guidelines contained in the Directive take effect following one year from date of publication thereof.

G. Legislation regarding commission fees

(1) Amendment to the Banking Rules (Customer service) (Commission fees), 2016

The Amendment to the Banking Rules (Customer service) (Commission fees), 2016, was formally published on July 19, 2016, with the addition of the Banking Order (Customer service) (Supervision over the standard report service at customer request), 2016, both of which regulate different amendments regarding commission fees, including:

- The initiated attachment of a customer, being a senior citizen or a handicapped person to the "basic channel service" (where the nature of the customer's banking operations indicates the advantage of the said commission fee option).
- Prohibition on charging customers with commission fees in respect of the delivery of a single copy of a notice required by legislation.
- Permission to increase the amount of commission fees charged by Banks in respect of the issue of a "letter of recommendation" (being a controlled service) from NIS 15 to NIS 89.
- Reduction in the maximum amount of commission fees charged in respect of a change in the repayment date of a housing loan, to the amount determined for a "teller fee".

The amendments to the said Banking rules and to the Banking Order took effect on August 2, 2016.

(2) Draft Amendment to the Banking Rules (Customer service) (Commission fees), 2008

An updated draft amendment of the Banking Rules (Customer service) (Commission fees), 2008, was published on December 20, 2016. It is proposed by the Amendment to determine reduced commission fees for on-line transactions, in amounts that would not exceed the amounts charged for service provided by a teller.

Moreover, it is proposed to require banking corporations to present on the monitors of automatic teller machines, upon providing cash withdrawal service, information regarding the fee charged for such service.

H. Legislation regarding clearing of credit card transactions

Within the framework of regulatory measures applied by Bank of Israel with a view of increasing competition in the field of financial services, including the field of issuance and operation of credit cards, Bank of Israel published on May 1, 2016, an amendment to Proper Conduct of Banking Business Directive No. 472 in the matter of "clearing agents and the clearing of charge card transactions".

The Directive is intended to remove barriers in the field of charge card transaction clearing with the aim of attracting the entry of new operators into this area, by means of reducing the capital requirements of such newcomers. The guidelines contained in the Directive reduce the capital required from clearing agents who do not have a significant credit activity, which would be based on the volume of their clearing operations (instead of in accordance with the Basel rules).

At the same time, the capital adequacy requirements applying to other clearing agents have also been reduced to a level of 8% (for the Tier I capital adequacy ratio) and to 11.5% (for the comprehensive adequacy ratio) (instead of the minimal capital requirement at the rates of 9% and 12.5%, respectively, stated in the previous Directive).

The guidelines contained in the amendment to the Directive took effect on June 1, 2016.

I. Legislation regarding the prohibition of money laundering

(1) Anti Money Laundering Act (Amendment No. 14), 2016

An amendment to the Anti Money Laundering Act was published on April 7, 2016, by which severe tax offenses were defines as "offenses of origin" for the purpose of the Anti Money Laundering Act, granting the investigation and enforcement authorities additional power with respect to "prohibited property" the source of which is in these tax offenses. The Act states circumstances and terms, including minimum levels, only upon existence of which, tax offences would be considered as "offenses of origin" for the purpose of the Anti Money Laundering Act, 2000.

The provisions of the Act took effect on October 7, 2016. In addition, the investigative powers of the Tax Authority have been extended as well as its entitlement to obtain information from the Anti Money Laundering Authority.

(2) Anti Money Laundering Bill (Amendment No. 19), 2016

Following legislative proceedings in this matter, the Anti Money Laundering Bill (Amendment No. 19), 2016, was published on December 6, 2016, which includes additional guidelines and restrictions in this matter, including:

- Reduction in the minimum amount for the definition of transactions in prohibited property from NIS 150 thousand to NIS 50 thousand. This restriction applies to any type of property.
- It is proposed to permit the Commissioner of currency services and the Commissioner of business service providers to deliver documents to the investigation and enforcement authorities, where such documents are required for the purpose of an investigation.

(3) Circular letter of Bank of Israel in the matter of "preparation for compliance risk management in view of the determination of tax offences as offenses of origin"

Following legislative proceedings in this matter, Bank of Israel published on November 24, 2016, a circular letter which includes guidelines intended to assist corporations in preparations for the implementation of the guidelines contained in the amendment to the Anti Money Laundering Act, as detailed in Item (1) above. According to the guidelines contained in the letter, banking corporations are required to test the need for changes in policy, in assessment of the risk and in their procedures, and bring such changes for discussion and approval by the board of directors, including:

- Testing the changes required as regards the anti money laundering and terror funding policy, with a focus on "know your customer" issues.
- Updating the risk assessment made by the banking corporation
- Testing and defining the mode of action of relevant customers in order to locate accounts, the source of funds deposited therein, might comprise tax evasion by the customer, or income that had not been reported to the tax authorities, as required.
- Testing the implementation in procedures of the bank of updates in policy and in risk assessment regarding this issue.
- Updating of controls and training programs regarding this issue, with reference to changes and updates made to procedures of the bank.

