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 2015.
- 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 1B (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 industry – see Chapter 6 B below).

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 79 branches at the disposal of its customers.

The Bank is being rated by S&P-Ma'alot (hereinafter – "the rating company") at an "AA" rating, which was last updated on December 23, 2015.

2. Condensed financial information

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

	For the year ended December 31				
	2015	2014	2013	2012	2011
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Interest income	**974**	1,011	1,128	1,224	1,268
Interest expense	**102**	211	406	495	551
Net interest income	**872**	800	722	729	717
Expense in respect of credit losses	**67**	15	75	35	36
Net interest income, after expense for credit losses	**805**	785	647	694	681
Non-interest income					
Non-interest financing income (expense)	**37**	42	81	7	(47)
Commissions	**310**	313	375	363	368
Other income (expense)	**33**	1	(1)	23	36
Total non-interest income	**380**	356	455	393	357
Operating and other expenses					
Payroll and related expenses	**518**	(1)585	(1)527	479	506
Maintenance and depreciation of buildings and equipment	**152**	(1)150	(1)154	(1)154	(1)149
Other expenses	**171**	(1)167	(1)161	(1)164	(1)165
Total operating and other expenses	**841**	902	842	797	820
Profit before taxes	**344**	239	260	290	218
Provision for taxes	**136**	(1)94	(1)85	(1)101	58
Profit after taxes	**208**	145	175	189	160
Share of the Bank in profits of equity base companies, net	**2**	2	4	-	-
Net profit for the year	**210**	147	179	189	160
Profit per share (in NIS thousands)	**1.69**	(1)1.18	(1)1.44	(1)1.52	(1)1.29
Shares of NIS 0.01 par value	**0.17**	(1)0.12	0.15	0.15	0.13

1. Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs".

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

	December 31				
	2015	2014	2013	2012	2011
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Assets					
Cash and deposits with banks	5,502	4,994	3,757	3,672	3,548
Securities	3,432	3,831	6,154	5,486	5,037
Credit to the public	20,754	19,234	18,157	16,966	16,036
Provision for credit losses	(337)	(319)	(365)	(337)	(320)
Credit to the public, net	20,417	18,915	17,792	16,629	15,716
Investment in equity base companies	7	11	9	5	-
Building and equipment	346	(1)397	(1)406	(1)430	(1)458
Assets in respect of derivative instruments	31	30	24	27	34
Other assets	341	(1)392	(1)335	(1)278	(1)248
Total assets	30,076	28,570	28,477	26,527	25,041
Liabilities and shareholders' equity					
Deposits from the public	25,388	24,060	23,964	22,254	20,981
Deposits from banks	459	492	487	137	148
Deposits from the government	151	139	168	167	157
Subordinate debt notes	672	681	823	923	915
Liabilities in respect of derivative instruments	122	109	140	250	251
Other liabilities	1,181	(1)1,173	(1)1,038	914	830
Total liabilities	27,973	26,654	26,620	24,645	23,282
Shareholders equity	2,103	(1)1,916	(1)1,857	1,882	(1)1,759
Total liabilities and shareholders' equity	30,076	28,570	28,477	26,527	25,041

1. Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs".

C. Principle performance indices

	For the year ended December 31		
	2015	2014	2013
	%	%	%
Income statement financial ratios			
Return on equity	**10.4**	(1)7.8	(1)9.9
Credit loss expense to credit to the public	**0.3**	0.1	0.4
Overall financial spread	**3.2**	2.9	2.5
Operating expenses to income	**67.2**	(1)78.0	(1)71.5
Net interest income to total assets	**2.9**	2.8	2.5
Total income to total assets	**4.2**	4.0	4.1
Total operating and other expenses to total assets	**2.8**	3.2	3.0
Rate of provision for taxes to pre-tax profits	**39.5**	(1)39.3	(1)32.7

	December 31		
	2015	2014	2013
	%	%	%
Balance sheet financial ratios			
Credit to the public to total assets	67.9	(1)66.2	62.5
Shareholders' equity to total assets	7.0	(1)6.7	(1)6.5
Deposits from the public to total assets	84.4	(1)84.2	84.2
Securities to total assets	11.4	13.4	21.6
Deposits from the public to total credit to the public	124.3	127.2	134.7
Financial stability ratios			
Comprehensive capital adequacy ratio	14.0	(2)14.5	(2)14.5
Ratio of Tier I equity capital to risk assets	10.6	(2)10.6	(2)10.5
Liquidity coverage ratio	116.0	-	-
Leverage ratio	6.6	-	-

1. Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Chapter 6 D below and Note 1 D (7-9) to the financial statements.
2. Restated in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Note 1 D (8) to the financial statements.

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.

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 August 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.

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:

- **"Branch method" –** within the framework of which, uniform work procedures and organizational division are implemented at the branches of the Bank, combined with processes and work concepts intended to improve the service to customers.
- **"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.

In addition to the above, the parent company, in cooperation with the Bank, introduced in 2015 a technological project designed to implement at both banks a new credit management operating system. Execution of the project is expected to be completed by the end of 2018.

E. Organizational changes

As stated in Section D above, the Bank has established within the framework of the implementation of the strategic plan, a back office unit that operates in two centers.
The new unit, which operates under responsibility of the Operations and Information Group, employs staff that had previously been employed by the head office and branches of the Bank.

5. Additional information

A. Changes in accounting policy

As from January 1, 2015, the Bank applies the US generally accepted accounting principles in the matter of "employee rights".

In accordance with directives of Bank of Israel, the said accounting principles have been applied by way of retroactive application as from January 1, 2013, and thereafter. Accordingly, the data for periods prior to that date are not comparable with the restated data (for additional information regarding the financial implications of the restated data for the years 2013 and 2014, stemming from the change in accounting policy – see Note 1 D (7) to the financial statements).

B. 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 24 B (6-7) to the financial statements.

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

6. Economic developments and trends

A. Economic developments in 2015

Most economic indicators for the year 2015 point to the continuation of the positive trend in economic development at the end of 2015.

Gross domestic product - According to preliminary estimates of the Central Bureau of Statistics, the gross domestic product rose by 2.3% in 2015, in continuation to a growth at the rate of 2.6% 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 2015 according to these preliminary estimates, by a moderate rate of 0.3%, in continuation of a growth of 0.6% recorded in this item in the previous year.

The Composite State of the Economy Index rose in December 2015 by a rate of 0.2% completing a cumulative increase at the rate of 2.9% in 2015, in continuation to an increase of 2.2% recorded in this item in the previous year.

Despite the increase recorded by this indicator, it points to a certain moderation in economic growth in comparison to the expansion trend existing in the market in prior years.