Within the framework of the said guidelines, banking corporations were instructed to obtain clarification from customers regarding the purpose or economic logic of an intended bank transaction (and not be satisfied by presentation of the transaction as "tax planning"), where the bank identifies the transaction as irregular or as included in modes of action defined as above, and this without referring to the minimum amounts determined in the Act. Refusal by the customer to provide details (including a declaration regarding the reporting of his income to the relevant tax authorities), shall comprise reasonable reason for refusing the opening of an account or the management thereof.

The guidelines of the letter took effect on date of publication. The Bank applies these guidelines as from their effective date.

J. Supervision over Financial Services Act (Provident funds) (Amendment No. 15), 2016

The Act, which was published on June 7, 2016, permits provident funds to offer their members a new savings product: "investment provident fund", which allows members to deposit funds in a long-term savings plan (which includes tax benefits) in amounts not exceeding NIS 70 thousand per year. The savings funds (including profits thereon) may be withdrawn at any time by way of a single withdrawal with no tax benefits, or may enjoy tax benefits if withdrawn by way of an annuity. This savings product resembles similar products offered by banks, though not enjoying tax benefits.

The Bank estimates that the introduction of this product may have implications on risk management at the Bank and on the cost of raising deposits.

K. Bank of Israel Bill Memorandum (Amendment) (Financial Stability Committee), 2016

In order to increase coordination between the different financial supervisory authorities, viz,: the Supervisor of Banks, the Capital Market, Insurance and Savings Commissioner at the Ministry of Finance, the Supervisor of off-institutional providers of financial services at the Ministry of Finance and the Securities Authority, the Government published on July 18, 2016, a Bank of Israel Bill Memorandum (Amendment) (Financial Stability Committee), 2016, by which it is proposed to establish a new body by the name of the Financial Stability Committee, which , inter alia, would be engaged in the identification, assessment and monitoring of system risks, control of the financial supervisory authorities, promotion of exchange of information between these authorities and increasing cooperation between them with a view of supporting the stability of the financial sector and its regular operation.

The Committee would be headed by the Governor of Bank of Israel, with the Accountant General at the Ministry of Finance acting as his deputy.

L. Control permit in banking corporations granted to institutional bodies

In accordance with the Banking Act (Licensing), the holding of means of control in a banking corporation at a rate exceeding 5%, requires the prior approval of Bank of Israel (hereinafter – "control permit").

The Supervisor of Banks issued on June 16, 2016, a document containing mitigating terms regarding the previous policy of Bank of Israel on this subject. In accordance with the document, institutional bodies would be permitted to hold means of control in banking corporations included in investment portfolios managed on behalf of their customers, at a rate not exceeding 7.5%, without having to obtain a control permit (but subject to obtaining a prior permit from Bank of Israel), on condition that the investment complies with criteria determined by Bank of Israel.

M. Bank of Israel circular letter in the matter of "accessibility to banking services for handicapped persons – business continuity aspects"

Equal Rights for Handicapped Persons Act, 1998 (hereinafter – "the Act") requires public institutions (including banking corporations) to have their services accessible to handicapped persons (as defined in the Act).

In view of the considerable importance given by the Supervisor of Banks to the implementation of the provisions of the Act, Bank of Israel published on September 27, 2016, a letter stating guidelines for the implementation of the provisions of the Act by banking corporations also in times of emergency and in periods of serious disruption of operations, within the framework of which, banking corporations are required, inter alia, to relate to the following aspects:

- Mapping of "core branches" (modified to operate in times of emergency) accessible to handicapped persons, and granting priority to applying the modifications required for the implementation at these branches of the provisions of the Act.
- Appointment of functions responsible for providing assistance to handicapped customers at branches not yet modified in accordance with the provisions of the Act.
- Inclusion of aspects relating to the special needs of handicapped persons within the framework of emergency drills conducted by banking corporations.

The Bank has completed it preparations for the implementation of the provisions contained in the document.

11. Credit rating

The Bank is being rated by S&P-Ma’alot (hereinafter – "the rating agency"). In view of the profitability data and the satisfactory capital adequacy ratios prevailing at the Bank, the rating agency decided on December 20, 2016, to raise the rating of the Bank by one grade to "AA+" (with a stable rating horizon). Concurrently, the rating of the deferred debt notes of the Bank was also raised by one grade to "AA", which is one grade lower than the rating awarded to the Bank, being the methodology of the international rating agency Standard & Poor's (the parent company of S&P Ma'alot), according to which, deferred debt notes are rated one grade lower than the rating of the issuer thereof.

It is further noted that, in accordance with the methodology of the international rating agency, the Bank has been defined by this agency as a "core company" within the Discount group. This determination creates a unique relation between the rating of the Bank and that of the parent company.

12. Regulatory segments of operation

A. General

In accordance with the instructions in the matter of "reporting segments of operation of a banking corporation", published by Bank of Israel on December 23, 2001, banking corporations were required to include in their financial statements quantitative and qualitative information regarding their banking operations by operating segments.

According to this instruction, an "operating segment" has been defined as a component of a banking corporation having three characteristics:

- The component engages in business activities that might produce income and incur expenses.
- The operating results of the component are being examined on a regular basis by the Board of Directors and Management, in order to evaluate its performance and take decisions as to the allocation of resources to the segment.
- Separate financial information is available in respect of the segment.