The business product (other than in relation to public and community services and housing services) rose by 2.1% in 2015, 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 2015 an annualized increase of 6.5%, in continuation of an annualized growth of 2.7%

recorded in this item the previous three months. The rise in the Index derives mostly from the growth in the product of the hybrid technology industries and the hi-tech industries.

Consumption - The turnover index for the retail trade, which serves as an indicator for the demand on the local market, rose in the months of October and November 2015 at annualized rate of 2.7%, in continuation to the rise in this Index at the rate of 0.5% recorded in the earlier two months.

Sales of the marketing chains (comprising about one third of the retail trade turnover) also rose in the last quarter of 2015 by an annualized rate of 0.7%, in continuation to a rise of 0.5% in this Index recorded in the previous quarter.

Foreign trade and the balance of payments

Israel's trade deficit decreased in 2015 by a rate of 38.2% amounting to NIS 30.5 billion.

Imports of goods decreased by 0.6% in 2015 and totalled approximately NIS 238.2 billion. This decrease is mainly attributable to the decrease of 6.6% in the import of energy materials, comprising 12.1% of total imports, and amounting to NIS 28.8 billion, a decrease of 20.6% in the import of raw and polished diamonds, comprising 10.3% of total import and amounting to NIS 24.4 billion, and to the decrease of 47.2% in the import ships and aviation products, comprising 0.3% of total imports, amounting to NIS 0.7 billion. On the other hand, the import of raw materials, which comprised approximately 43.6% of total imports and totalled approximately NIS 103.8 billion, increased by 4.3%, the import of consumer goods comprising approximately 19.5%% of total imports and totalled approximately NIS 46.4 billion, increased by 3.5% and the increase of 4.3% in the import of investment products, comprising 14.2% of total imports and amounting to NIS 33.8 billion, increased by 1.5%.

On the other hand, the seasonally-adjusted trend data point to an increase at an annualized rate of 6.1% in the import of goods (excluding diamonds, ships, aviation and energy products) in the last quarter of 2015, in contrast to a decline of 5.1% recorded in this item in the preceding quarter.

The export of goods in 2015 increased by 0.8%, and totalled approximately NIS 207.7billion. The increase in the export of goods is mainly attributable to a growth of 4.4% in industrial exports, which comprised approximately 84.5% of total goods exported and totalled NIS 175.6 billion.

On the other hand, a decrease of 8.5% was recorded in exports of agricultural, forestry and fisheries products comprising 2.2% of total exports and amounting in 2015 to NIS 4.6 billion. Also, the export of polished diamonds, which comprised 9.4% of total goods exported in 2015 and amounting to NIS 19.5 billion, recorded a decline of 13.1%,.

The seasonally-adjusted trend data also point to an increase of 3.0% on an annualized basis, in the export of goods (excluding diamonds, ships and aviation products) in the fourth quarter of 2015, in contrast to a decline of 4.8% on an annualized basis, recorded in this item for the preceding quarter.

Tourism

In 2015, bed-nights occupancy at tourist hotels recorded a decrease of 2.0% totalling approximately 21.7 million. The decrease in this item is mostly attributable to a decrease of 11.0% in occupancy by foreign tourists and on the other hand an increase of 4.0% in bed-nights occupancy by Israeli residents.

The seasonally-adjusted trend data also point to a decline of 20.0% in the number of tourist bed-nights occupancy and to a decline of 2.0% in the Israeli resident bed-nights occupancy in the last quarter of 2015.

The State Budget

State revenues from taxes and fees increased by approximately 5.4% in 2015, and totalled approximately NIS 268.5 billion.

The increase in State revenues in 20154 is attributable to an increase of 8.2% in revenues from direct taxes totalling approximately NIS 135.4 billion, to an increase of 2.3% in revenues from indirect taxes, which totalled approximately NIS 126.4 billion and to an increase of 11.8% in State revenues from fees and levies totalling NIS 6.7 billion.

A preliminary assessment shows that the total deficit arising from State operations in 2015 amounts to approximately NIS 24.5 billion, comprising 2.2% of GDP. Most of this deficit (NIS 16.4 billion) was recorded in December 2015. Notwithstanding, this data is lower than the maximum deficit target determined by the Government for 2015 (NIS 31.3 billion).

An analysis of the budgetary deficit by Government operations shows that most of the deficit in the amount of NIS 20.0 billion, stems from domestic operations of the Government (excluding the granting of credit), the remaining balance, in the amount of NIS 4.5 billion, stemming from the Government's foreign operations

Employment

According to the trend data for the month of December 2015, the rate of unemployed amounted to 5.2% of the total work-force in the market, comprising a decrease of 0.5 percentage points as compared to the data recorded at the beginning of the year.

The rate of participation in the work-force in December 2015, amounted to 64.0%, comprising a decrease of 0.2 percentage points in relation to the data at the beginning of the year.

Inflation

The Consumer Price Index ("CPI") fell by 1.0% in 2015, in continuation to a decrease of 0.2% in 2014. The decrease in the CPI in 2015 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 1.9%, and the CPI after excluding fruit and vegetables fell by 1.3%.

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 2015. 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 2015 Bank of Israel continued the implementation of the monetary policy adopted by it in the years 2012-2014, and reduced the interest rate in the monetary tender by 0.15 percentage points – to a historical low level of 0.10% only. The lowering of the monetary interest rate stemmed from the strong shekel exchange rate as against foreign currencies, as well as from similar monetary measures taken by other 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 2015, to a rate of only 0.1%, comprising a decline of 0.5 percentage points in comparison with the rate recorded at the end of 2014 (0.6%). These expectations are below than the lower limit of the targeted range of the Government's official inflation target of 1%-3%.

The money supply in 2015 rose by approximately 40.5%, amounting to approximately NIS 277.9 billion.

The exchange rate

A mixed trend prevailed in 2015 in the development of the exchange rate of the Israeli shekel as against most of the leading foreign currencies: against the Pound Sterling it strengthened by 4.6%, against the Japanese Yen by 0.4% and against the Euro the shekel strengthened by a rate of 0.1%.

On the other hand, the shekel weakened against the US dollar the shekel by 0.3%. 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 2015 saw a rise both in share prices on the local equities market (on background of a positive trend being recorded in most markets in the world) and in bond prices (government and corporate) in all linkage segments (except for the CPI linked government bonds market). The rise in prices on the capital market recorded in 2015, comprise the continuation of the trend existing in this market in the previous year.

The positive trend in the equity market has been influenced by several factors, amongst which may be cited the following:

- The lowering of interest rates in the monetary tenders by Bank of Israel during 2015, to a historical low level of 0.1%, on background of the low inflationary environment and similar trends prevailing in the foreign markets –reduced the attraction for less risky investments (bank deposits) and led to the shifting of short-term investment and savings monies to the capital market.

- The rising prices on the overseas equities markets, particularly in the US, on background of signs of recovery of the US economy.

- Decline in unemployment to a rate of 5.2% and the decrease in Government deficit.