Information regarding the distribution of assets, liabilities and business results by segments of operations presented by banking corporations in terms of this instruction, stems from subjective definitions determined by the various banks for each of the segments of operation, in accordance with the specific organizational structure characterizing them.

Whereas there is no uniformity in the distribution of banking activity by segments of operation stemming from this methodology, the disclosure of segments of operations based on these definitions is subjective and is not comparable.

In order to present comparable information in this respect Bank of Israel published on November 3, 2014, an amendment to the public reporting instructions in the matter of "segment reporting".

The amendment to the instructions includes a new guideline, whereby banking corporations are required to include in their financial statements additional information as to their results of operations by "regulatory segments of operations" (in addition to the information provided hitherto in this respect according to "Management's approach").

The regulatory segments of operation have been determined by bank of Israel in the amendment based on the characteristics of their customers, such as: the nature of their activities (in case of private customers) or their business turnover (in case of business customers), in a manner that connects on a uniform and exclusive basis the various customers in the banking sector as a whole and the regulatory segments of operation, as follows:

- **"Households"**: private customers, the volume of their financial asset portfolio is typical to that of households (less than NIS 3 million).
- **"Private banking"**: private customers, the volume of their financial asset portfolio exceed NIS 3 million.

- **"Petty businesses"**: business customers, whose annual turnover is lower than NIS 10 million.
- **"Small businesses"**: business customers, whose annual turnover amounts to between NIS 10 and 50 million.
- **"Middle market businesses"**: business customers, whose annual turnover amounts to between NIS 50 and 250 million.
- **"Large business"**: business customers, whose annual turnover exceeds NIS 250 million.

In addition, the amendment to the instruction has defined a "financial management" segment, which principally includes banking operations that had not been attributed to the other operating segments (such as: trading, asset and liability management, non-financial investments, etc.).

Accordingly, the information presented in the financial statements, based on such definitions, includes financial data, defined, as stated, on a uniform and comparable basis, in respect of each of the operating segments.

The disclosure required by the said amendment is mostly included in the periodic financial statements of all banking corporations, taking effect gradually, as follows:
- The disclosure relating to balance sheet data of the "regulatory operating segments" (as defined in the amendment) took effect on December 31, 2015.
- Other disclosure requirements included in the amendment, took effect as from January 1, 2016 (except for the disclosure required in respect of the financial management segment that becomes effective as from the first quarter of 2017).

For additional information regarding the distribution of credit and deposits at the Bank as of December 31, 2016, and regarding the business results of the Bank by regulatory segments of operation, see Note 27 to the financial statements.

For additional information regarding the operations of the Bank by segments of operation according to Management's approach, based on the organizational structure of the Bank, see Note 28 to the financial statements.

B. Structure of competition in the different segments of operation

(1) Household segment

The household segment is one of the central segments of the Bank, and accordingly, comprises a central goal in the business development of the Bank. This segment is typified by a relatively low risk level, due to the wide spread of credit to customers, and therefore comprises a preferred goal for expansion by other banks in the market (including the large and medium banks), despite the high costs of conducting this operation. Therefore, extensive competition exists between all banks on this customer segment. In facing competition against all other banks on this segment of customers, the Bank approaches customers through different channels conveying messages reflecting the commitment of the Bank for providing qualitative, personal and dedicated service to customers of this segment.

Furthermore, a part of the customers belonging to this segment of operation reside in areas having an absolute majority of non-Jewish population, in which other banks are also active. The Bank competes with these banks on this segment of population by providing a personal and dedicated service by means of employees well versed in the customs and culture of these customers, who provide services adjusted to their special needs. In addition, from time to time, the Bank launches special advertising campaigns directly addressing the population residing in these areas through the local media.

It is noted that different financial bodies (mainly insurance companies and credit card companies) are preparing in recent years for the granting of financial services to customers of this segment (mostly credit services), whether independently or through cooperation with banking corporations.

For further information regarding developments in competition in the retail sector and in the household sector in particular, including expected structural changes both as regards the composition of providers of financial services to customers of this segment and as regards additional information channels that would be available to customers of this segment, stemming from new legislation on this subject – see item (6) below.

(2) Private banking segment

Customers belonging to this segment are characterized by considerable sophistication and by the requirement for service at the highest level. This fact, together with the absence of effective barriers on mobility of these customers, brings about high competition between all banks regarding this segment of customers.

Competition is reflected both as regards prices (commission fees and cost of raising deposits) and as regards service. In addition to the competition in the banking sector, competition exists as regards this customer segment also on the part of other entities active on the capital market, as: portfolio management companies, private brokers, etc.

The Bank faces the increased competition in this segment, both by developing and upgrading of the professional, technological and human infrastructure which it puts at the disposal of customers of this segment, and by offering solutions and attractive terms to customers and by creating cooperation with institutional bodies in this field, including the signing of distribution agreements with mutual fund management companies

Furthermore, in the wake of the exit of banks from the field of institutional management of member funds (including mutual fund management), following the implementation of legislation enacted within the framework of the "capital market reform", which included the sale of assets and investment products of customers mostly belonging to this segment, to insurance companies and other off-banking financial bodies, competition on the part of these entities regarding this segment of customers has increased. As part of the competition with these entities, large resources are being invested in the improvement of service to customers, in raising the professional level of investment consultants, in improving the technological infrastructure and in the updating of investment products offered to customers.