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

- Moderation in the growth rate of the Israeli economy, similarly to the trend recorded in the previous year.

- Increase in the level of uncertainty due to the increasing number of security events recorded in the last quarter of the year.

The rise in prices of equities in 2015 was accompanied by growing trading turnovers on and off the Stock Exchange. In total for 2015, trading turnover recorded an increase at the rate of 15.9% to an amount of NIS 1,449 million.

Following the recovery in trading turnovers as stated, and the decline in the rates of return on the riskless market, the volume of funds raised in the primary market increased in 2015 increased by 350% to an amount of NIS 38.9 billion, in contrast to NIS 8.7 billion raised in 2014.

In total for 2015, most share indices recorded price increases. The TA 25 Index rose by approximately 14.4%, and the TA 100 Index rose by approximately 2.0% and the "other shares" Index rose by approximately 26.2%. In contrast, the TA 75 Index dropped by approximately 95.4%

Price increases were also recorded in 2015 in the non-linked government bonds market and in the corporate bonds market while the CPI-linked government bonds market recorded price decreases. In total for 2015, the prices of CPI-linked government bonds had decreased by 0.2% and the prices of non-linked government bonds had risen by approximately 5.8%, and non-linked Government bonds had risen by 2.8%. As of the end of the year, the gross yield to maturity of CPI-linked government bonds ranged from 0.4% for short-term bonds to 1.2% for long-term bonds.

Concurrently, the rates for short-term government loans also increased in 2015 by approximately 0.1%. 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 2015 by 20.6% amounting to approximately NIS 508 million.

The total amount of funds raised by the Government through the medium of bonds (in gross terms) amounted to approximately NIS 38.7 billion, as compared to approximately NIS 51.0 billion in the previous year. Despite the decline in volume of the Government deficit, the net raising of funds was in 2015 at a level of only NIS 5.9 billion, in contrast to the net amount raised by the Government in the previous year of NIS 1.7 billion. Approximately 74.0% of the funds were raised through the medium of non-linked bonds, reflecting an increase of 4 percentage points in comparison to the figure for previous year (70.0%).

In 2015, the component of the asset portfolio of the public invested in the mutual funds declined by approximately NIS 33.7 billion, in contrast to a positive growth of NIS 26.4 billion invested in this investment channel in the previous year. The distribution of amounts deposited with mutual funds by channels of investment shows amounts of NIS 1.5 billion invested in funds specializing in equity investments, and NIS 1.4 billion invested in foreign funds. On the other hand, withdrawals of NIS 2.1 billion were recorded in funds specializing in "Shekel" investments, NIS 26.7 billion were withdrawn from the "monetary" funds, and NIS 7.8 billion were withdrawn from foreign investments funds.

B. Developments in legislation and other directives applying to the banking sector in Israel

(1) The US Foreign Account Tax Compliance Act (FATCA)

In March 2010, the US Tax Authorities amended the US tax laws, including a change in the reporting regime for financial institutions in the US. This included the duty of identifying all accounts of US citizens managed by them (hereinafter – "the FATCA Rules").

Following the publication of these Rules, the Bank, in cooperation with the parent company and external legal advisors, has formed a policy and procedures in this respect. Moreover, the Bank has begun preparations for the implementation of the FATCA Rules, in accordance with milestones defined in these Rules. According to these milestones, new US persons are required, as from the year 2012, to sign appropriate US tax forms and to provide a declaration stating their compliance with reporting duties and waiver of confidentiality. In this respect and in accordance with these guidelines, the Bank has introduced a process within the framework of which US customers are being identified and are required to sign the relevant documents.

Within the framework of the preparations for the implementation of the FATCA Rules, the Bank was registered in March 2014, with the designated online portal of the US Tax Authorities. Furthermore, the Supervisor of Banks published on April 4, 2014, a letter in the matter of the preparations for the implementation of the FACTA Rules, in which banking corporations are required to prepare for the implementation of the US rules, including the appointment of an officer responsible for the matter, the establishment of designated work teams to deal with the implementation of the rules and the formation of a policy, including procedures regarding the manner of implementation of the rules, to be approved by the Board of Directors. In addition, the Supervisor of Banks permitted banking corporations to refuse the opening of a new bank account, or the provision of banking services to an existing account, to the extent that operating such account might expose the banking corporation to a risk of collaboration with a customer in evading the FATCA Rules, without such refusal being considered as unreasonable for the purpose of the provisions of the Banking Act (Customer service). Likewise, banking corporations are required to adopt measures that would increase awareness to the FATCA Rules and their possible implications on bank customers in general and on customers classified as financial institutions in particular.

Following these changes in legislation and agreements reached between the US and Israeli governments, an inter-state treaty was signed on June 30, 2014. Within the framework of this treaty, the State of Israel has committed to initiate legislation requiring financial institutions in Israel to report to the Israeli Tax Authorities accounts belonging to US persons, for the purpose of transmitting the relevant information to the US government.

Concurrently with the signing of the inter-state treaty, Bank of Israel published a letter requiring banking corporations to apply to new bank accounts opened as from that date, the relevant requirements stated in the inter-state treaty.

With a view of regulating banking operations in this matter, including the establishment of an infrastructure enabling banking corporations to comply with the requirements of the inter-state treaty, as stated, the Supervisor of Banks issued on March 16, 2015, a letter in the matter of: "management of the risk involved in cross-border operations". The letter includes guidelines intended to hedge against exposure of banking corporations to risks arising from cross-border operations, including:

- Classification of customers considered as having a significant potential for high risk in respect of their cross-border operations.
- Classification of countries, the transfer of funds to or from which, is considered as having a high potential for cross-border risks being realized (such as countries identified as "tax havens").
- Classification of customers whose identity details had been changed in a manner that might affect their tax liability.
- Customers of banking corporations would be required to declare their country of residence and the tax returns submitted by them in accordance with the law applying in their country of residence.
- In addition, customers would be required to provide the banking corporations in which their accounts are being managed, with waiver letters as to the confidentiality regarding foreign tax

authorities, permitting the banks to provide relevant information to such authorities, if required to do so.

- Banking corporations would be required to determine procedures and hierarchy of authority for the opening of bank accounts and for accepting transactions defined as having potential for cross-border risks being realized.
- Banking corporations would be permitted to refuse providing banking services, including the opening of a bank account to a new customer and continuing the provision of services to an existing customer who refuses to cooperate in this matter with the bank managing his account, in a way that might expose the banking corporation to the realization of a cross-border risk.

Most of the guidelines included in the document took effect on date of publication (March 16, 2015). However, transitional instructions are included in the letter, which permit the gradual adoption of certain of the guidelines, as follows:

- The requirement to classify high risk customers should be completed by December 31, 2015.
- The requirement to classify other customers should be completed by December 31, 2016.

The Bank is a member of the Discount Bank Group. Accordingly, risk management at the Bank, including risk stemming from cross-border operations of its customers, is being applied within the framework of the Group, including the adoption of the guidelines issued by Bank of Israel in this matter, and the determination of policy, work procedures and guidelines concerning work with customers. Further to these acts of legislation, the US Tax Authorities and the US Treasury issued on September 24, 2015, an announcement permitting countries which had not yet completed their preparations for the implementation of the required regulations in this matter, to postpone by one year the date of the first report in accordance with the inter-state treaties (the report should have been submitted on September 30, 2015).

As part of the preparations for the fulfillment of the obligations accepted by the State under the treaties signed by it, as stated, An Income Tax Bill Memorandum was published on June 25, 2015, which includes guidelines in this matter, including:

- The Minister of Finance will be empowered to issue regulations regarding the duties that would be imposed upon an Israeli financial institution which is subject to reporting.
- The Minister of Finance will be empowered to establish in regulations criteria permitting an Israeli financial institution to close an account of a customer, in respect of which no required declarations or reports had been received.
- A financial institution would be subject to monetary sanctions in respect of failure to identify an account holder or failure to submit required information (including a part thereof), relating to accounts managed by it.
- The Tax Authority would be empowered to provide information to tax authorities in other countries in accordance with international treaties.

Amendment No. 207 to the Income Tax Ordinance was approved in December 2015, after being separated from the Economic Efficiency Bill (Legislation amendments for achieving of the budget goals for the budget years 2016-2017), 2015. The said Amendment empowers the Director of the Tax Authority to provide information to a tax authority in a foreign country (subject to certain limitations), in accordance with the "Avoidance of double taxation treaty" and the agreement for exchange of information signed between the State of Israel and a foreign country, for the purpose of enforcing the tax laws of the State of Israel and those of the foreign country. Whereas the exchange of information between tax authorities are based, as a general rule, on the principle of mutuality, use of such power is expected to increase the information in the hands of the Israeli Tax Authority.
As of now, no formal information is available regarding the conclusion of other legislation proceedings in this matter.

In accordance with reports appearing in the media, The US tax authorities had conducted an investigation against Bank Leumi (hereinafter – "Leumi") on suspicion of involvement in tax offences committed by its customers holding US citizenship. According to such reports, Leumi has signed agreements with the US tax authorities giving it the option to pay fines to the US authorities in consideration for their consent not to institute criminal proceedings against it. In this respect, on August 28, 2015, Leumi published on the Internet website of the Securities Authority (MAGNA) an immediate report, which included details of the findings presented in the report on the audit conducted at this bank by the Supervisor of Banks in the matter of "Exposure management of the cross-border risks relating to US customers".

The findings included in the said report, may provide indications as to the regulatory expectations of Bank of Israel regarding the proper criteria that have to be implemented by banking corporations in this respect, including:

- A banking corporation maintaining cross-border activity with foreign customers, must analyze, as a matter of routine, the foreign legislation relevant to its banking activity, identify the risk arising there from, and adopt the necessary measures in order to reduce it to the possible minimum and adapt its policy to the prevailing changes.
- On background of developments that had taken place since 2008 in the approach of the US Administration and enforcement agencies, banking corporations conducting cross-border activity with US customers, are required to map the entire operations and services provided by them to US customers and to identify those which might be considered by the US authorities as aiding tax evasion. This, in order to assess the risks to which a bank might be exposed in respect of such operation, including the legal risk, and take steps required to reduce such risks.
- The duty to maintain a basic process for risk management in this matter is required even where the cross-border activity of a bank with US persons is negligible and of a marginal contribution to its income, as even such negligible activity might create high exposure to the bank.
- In accordance with Israeli law, a tax offence is not an offence of origin under the Money Laundering Act. However, even the absence of duties relating to the examination and reporting of tax issues, does not discharge a bank from the duty of managing its risks in an appropriate manner and of not allowing its banking services to be used for the purpose of tax evasion. Such duty applies in a stricter manner in respect of the bank's US customers, following the actions taken by the US authorities against tax evasion by US taxpayers through the management of their funds outside the United States.
- Responsibility for the review of the policy regarding everything relating to cross-border activity with US citizens, for mapping the operations and services provided by a bank to its US customers, including operations considered by the US authorities as aiding tax evasion, including by way of obtaining a legal opinion in the matter – lies with the management of the banking corporation.

Following these developments, and according to the requirements of Bank of Israel, the Bank has conducted an internal audit in the matter of management of exposure to cross-border risks relating to operations with foreign resident customers.. This audit examined the level of exposure of the Discount Group and of the Bank to such risks. The audit work at the Bank and at the Group has been performed with the assistance of an independent audit firm.

Within the framework of the said audit, the Bank had been asked to relate mainly to the following matters:

- Appropriateness of the management of cross-border risks inherent in activity with foreign residents.

- Appropriateness of the policy, corporate governance performance and the quality of controls applied in all three control circles.

The findings contained in the audit report were discussed by the Audit Committee on June 22, 2015 and by the Board of Directors on June 30, 2015.

In addition, in accordance with a guidance letter received from Bank of Israel on April 20, 2015 (following a group audit conducted in this matter), the Bank was requested to perform an audit relating to the following matters:

- Examination of the policy and procedures applied by the Bank in the matter of preparations for the implementation of the FATCA Rules as from August 2010 (hereinafter – "relevant date").
- Locating customers identified as "US persons" (hereinafter – "relevant customers") who opened an account with the Bank since the relevant date, and examining the manner of operation with them upon the opening of the account and thereafter.
- Determining an operating outline as regards relevant customers, in order to reduce exposure deriving from their being customers of the bank, no later than six months from date of the audit.
- The Audit Committee has to discuss the audit report, its findings and the outline for elimination of differences, as proposed following the audit.

The Bank has performed the audit, as required, and its findings are included in an audit report discussed by the Audit Committee on August 4, 2015.

(2) Regulation of operations involving derivative instruments: the Dodd-Frank Reform (in the US) and the Emir Reform (in Europe)

In the years 2010-2012, two reforms were published in the United States and Eun rope aimed at regulating the activities of banks and financial institutions in matters of derivative instruments, as follows:

- "The Dodd-Frank Wall Street Reform and Consumer Protection Act" (published in the US) (hereinafter – "the Reform").
- "The European Market Infrastructure Regulation ("EMIR") (published in Europe and based on principles similar to those of the reform published in the US).

The reforms include guidelines aimed at reducing credit risk and other system risks deriving from the activity in the derivative instrument market, through the requirement to settle transactions in derivatives entered into with US and European financial institutions through "central settlement agents" being large and central banks.