For further information regarding developments in competition in the private banking sector, including expected structural changes both as regards the composition of providers of financial services to customers of this segment and as regards additional information channels that would be available to customers of this segment, stemming from new legislation on this subject – see item (6) below.

(3) Small businesses

This segment is one of the prominent segments of the Bank and accordingly comprises a central goal in the business development of the Bank. Customers of this segment are exposed to competition from all banks in the sector (including the large and medium banks).

Whereas this segment comprises a preferential target for other banks in the sector – extensive competition from other banks exists as regards customers of this segment. In addition, a part of the customers of this segment reside in areas having an absolute majority of non-Jewish population, where other banks compete with the Bank in offering banking services to such customers.

In order to face such competition, the Bank invests resources in advertising, creating personal contacts with customers, providing personal service and finding solutions for all business needs of the customer through providing banking services by employees who are well versed in the customs and culture of customers belonging to these segments of population, and offer them services adjusted to their special needs.

It is noted that different financial bodies (mainly insurance companies and credit card companies) are preparing in recent years for the granting of financial services to customers of this segment (mostly credit services), whether independently or through cooperation with banking corporations (such as: within the framework of "business funds" – see extended discussion in item (7) below).

For further information regarding developments in competition in the retail sector in general and in the small business segment in particular, including expected structural changes both as regards the composition of providers of financial services to customers of this segment and as regards additional information channels that would be available to customers of this segment, stemming from new legislation on this subject – see item (6) below.

(4) Middle market businesses

Customers of this segment are characterized by relatively high business acumen. This, together with relatively low barriers on the mobility of these customers creates an infrastructure for high competition between all banks in the banking sector. This competition is reflected both in prices (interest spreads and commission fees) and in higher exposure levels to credit risk, which competitors are ready to accept.

The measures adopted by the Bank in facing such competition include: improvement in customer service (including availability of service), maintaining personal contact with customers and occasionally by granting price rebates.

(5) Large businesses

Customers of this segment are characterized by the highest business acumen relatively to all other segments of operation. In view of this fact, and due to the absence of effective barriers on the mobility of such customers, fierce competition exists among all banks with respect to this segment. This competition is reflected both in prices (interest spreads and commission fees) and in the level of service being offered.

(6) The impact of legislation on the structure of banking services and on competition in the segments of operation.

- **Increase in Competition and Reduction of Conflict of Interests in the Banking Sector in Israel Act (Legislation amendments), 2016**

  Following legislation and regulation actions taken to increase competition in the banking services field, a "committee for the increase in competition in prevalent banking and financial services" (the "Strom Committee") was appointed on June 3, 2015. The Committee was asked to examine the possibility of introducing into the market of new bodies for the provision of banking services, and to recommend measures that might reduce barriers preventing competition in the banking sector.

  Following the recommendations published in the matter on July 6, 2016, by the Strom Committee, the Knesset passed on January 31, 2017, the Increase in Competition and Reduction of Conflict of Interests in the Banking Sector in Israel Act (Legislation amendments), 2016, which implements the recommendations of the Strom Committee.

  The Act contains guidelines for structural changes with the aim of encouraging additional factors to provide financial services to customers of the retail sector ("households", "small businesses" and "private banking"), as an alternative to services , which hitherto had been provided, mainly, by the banking sector:

  - Directive, in terms of which, the two large banks ("Leumi" and "Hapoalim") would be obliged to sell their holdings in the credit card companies owned by them;
  - Regularizing the activities of "credit societies" engaged in providing retail banking services;
  - With a view of reducing the barriers preventing the entry of competitors into the banking market, the Minister of Finance intends to issue a public tender for the establishment of a technological infrastructure that would provide computer services to financial bodies;
  - The large banks would be required to reduce the volume of credit facilities offered to customers via credit cards:
  - Banking corporations would be required to present to their customers, at their request, the balances and transactions made in their accounts, by means of a technological interface that would provide to customers up-to-date information regarding the cost of banking services charged

to their accounts, and would offer them competitive alternatives at other banks;

- With a view of allowing retail customers access to additional credit sources outside the banking sector, customers would have the possibility of registering an additional pledge, inferior in degree, on assets already pledged by them to banking corporations.

- **Outline for the establishment of a new bank in Israel**

  With the aim of increasing competition in the retail sector, Bank of Israel published on July 14, 2016, a draft document in the matter of "an outline for the establishment of a new bank in Israel", which includes mitigating provisions both as to the entry terms required from bodies interested in obtaining a banking license, and as to existing requirements regarding infrastructure and regulation, which would facilitate the establishment by other bodies of banks that would offer banking services to the retail sector.

- **Regulation of financial services operations by off-banking bodies**

(a) Supervision over Financial Services Act (Regulated financial services), 2016

The Act, which was published on August 1, 2016, deals with the regulation of the activity of entities providing off-institutional financial services ("providers of currency services") and providers of Off-institutional credit services.

According to the provisions of the Act, engagement in providing service in a financial asset and in providing credit would require a license. Licenses granted under this Act shall be graded in accordance with the scope of operation of the service provider.