The Bank, in cooperation with the parent company, is preparing for the implementation of the rules contained in the instructions. Within the framework of these preparations, the Bank mapped differences existing between work procedures and the requirements of the instruction, and examined possibilities of engagement with potential central settlement agents. In addition, the Bank has signed a protocol regulating the work format as regards the settlement of transactions in derivatives of members of the ISDA organization.

(3) Legislation in the matter of bank commissions

(a) Amendment to the Banking Rules (Customer service) (Commissions), 2008 (hereinafter – "commission rules")

Following the publication of the report of the Commission for the Examination of Competition in the Banking Sector (hereinafter – "the Commission"), formed by the Ministry of Finance and Bank of Israel, and which included recommendations aimed at increasing competition in the banking sector and reduce the cost of managing current accounts of bank customers (with an emphasis on "individuals" and "small businesses"), Bank of Israel published in recent years several amendments to the Banking Rules (Customer service) (Commissions) (Amendment), 2015 (the last of which published on January 21, 2015).

The amendments to the Banking Rules include changes both in the definition of customers and in commission pricelists determined in the commission rules, as follows:

- Change in the definitions of "individual customer" and "small business":
  According to the Amendment, the definition of "small business" was expanded to include also corporations the annual business turnover of which does not exceed NIS 5 million (instead of NIS 1 million, previously).
- Relief in the classification rules of "small businesses"
  In order to facilitate the inclusion of customers in the "small business" category, the guideline requiring these customers to present annually a financial report showing their agreement with the required criteria (as required by the prior rules for classification as a "small business") has been withdrawn. According to the new rules, such customers would be required to present one financial report (upon their classification as a "small business"), and to present additional reports only when required to do so by the bank (and on condition that such demand derives from indications in the hands of the bank for prima facie evidence of possible deviation by the customer from the criteria defining this class of customers).
- Reduction in the price of certain commissions:
  Within the framework of the Amendment the price of certain commissions has been reduced and the charging of other commissions has been prohibited, as follows:

  - "Online channel" commission charged in respect of charges to an account through use of an "immediate debit" card, has been cancelled by deleting this commission from the commission pricelist.
  - Banking corporations may charge a commission for the issue of an account ownership confirmation, only as from the second confirmation letter in a calendar year.
  - A bank transfer by means of the RTGS system up to an amount of NIS 1 million has been defined as a "teller operation". Accordingly, the maximum commission amount which may be charged in respect of this service has been limited to the price applicable to such an operation.
  - Banks may not charge a "management fee" in respect of a housing loan.

  The new instructions determined in the amendment to the commission rules take effect gradually as from February 1, 2015 and until July 1, 2015. The Bank has implemented the instructions on their effective dates.

  The data gathered by the Bank in the period since the implementation of the new rules, do not present a full picture, at this stage, regarding the scope of impairment to the income of the Bank. Notwithstanding, based on the data gathered until now, Management of the Bank estimates that the implementation of the new rules and the revised commission pricelist, are expected to reduce the income of the Bank from current account ledger fees by an amount of between NIS 3 and 5 million per year.

Following the above, Bank of Israel announced on January 24, 2916, is intention to map the commission pricelists in the banking sector with the aim of identifying exceptional commissions and take action to reduce them. Inter alia, Bank of Israel intends to hold a discussion on proposals for the reduction of certain commissions, including:

- A proposal for a maximum price of NIS 15 per report, in respect of the service of issuing standard reports at the request of the customer.
- A proposal for a maximum price, in the amount of one "teller commission" per change, in respect of changes made in repayment dates of housing loans.

The Bank is studying the implications involved in such regulation proposals and is preparing for their implementation, if approved in their proposed format. At this early stage it is not possible to assess the implications which such regulation proposals (if approved) will have on the financial results of the Bank in the future.

(b) Declaring the service of "issue of notices to customers" as a "controlled service"

Bank of Israel is of the opinion that the commission prices charged by the banking sector in the past in respect of this service reflect excess profits for the banking corporations. Accordingly, Bank of Israel amended on May 10, 2015, the Banking Order (Customer service) (Regulation of notices and warning letters service), 2015, defining such service as a "controlled service", which limits its maximum price to only NIS 5.

The amended Order was formally published on May 31, 2015, and took effect on July 1, 2015. At this stage, the Bank does not have as yet, complete data regarding the implications on the Bank's financial results in the future stemming from the implementation of the Order. Management of the Bank estimates, however, that the said amendment to the Order will reduce the future income of the Bank from current account ledger fees by an amount of NIS 10 to 15 million per year.

(c) Legislation in the matter of "commission channels"

In the recent years, Bank of Israel is advancing legislation procedures in the matter of "commission channels", as an alternative method for computing income from current account management services provided by banking corporations.

With the aim of increasing awareness of the public to the advantages offered by the new outline ("the channel method") to bank customers – Bank of Israel issued on June 21, 2015, a new Proper Conduct of Banking Business Directive (No. 423) in the matter of "channel service".

In accordance with the guidelines contained in the Directive, banking corporations have to take action in order to make their customers aware of the "channel method", as follows:

- Upon the opening of a new current account, banking corporations are required to provide the customer with a condensed pricelist regarding the costs involved in the management of a current account, including explanatory material in respect of the "channel service". This material should include details regarding the cost of each of the channels being offered by the bank, in comparison with a separate computation in respect of each of the services included in these channels. In addition, the explanatory material should include information regarding the manner of joining the "channel service" offered by the bank.

- In addition, upon the opening of an account, banking corporations are required to obtain from the customer a confirmation regarding the method preferred by him for the computation of the fees involved in the management of his current account: the "channel method" or the computation of a separate cost in respect of each bank transaction ("pay as you go" method).
- Banking corporations are further required to provide existing customers wishing to join the "channel method", information in writing as to the amount of fees charged to them during the quarter preceding the date of request – with the aim of providing them the possibility of making an intelligent decision regarding the method of fee computation that would be most beneficial to them, based on the characteristics of their banking activity.
- In addition, banking corporations are required to publish on their Internet website a link to the explanatory page regarding the "channel service"

Concurrently with such legislation steps, Bank of Israel published on May 18, 2015, guidelines intended to ensure that the information regarding the "channel service" is presented to customers in the best possible manner. Within the framework of these guidelines banks are required to:

- Locate potential customers for joining the channel method (customers who had paid at least NIS 10 in respect of current account ledger fees in each of the first five months of the year, or at least NIS 50 for the whole period).
- To provide such customers with information in writing regarding the amount of fees paid by them for current account management in that period, in comparison with the price that would have been paid under the "channel method", while noting the number of transactions made by them (differentiating between "teller transactions" and "online transactions"), and detailing the manner offered to them for joining the "channel method".

The guidelines of Bank of Israel took effect on August 1, 2015, and were implemented by the bank on that date.