The financial services detailed in the Act shall be supervised by a designated financial regulator.

(b) Chapter "I" of the Economic Policy Act (Legislation amendments for the implementation of the economic policy for the budget years 2017 and 2018), 2016

This Act, which was published on December 29, 2016, deals, inter alia, with the regulation of activities of cooperative societies offering their members deposit and credit services alongside basic banking services.

The Act provides for the regulation of the activities of cooperative societies, the volume of credit or deposits managed by them does not exceed NIS 1.5 billion.

The activity of such cooperative societies (engaged also in providing basic banking services) shall require licensing and shall be supervised by a designated regulator, who supervises financial services.

Cooperative societies wishing to operate in larger volumes would require a license from bank of Israel.

In addition, the Act includes a legislative infrastructure that would allow providers of credit services (as defined in the Act), to issue credit cards with no involvement by banking corporations.

(c) Supervision over Financial Services Bill (Regulated financial services) (Amendment) (Deposit and credit services that do not carry interest, 2016

The Bill, which passed its first reading by the Knesset on November 21, 2016, deals, inter alia, with the regulation of activities of associations engaged in providing basic banking services (such as: loans and deposits) with no charge of interest. The Bill proposes to regulate the activities of associations granting loans and raising deposits in a volume not exceeding NIS 1.5 billion.

The activity of such associations would require a license and would also be supervised by the designated regulator supervising financial services.

- **Increasing competition by way of expansion of the financial database regarding customers of the banking sector**

(a) Credit Data Service Act, 2016

The Credit Data Service Act, 2016, which was published on April 12, 2016, applies in practice the recommendations of the "Dorfman Committee", establishing a general arrangement for participation in the credit database, within the framework of which financial institutions and public bodies would be required to gather information regarding credit that would include both positive and negative data. The data gathered would be maintained in a central database, which would contain information regarding households and small businesses and would be the responsibility of Bank of Israel.

(b) Provisional Directive No. 100 in the matter of "maintenance of information for delivery to the credit database

Following the enactment of the Credit Data Service Act (hereinafter – "the Act"), Bank of Israel published on June 21, 2016, a provisional directive in the matter of the maintenance of information for delivery to the credit database, designed to implement the provisions of the Act by means of a central database to be established and operated by Bank of Israel.

The provisional directive requires banks and credit card companies to make preparations for the gathering of information that would be contained in the database.

For detailed information regarding all legislation procedures in this respect – see Chapter 10 above.

(7) Developments in competition in the small business segment

Note 24B (14) to the financial statements contains information regarding a tender for the granting of loans within the framework of the "small business fund", published by the Ministry of Finance (hereinafter – "the tender").

This format (the granting of loans in full participation with an institutional body) is designed to allow institutional bodies access to applications and income, being previously the sole domain of the banking sector, thus contributing to the expansion in suppliers of credit and to increased competition in this field.

The Ministry of Finance informed on January 17, 2016, of its decision to choose the bidding of the Bank (and its institutional partner) as one on the successful biddings in the tender. The volume of credit that the Bank (together with its partner) would be allowed to grant to customers in the first stage of the tender, amounts to NIS 660 million (the wording of the tender enables the State to increase the volume of loans, which the bidders successful in the tender (including the Bank) may grant by means of the designated fund, to an amount of NIS 2 billion).

During 2016, the Bank (together with the institutional body) granted loans to customers, within the framework of the designated fund, the balance of which, at December 31, 2016, amounted to NIS 190 million.

appendix no. 1 - Rates of interest Income and Expenses on a consolidated basis and analysis of the changes in interest Income and expenses[(1)]