Further to that stated above, Bank of Israel issued on January 24, 2016, an announcement of its intention to join senior citizen and handicapped customers to the "basic commission channel". Banking corporations would be required to locate among their customers senior citizen customers or handicapped customers (not yet members of one or the other "commission channels"), the transfer of whom to the "basic channel" might reduce their banking costs (based on computations made by the banking corporations).

It is the intention of Bank of Israel to require banks to initiate the transfer of such customers to the "basic channel", following an advance notice to them.

Binding legislation proceedings have not yet been formed in the matter, and at this stage, the Bank has no data regarding the expected implications on the Bank's future income stemming from such action. However, preliminary assessments made by the Bank's Management show that the effect of the proposed change in rules on the income of the Bank is not expected to be material.

(d) Legislation initiatives for changes in commission rules

- **Legislation in the matter of commission rules**

Further to the legislation initiative described above, and the intention of Bank of Israel to initiate additional legislation with the aim of easing the burden regarding households and small businesses by reducing the cost of managing current accounts – an amendment to the Commission rules was published on July 28, 2015, by which the prices of additional commissions were reduced, as follows:

- Banking corporations are prohibited from charging a commission in respect of dishonored checks to customers depositing these checks – this, by deleting this service from the commission pricelist contained in the commission rules.
- Prohibition on the charging of card fees for an immediate debit card.
  Following the announcement published by Bank of Israel on February 10, 2015 (see Section 4 below) regarding "encouraging the use of immediate debit cards", it has been decided to prohibit banks from charging card fees in respect of such cards issued to customers to whom the bank had also issued a credit card.

The guidelines contained in the amendment to the commission rules took effect gradually in the period from February to July 2015, and have been applied by the bank on their due dates.

At this early stage it is not possible to accurately assess the effect of such legislation on the income of the Bank. Management of the Bank estimates, however, that the implementation of the new rules might reduce the future income of the Bank from commissions by an amount of between NIS 3 to 5 million per year.

- **Amendment to the Banking Order (Customer service) (Control over the service of purchase, sale and redemption of securities traded on the Tel Aviv Stock Exchange), 2016**

  As part of the action initiated by Bank of Israel for the regulation of commissions, it is proposed to define the services included in this Order as "controlled services" and determine a maximum price in their respect that would not exceed 0.4% of the amount of the relevant transaction.

  The Bank is studying the implications of these proposed changes and is preparing for their implementation on the dates that would be determined upon completion of the legislation process.

  At this early stage it is not possible to accurately assess the expected effect of such proposed legislation on the future income of the Bank. Management of the Bank estimates, however, that the income of the Bank is not expected to be materially impaired as a result of the proposed changes.

- Private legislation initiatives regarding commissions:

  Several private Bills have been tabled before the Knesset in the matter of bank commissions, including:

  - **Banking Bill (Customer service) (Amendment – cancellation of commission for change in repayment date of a housing loan and limiting the price of commissions), 2015**

This private Bill was tabled before the Knesset on May 15, 2015, proposing to regulate the charging of certain commissions relating to housing loans included in the Banking Act, including the proposal to prohibit the charging by banking corporation of commissions in amounts exceeding the value of the transaction in respect of which the service had been provided (including the prohibition to charge commissions in respect of the withdrawal of a permanent payment order in an amount exceeding that of the order).

- **Banking Bill (Customer service) (Amendment – cancellation of commissions on basic services relating to current accounts), 2015**

  This private Bill was tabled before the Knesset on May 4, 2015, proposing to amend the Banking Act with the aim of prohibiting the charging by banking corporation of commissions in respect of basic services provided in respect of current accounts of customers, including the prohibition of charging any "minimum commission".

As of now, these legislation proposals have not been approved, and at this stage it is unclear whether they would in fact become binding legislation.

Management of the Bank estimates, however, that if these Bills are passed as read, the Bank's income from current account ledger fees are expected to be materially impaired.

Following is a summary of the implications on the Bank's income from commissions (annualized) stemming from the above legislation initiatives, based on data gathered by the Bank during 2015:

- Change to the "channel method" – NIS 1-2 million.
- Legislation regarding immediate debit cards – NIS 3-5 million.
- Determination of the "notice to customer" service as a controlled service – NIS 10-15 million.
- Prohibition of the charging of commission on return of checks to the depositor – NIS 2-3 million.

(4) Legislation in the matter of "immediate debit card"

The Government of Israel initiated in recent years regulatory actions intended to increase enforcement as regards the collection of taxes, inter alia, by means of limiting the use of cash in settling transactions in large amounts, and by recommending the use of immediate debit cards as an alternative to the use of cash.

In continuation of the Government initiatives, the Knesset approved on July 27, 2015, in first reading, the Bill reducing the use of cash, which adopts the recommendation of the Commission formed by the Government in this matter ("the Locker Commission").

Concurrently with these actions, Bank of Israel published on February 10, 2015, a document defining the immediate debit card as a "bank shelf product", to form an integral part of the management of a current account.

Further to this document, Bank of Israel published on March 8, 2015, an announcement that includes the outline designed to increase awareness to the use of an immediate debit card, as well as complementary practical steps encouraging the absorption of this product, including:

- Banking corporations will be required to offer immediate debit cards to all customers having current accounts, this by an initiated approach no later than June 30, 2016.
  The banks will have to report to Bank of Israel in a detailed quarterly report, regarding the action taken by them in this respect and regarding the scope of distribution of these cards.
- Banking corporations will not be allowed to charge a fee in respect of the issue of an immediate debit card to customers holding a credit card issued by the bank.

In addition, Bank of Israel initiated the following legislation proceedings in this matter:

- **Amendment of Proper Conduct of Banking Business Directive No. 470 in the matter of debit cards**

  The above amendment regarding immediate debit cards was published by Bank of Israel on June 29, 2015, and includes new guidelines designed to encourage the use of these cards, including:

  - The requirement to transfer the consideration due to a trading house in respect of transactions paid for by use of an immediate debit card – within three business days from date of the transaction at the latest.
  - Transactions made by use of an immediate debit card shall be recorded in the current account of the customer soon after consummation of the transaction and shall be presented separately from other transactions.

- **Draft amendment to the Banking Order (Customer service) (Control over the service provided by an issuer to a trader regarding the cross-clearing of immediate debit transactions) (Provisional instruction), 2015 (hereinafter – "the Banking Order")**

  With the aim of encouraging the use of immediate debit cards, it is proposed to amend the Banking Order and limit the amount of the clearing commission in respect of transactions made by use of such cards, to a maximum rate not exceeding 0.3% of the amount of the transaction.

  The rules contained in the Banking Order are expected to take effect on May 1, 2015. However, as yet these rules have not been approved as binding.

  The scope of future use of this product depends on the readiness of customers to change their consumption habits and adopt the use of a different banking product.