PART "A" - AVERAGE BALANCES AND INTEREST RATES - ASSETS

	2016			**2015**			**2014**		
	Average balance[(2)]	Interest income	Rate of income	Average balance[(2)]	Interest income	Rate of income	Average balance[(2)]	Interest income	Rate of income
	In NIS millions		In %	In NIS millions		In %	In NIS millions		In %
Interest bearing assets*:									
Credit to the public[(3)]	**21,409**	**[(6)]1,014**	**4.81**	19,593	[(6)]931	4.75	18,022	[(6)]910	5.05
Deposits with banks	**700**	**7**	**1.02**	567	4	0.63	907	9	0.91
Deposits with central banks	**2,706**	**3**	**0.10**	3,194	4	0.13	2,323	13	0.58
Bonds held for redemption and available for sale[(4)]	**4,469**	**33**	**0.74**	3,001	35	1.17	4,620	77	1.66
Trading bonds	**20**	**-**	**1.13**	23	-	1.52	30	2	5.94
Other assets	**4**	**1**	**32.58**	-	-	-	-	-	-
Total interest bearing assets	**28,948**	**1,058**	**3.66**	26,378	974	3.69	25,902	1,011	3.90
Debtors in respect of credit card operations	**420**	**-**	**-**	372	-	-	341	-	-
Other non-interest bearing assets[(5)]	**1,314**	**-**	**-**	1,236	-	-	1,157	-	-
Total assets	**30,682**	**1,058**	**3.66**	27,986	974	3.69	27,400	1,011	3.90
Liabilities bearing assets*:									
Deposits from the public -On call	**2,129**	**-**	**(0.02)**	2,094	(1)	(0.02)	1,871	(2)	(0.13)
Deposits from the public – Time deposits	**18,421**	**(94)**	**(0.51)**	16,864	(77)	(0.46)	18,166	(173)	(0.95)
Deposits from the Government	**155**	**(2)**	**(1.23)**	154	(2)	(1.34)	160	(3)	(1.79)
Deposits from banks	**325**	**(1)**	**(0.22)**	467	(2)	(0.35)	380	(4)	(0.95)
Bonds and deferred debts notes	**860**	**(27)**	**(3.23)**	674	(19)	(2.90)	755	(29)	(3.79)
Other liabilities	**-**	**-**	**-**	-	(1)	-	-	-	-
Total interest bearing liabilities	**21,890**	**(124)**	**(0.57)**	20,253	(102)	(0.50)	21,332	(211)	(0.99)
Non-interest bearing deposits from the public	**5,380**	**-**	**-**	4,545	-	-	3,047	-	-
Non-interest bearing creditors in respect of credit card operation	**420**	**-**	**-**	371	-	-	341	-	-
Other non-interest bearing liabilities[(7)]	**853**	**-**	**-**	841	-	-	*877	-	-
Total liabilities	**28,543**	**(124)**	**(0.57)**	26,010	(102)	(0.50)	25,597	(211)	(0.99)
Total capital resources	**2,139**	**-**	**-**	1,976	-	-	1,803	-	-
Total liabilities and capital resources	**30,682**	**(124)**	**(0.57)**	27,986	(102)	(0.50)	27,400	(211)	(0.99)
Interest margin	**-**	**-**	**3.09**	-	-	3.19	-	-	2.91
Net return[(8)] on interest bearing assets	**28,948**	**934**	**3.23**	26,378	872	3.31	25,902	800	3.09

* The data relates to assets and liabilities of the Bank in Israel and to interest income and expenses generated by them.

appendix no. 1 - Rates of interest Income and Expenses on a consolidated basis and analysis of the changes in interest Income and expenses (continued)

PART "B" - AVERAGE BALANCES AND INTEREST RATES - ADDITIONAL INFORMATION REGARDING INTEREST BEARING ASSETS AND LIABILITIES ATTRIBUTED TO OPERATIONS IN ISRAEL

	2016			2015			2014		
	Average balance[2]	Interest income	Rate of income	Average balance[2]	Interest income	Rate of income	Average balance[2]	Interest income	Rate of income
	In NIS millions		In %	In NIS millions		In %	In NIS millions		In %
Non-linked shekels:									
Total interest bearing assets	**23,777**	**954**	**4.02**	21,500	879	4.09	19,947	873	4.38
Total interest bearing liabilities	**16,189**	**(69)**	**(0.43)**	13,829	(67)	(0.48)	14,906	(129)	(0.86)
Interest margin			**3.59**			3.61			3.52
CPI-linked shekels:									
Total interest bearing assets	**3,369**	**64**	**1.87**	3,155	54	1.71	4,261	100	2.33
Total interest bearing liabilities	**3,344**	**(47)**	**(1.41)**	3,755	(29)	(0.77)	4,046	(74)	(1.82)
Interest margin	**-**	**-**	**0.46**	-	-	0.94	-	-	0.51
Foreign Currency *:									
Total interest bearing assets	**1,802**	**40**	**2.24**	1,723	41	2.37	1,694	38	2.19
Total interest bearing liabilities	**2,357**	**(8)**	**(0.34)**	2,669	(6)	(0.24)	2,380	(8)	(0.35)
Interest margin	**-**	**-**	**1.90**	-	-	2.13	-	-	1.84
Total operations in Israel:									
Total interest bearing assets	**28,948**	**1,058**	**3.66**	26,378	974	3.69	25,902	1,011	3.90
Total interest bearing liabilities	**21,890**	**(124)**	**(0.57)**	20,253	(102)	(0.50)	21,332	(211)	(0.99)
Interest margin	**-**	**-**	**3.09**	-	-	3.19	-	-	2.91

* Including Israeli currency linked to foreign currency

appendix no. 1 - Rates of interest Income and Expenses on a consolidated basis and analysis of the changes in interest Income and expenses (continued)

PART "C" – ANALYSIS OF CHANGES IN INTEREST INCOME AND EXPENSES

	2016 Compared to 2015			2015 Compared to 2014		
	Increase (decrease) due to change		Net change	Increase (decrease) due to change		Net change
	Quantity[9]	**Price[10]**		**Quantity[9]**	**Price[10]**	
Interest bearing assets:						
Credit to the public	**70**	**13**	**83**	75	(54)	21
Other interest bearing assets	**24**	**(23)**	**1**	(57)	(1)	(58)
Total interest income	**94**	**(10)**	**84**	18	(55)	(37)
Interest bearing liabilities:						
Deposits from the public	**(8)**	**(8)**	**(16)**	6	91	97
Other interest bearing liabilities	**(1)**	**(5)**	**(6)**	(1)	13	12
Total interest expenses	**(9)**	**(13)**	**(22)**	5	104	109

Footnotes:

(1) The data is presented after the effect of hedge derivative instruments.

(2) Based on monthly opening balances, except for the non-linked shekels segment in respect of which the average balances are based on daily data.

(3) Before deduction of the average stated balance of allowances for credit losses. Including impaired debts that do not accrue interest income.

(4) From the average balance of trading bonds and of available-for-sale bonds was deducted the average balance of non-realized gains in respect of available-for-sale bonds included in shareholders' equity as part of accumulated other comprehensive income, in the item "Adjustments in respect of available-for-sale securities according to fair value" in the amount of NIS 34 million; (2015 - NIS 75million; 2014- NIS 121 million).

(5) Including derivative instruments and other assets that do not carry interest and net of allowance for credit losses.

(6) Interest income includes fees in an amount of NIS 111 million (2015- NIS 118 million, 2014- NIS 103 million).

(7) Including derivative instruments.

(8) Net return – net interest income divided by total interest bearing assets.

(9) The quantitative impact has been computed by multiplying the present price by the change in the quantitative.

(10) The price impact has been calculated by multiplying the change in the price by the change in the average balance last periods.

Appendix No. 2: Consolidated Statements of Profit and Loss for the Years Ended December 31

Reported amounts (NIS millions)

	2016				2015			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Interest income	**263**	**286**	**278**	**231**	236	263	283	192
Interest expenses	**25**	**48**	**50**	**1**	8	43	76	(25)
Net interest income	**238**	**238**	**228**	**230**	228	220	207	217
Provision for credit losses	**15**	**7**	**19**	**(5)**	57	20	(8)	(2)
Net interest income after provision for credit debts	**223**	**231**	**209**	**235**	171	200	215	219
Non-interest income								
Non-interest financing income (expenses)	**20**	**11**	**3**	**2**	3	(13)	4	43
Fees	**78**	**78**	**75**	**73**	79	76	77	78
Other income (expenses)	**1**	**-**	**7**	**1**	-	33	-	-
Total non-interest income	**99**	**89**	**85**	**76**	82	96	81	121
Operating and other expenses								
Salaries and related expenses	**149**	**143**	**142**	**147**	128	139	129	122
Maintenance and depreciation of buildings and equipment	**38**	**38**	**39**	**39**	39	40	37	36
Other expenses	**46**	**42**	**44**	**43**	41	46	44	40
Total operating and other expenses	**233**	**223**	**225**	**229**	208	225	210	198
Profit before taxes	**89**	**97**	**69**	**82**	45	71	86	142
Provision for taxes on profit	**46**	**38**	**24**	**38**	24	24	34	54
Profit after taxes	**43**	**59**	**45**	**44**	21	47	52	88
Banks net share in the results of investee companies, after taxes	**-**	**1**	**-**	**1**	-	1	1	-
Net profit	**43**	**60**	**45**	**45**	21	48	53	88
Earnings per share (in NIS thousands)								
Stock per share of NIS 0.1	**0.35**	**0.48**	**0.43**	**0.36**	0.17	0.38	0.43	0.71
Stock per share of NIS 0.01	**0.03**	**0.05**	**0.03**	**0.04**	0.02	0.04	0.04	0.07

Appendix No. 3: Consolidated Balance Sheets as at December 31

Reported amounts (NIS millions)

	2016				2015			
	Q4	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
Assets								
Cash and deposits with banks	**3,422**	**2,603**	**4,338**	**5,216**	5,502	5,282	4,894	3,734
Securities	**3,650**	**2,777**	**4,227**	**3,650**	3,432	2,777	2,868	3,296
Credit to the public	**22,349**	**22,280**	**21,859**	**21,264**	20,754	20,580	20,399	19,857
Allowance to the credit losses	**(348)**	**(355)**	**(351)**	**(342)**	(337)	(312)	(299)	(310)
Credit to the public, net	**22,001**	**21,925**	**21,508**	**20,922**	20,417	20,268	20,100	19,547
Investments in investee companies	**9**	**9**	**8**	**8**	7	7	6	5
Buildings and equipment	**342**	**356**	**356**	**358**	346	353	405	420
Assets in respect of derivative instruments	**19**	**22**	**12**	**26**	31	29	21	33
Other assets	**409**	**355**	**395**	**346**	341	396	341	360
Total assets	**32,164**	**31,434**	**30,814**	**30,566**	30,076	29,112	28,635	27,395
Liabilities and shareholders' equity								
Deposits from the public	**27,199**	**26,400**	**25,815**	**25,606**	25,388	24,081	23,774	22,779
Deposits from banks	**259**	**263**	**386**	**376**	459	790	714	461
Deposits from the Government	**149**	**152**	**156**	**159**	151	157	156	159
Bonds and deferred debt notes	**926**	**921**	**920**	**920**	672	672	672	670
Liabilities in respect of derivative instruments	**79**	**102**	**122**	**142**	122	120	149	114
Other liabilities	**1,308**	**1,409**	**1,243**	**1,232**	1,181	1,201	1,120	1,229
Total liabilities	**29,920**	**29,247**	**28,642**	**28,435**	27,973	27,021	26,585	25,412
Shareholders' equity	**2,244**	**2,187**	**2,172**	**2,131**	2,103	2,091	2,050	1,983
Total liabilities and shareholders' equity	**32,164**	**31,434**	**30,814**	**30,566**	30,076	29,112	28,635	27,385