  Accordingly, it is not possible at this stage to assess the implications that the planned distribution of the new product might have upon the Bank's operations and financial results in the future. Notwithstanding, Management of the Bank estimates that the implementation of these guidelines is expected to reduce the income of the Bank from credit card fees, on the one hand, though may increase the interest income of the Bank, due to earlier charges to current accounts, on the other hand. The amount of the Bank's income in 2015, from service fees to holders of immediate debit cards, totaled approximately NIS 1 million.

- **Guidelines regarding expanding the issue of immediate debit cards**

  Further to the above legislation, Bank of Israel published on June 29, 2015, guidelines whereby banking corporations were required to act in order to expand the issue of immediate debit cards, as follows:

- Upon the opening of a new current account, banking corporations would be required to offer the customer an immediate debit card.
- Bank would be required to approach also existing customers until December 31, 2015 at the latest, offering them immediate debit cards.
- In parallel, banks are required to form an effective policy and clear work procedures supporting the above guidelines.
- Banks are not permitted to charge card fees in respect of immediate debit cards issued to customers holding also credit cards – for a period of not less than thirty-six months from date of issue of the immediate debit card.

In addition, banks are required to submit to Bank of Israel, as from January 1, 2016, quarterly reports regarding the progress made in the distribution of immediate debit cards.

(5) Legislation regarding bank-customer relations

Within the framework of regulating measures adopted in recent years by Bank of Israel, with the aim of improving the confidence of the public in the banking sector (as part of the process for determining standards that would ensure the provision of proper service to bank customers), and simplify cumbersome directive creating barriers impeding competition in the banking sector – Bank of Israel published in the reported period clarification documents and amendments to Proper Conduct of Banking Business directives, as follows:

(a) Proper Conduct of Banking Business Directive No. 454 in the matter of premature redemption of a non-housing loan

The rules determined in the previous Directive in the matter of commission charged in respect of the premature redemption of non-housing loans, created a link between the computation of commission applied in the case of premature redemption of housing loans and the parameters used in determining the commission in respect of the premature repayment of non-housing loans – only where loans in amounts not exceeding NIS 750 thousand were concerned, leaving room for discretion where other loans were concerned.

With the aim of narrowing this room for action and introducing higher standardization of the mechanism for computing the premature redemption commission, Bank of Israel published on June 21, 2015, an amendment to Proper Conduct of Banking Business Directive No. 454 in the matter o the premature repayment of non housing loans, including:

- The class of non-housing loans in respect of which banks will have to apply the commission computation formula applied in the case of premature repayment of housing loans has been expanded to include loans granted to private individuals and small business of whatever type.
- The rate of the "reference interest" comprising a component of the computation of the premature repayment commission has been changed from: "the interest rate prevailing at the bank" (determined in the earlier rules, to "the most recent published rate of interest" (similarly to the rules applied in the computation of the commission in respect of premature repayment of housing loans).

The ruled determined in the Directive become effective on April 1, 2016.

The Bank is preparing for the application of the rules on their due date. However, at this early stage, it is not yet possible to assess the implications of these guidelines (upon taking effect) on the income of the Bank.

Management of the Bank estimates that the implementation of the above mentions rules will not have a material effect upon the interest income of the Bank.

(b) Providing information to customers regarding differences in interest rates

Prima facie findings of examinations performed by Bank of Israel show that certain banks offer their customers to deposit funds in bank deposits by means of a permanent order, despite the fact that they have a debit balance on their current accounts, and this without providing them information regarding the difference between the return on the deposit and the cost of credit on a current account.

Bank of Israel is of the opinion that such a procedure is in contrast to Section 3 of the Banking Act (Customer service), 1981, which prohibits banks from performing operations that might mislead their customers in any matter material to the granting of service.

Accordingly, and with the aim of establishing banking procedures matching the required standards, Bank of Israel published on January 2015, a clarification document that includes guidelines in this matter, including:

- The requirement to provide information regarding interest rate differences existing between credit products and deposit products, to customers wishing to deposit funds in a bank deposit while their current account shows a debit balance, and this prior to making the deposit.
- Such information will be provided in writing to customers who had given a permanent order for the deposit of funds in a bank deposit while their current account shows a debit balance.
- Banking corporation may not initiate approaches to customers having a debit balance on their current account, for the deposit of funds in bank deposits.

The Bank implements the guidelines contained in the clarification document as from their effective date.

(c) Waiver of customer signature in certain cases

In order to increase competition in the banking sector by way of reducing barriers regarding the movement of customers between the different banks, Bank of Israel published on January 4, 2015, a document permitting banks to enter with customers into certain agreements (detailed below) by obtaining the consent of the customer through the Internet rather than requiring the customer to physically sign the agreement:

- General business terms agreement or agreement for the opening of a current account.
- Agreement for the depositing of funds in a fixed-term deposit for a period not exceeding one year.
- Authorization for providing service by telephone calls.

On the other hand, Bank of Israel revised Proper Conduct of Banking Business Directive No. 435 in the matter of orders through telephone calls, by including a guideline requiring banks to implement procedures by which a bank would identify the customer both at time of receiving the request for telephonic orders and upon receiving the order itself.

Following these measures, Bank of Israel published in January 2016, a new draft amendment, proposing to apply these reliefs also to agreements for the granting of credit, for securities deposits and for the request for an ATM card for banking transactions.

The Bank, in cooperation with the parent company, is preparing for the development of technological means complying with the requirements of bank of Israel in this matter.

(d) Draft of a new Proper Conduct of Banking Business Directive in the matter of "online banking"

On January 31, 2016, Bank of Israel published a draft Proper Conduct of Banking Business Directive in the matter of "online banking" aimed at replacing Proper Conduct of Banking Business Directive No. 435 in the matter of "telephonic orders".

The new draft Directive contains guidelines aimed at regularizing the provision of banking services through communication banking, in order to allow the integration of bank services by way of technological means and online channels.

The draft Directive requires banks to determine operating principles and to revise their risk management policies in this matter.

In addition, the draft relates also to the duties of the Board of Directors and Management regarding everything relating to the formation of appropriate policy and principles for risk management in this matter.

(e) Draft amendment of Proper Conduct of Banking Business Directive No. 420 in the matter of "providing information by electronic means"

Within the framework of the regulation initiated by Bank of Israel, designed to expand banking services provided through online communication, Bank of Israel published on October 13, 2015, and on January 31, 2016, draft amendments of Proper Conduct of Banking Business Directive No. 420, proposing the possibility of permitting banks to send to customers notices as well as documents for effecting transactions, also by electronic means instead of by ordinary mail.

In addition, it is proposed to allow banks to send to customers warning notices by means of SMS messages or by electronic mail.

The bank is studying the guidelines contained in the draft amendment and is preparing for their implementation upon them taking effect.