GLOSSARY

Option	A contract between two parties within the framework of which one of the parties (the option writer) grants the counterparty a right to acquire or a right to sell an asset specified in the contract, in consideration for a predetermined price on a date set in advance or prior thereto.
Bond	A security that includes a commitment by the issuer to pay the holder of the security (the bond) the principal specified in the bond with the addition of interest, on the dates prescribed or upon fulfilment of a certain condition (in accordance with the terms prescribed in the bond).
Least developed countries - LDC	Countries classified by the World Bank in a low or medium income group.
Regulatory capital	The capital components used in calculating the stability ratios (e.g., capital adequacy) and consisting of two tiers: a. Tier 1 capital that comprises the accounting common equity after regulatory adjustments (as defined in Proper Conduct of Banking Business Directive No. 202). b. Tier 2 capital that mainly comprises capital debt instruments and other regulatory adjustments.
Indebtedness	Credit and commitments to provide credit (balance-sheet and off-balance-sheet) as defined in Proper Conduct of Banking Business Directive No. 313).
Special mention debt	A debt that has potential weaknesses for which Management's special attention is required, and which, if not attended to, might adversely affect the repayment of the credit or the position of the Bank as a creditor.
Problematic debt	A debt that is classified as "impaired", "substandard" or under "special mention".
Substandard debt	A debt that is inadequately safeguarded by collateral or by the solvency of the debtor, and in respect of which there is a distinct possibility that the Bank will sustain a loss, if the deficiencies are not rectified.
Impaired debt	A debt in respect of which the Bank expects that it will be unable to collect the amounts due to it from the debtor, on the dates prescribed under the debt agreement.
Collateral dependent debt	An impaired debt whose repayment, in the Bank's opinion, is expected from the realization of only the collateral provided to secure the said debt, since the debtor has no other available resources for its repayment.
Total capital adequacy ratio	The ratio of the total capital resources (Tier I and Tier II) to the Bank's total risk assets.
L LCR – Liquidity Coverage Ratio	The ratio between high quality liquid assets and the net cash outflow for the coming thirty days. In a stress test, the ratio serves as an index for the ability of the Bank to serve its liquidity requirements for a future period of thirty days.
Leverage ratio	The ratio (in percentage) between the "capital measurement" and "exposure measurement".
Stated amount of a debt	The balance of a debt, including accrued interest that has been recognized, any premium or discount that has not yet been amortized, deferred net commissions or deferred net costs that have been added to the debt balance and have not yet been amortized, net of any part of the debt that has been subject to an accounting write-off.
Basel rules	Rules for the management of bank risks that have been prescribed by the Basel Committee that deals with supervision and the setting of standards for the worldwide supervision of banks.

Subordinated debt notes	Debt notes, the rights conferred there under are subordinate to claims by the rest of the Bank's creditors, except for other debt notes of the same class.
Off-balance-sheet credit instruments	Debt instruments such as commitments to provide credit and guarantees (not including derivative instruments).
Derivative instrument	A financial instrument or other contract that contains three cumulative features: a. A basis and nominal value that determine the settlement amount of the instrument. b. The net initial investment required is less than that that would be required in other types of contracts that are exposed in a similar manner to changes in market factors (or where no investment is required). c. Its terms require or permit net settlement.
Financial instrument	Cash, evidence of the rights of ownership in a corporation, or a contract that fulfils the following two conditions: a. The instrument imposes a contractual obligation on one party to transfer cash or another financial instrument to the second party, or to exchange other financial instruments with the second party under terms that might be unfavorable to the first party. b. The instrument grants the second party a contractual right to receive cash or another financial instrument from the first party, or to exchange other financial instruments with the first party under terms that might be beneficial to the second party.
Average maturity	A weighted average of the time to the principal repayment and to the interest payments of interest-bearing financial instruments.
Over-the-counter (OTC) derivative	Derivative instruments which are not traded on an official stock exchange and are created within the framework of an agreement between two counterparties.
Counterparty credit risk - CVA (Credit Valuation Adjustment)	The exposure to a loss that might arise if the counterparty to a derivative instrument transaction does not fulfil the terms of the transaction.
Active market	A market in which transactions in an asset or a liability take place with sufficient frequency and volumes as to provide information regarding the pricing of the assets or liabilities on a current basis.
Financing rate – LTV (Loan To Value Ratio)	The ratio of the approved debt facility, at the time of granting the facility, to the value of the asset that secures the debt, as approved by the Bank at the time of granting the facility, which is used in calculating the "capital adequacy".
FATCA (Foreign Accounts Tax Compliance Act	US legislation designed to improve enforcement of tax laws, which states that financial institutes outside the US must report to the US tax authorities any customer accounts managed with them, that require reporting to the US tax authorities, even if the customer is not a US resident.
ICAAP (Internal Capital Adequacy Assessment Process)	The Bank's internal capital adequacy assessment process. The process combines, among other things, setting capital targets, capital planning measures and examining the capital position under a variety of stress tests.