(f) Draft amendment of Proper Conduct of Banking Business Directive No. 418 in the matter of "the opening of account via the Internet"

The draft amendment published by Bank of Israel in January 2016, contains guidelines for the expansion of the variety of operations that may be effected via the Internet, among other, it is proposed to enable an individual owning a business to enter, via the Internet, into an agreement for obtaining credit card clearing services.

(g) The electronic clearing of checks Act, 2016

With a view of improving the efficiency of the present practice for the clearing of checks, by eliminating the need to physically send the checks from the collecting bank to the drawee bank and for the safekeeping of the paid checks – the Knesset passed on February 1, 2016, the Electronic clearing of checks Act, 2016.

The Act regulates the electronic clearing of checks in the banking sector, including the duty to present checks for payment between banks by electronic means.

The guidelines contained in the Act will take effect six months after the publication of the Act.

Notwithstanding the above, the Act determines a period of preparations of additional eighteen months, following the effective date if the Act, in order to allow banks to clear checks by one of the two methods in parallel (by the present method – based on the previous regulations, or by the new method – based on the new rules).

(h) Location of dormant accounts initiated by Bank of Israel

In October 2015, Bank of Israel announced its intention to establish, through the Internet, a data base for dormant deposits and accounts of deceased persons held by banks.

Further to this announcement, Bank of Israel issued a requirement to banking corporations, on November 18, 2015, for information regarding dormant deposits held by them, differentiating between deposits with no communication with their owners and deposits of deceased persons.

The Bank is preparing for providing the said information.

(i) Draft Proper Conduct of Banking Business Directive No. 450 in the matter of "procedures for the collection of debts"

In the ordinary course of business, banks apply from time to time procedures for the collection of debts from customers who had failed to pay their debt to the bank (including the application of legal proceedings).

As part of the regulation applied by Bank of Israel with the aim of establishing proper standards for the framework of relations existing between banks and their customers, Bank of Israel published on May 18, 2015, a draft of a new Proper Conduct of Banking Business Directive No. 450 in the matter of "debt collection procedures", proposing to establish rules and yardsticks for the conduct of banks in this respect, including:

- Banks would be required to appoint a designated function for the handling of collection of debts, which would conduct the required actions in this respect while maintaining fairness of relations between the parties. The activity of this function is to be supervised by the Board of Directors and Management.
- The loan agreements signed by a bank and its customers shall include a formula for the computation of the arrears interest charged on the debt.
- The maximum rate of the arrears interest shall not exceed the maximum rate charged by the bank in respect of deviation from approved credit facilities.
- Banks would be required to send a warning letter to all customers failing to pay their debt, proximate to date of failure, and prior to any legal proceedings instituted against such customers.
- It is proposed to establish a uniform and simple format for the interest tables submitted by banks to the debt execution office.
- It is proposed to require banks to maintain supervision and control over the outside entities representing them (hereinafter – "the representatives") in the debt collection process against customers. This supervision is to include:

- Obtaining computerized monthly reports from the representatives.
- Involvement of the bank in any request of the customer for a debt arrangement presented to the representatives.
- Performance of an audit of the representatives, at least at yearly intervals.

The guidelines contained in the draft, were intended to take effect on January 1, 2016. Notwithstanding this, representatives of the Supervisor of banks informed at a discussion held at Bank of Israel on October 15, 2015, that they intend to publish an amended draft. Accordingly, a delay is expected in date of implementation of the new Directive.

(j) The Pledge Bill, 2015

The Bill passed its first reading by the Knesset on July 27, 2015. It contains material changes in respect of the pledge laws in effect at present, including:

- It is proposed to allow debtors to create additional pledges on a pledged asset, without obtaining the consent of the existing pledge holder.
- It is proposed to enable debtors to create a pledge on future assets, including such not yet in existence or which have not as yet come into the hands of the debtor.
- It is proposed to disallow the creation of floating pledges.
- New ways are proposed to improve a pledge (not by way of registration).
- New ways are proposed for the pledge of securities and deposits.
- It is proposed to make changes in the order of preference between the different creditors, in accordance with the type of the pledge.
- It is proposed to allow the exchange of one pledge for another.

At this stage it is unclear whether the provisions of the Bill would be approved as read at the end on the legislation process. Accordingly, it is not possible at this stage to assess the implications that implementation of the provisions of the Bill might have on the operations of the Bank in the future.

(k) Insolvency and Economic Rehabilitation Bill Memorandum, 2015

The Committee of Ministers on Legislation Matters approved on January 17, 2016, the Memorandum of the Insolvency and Economic Rehabilitation Bill, comprising a comprehensive reform in insolvency proceedings of individuals and corporations. The Memorandum includes material changes of the existing rules in the matter, including:

- A proposal to cancel most of the preferential debts.
- A creditor secured by a floating pledge, would be entitled to a repayment not exceeding 75% of the value of the pledged assets. The balance of the pledged assets would serve as a source for repayment of debts due to the unsecured creditors.
- The changes included in the Bill Memorandum would apply only to credit granted after the date of approval of the Bill.

The legislation proceedings regarding the above mentioned Bill have not as yet been completed and no date for their entry into effect has been proposed. Not withstanding the above, Management of the Bank estimates that approval of the Bill in its present form may lead to an increase in expenses of the Bank from credit losses.

(l) Guideline in the matter of "initiated approach offering credit to retail customers"

Following the significant growth in the volume of retail credit granted by the banking sector, Bank of Israel published on June 23, 2015, guidelines aimed at ensuring that the credit offered to retail customers (within the framework of initiated approaches by the banks) is adapted to their needs. The guidelines require banks to apply the following measures:

- Determination of policy, procedures and proper processes regarding this field, including:
  - Defining the target population for an initiated approach offering credit, based on indicators rating the risk related to the customer, with reference to the considerations of the customer as to the advisability of the credit offer.
  - Determination of defined conversation scenarios, which would include disclosure of the credit terms and reference to the needs of the customer, including noting the assets and liabilities of the customer with the bank and the return earned in their respect.
  - The approach to the customers would be documented including information regarding the function making the approach, the contents of the approach and the response of the customer. In this framework, banks are required to record approaches made by phone calls or by similar means.

- The above guidelines have to be integrated in the work plans of the compliance officer, the legal advisory group and the internal audit.

As required, the Bank submitted for review by bank of Israel the policy and work procedures documents formed by it in the matter.

In continuation to these guidelines, the Deputy Supervisor of Banks published on November 17, 2015, an additional letter, whereby the requirement to record phone conversation, as above, is replaced by a requirement for a detailed documentation of such conversations. In addition, the board of directors and management of a bank are required to verify that the "loan marketing" process is conducted in a fair manner and that the loans offered to customers are indeed in accordance with their needs.

(m) Letter of Bank of Israel regarding the removal of pledges where the related credit had been repaid

Following a class action, which is being conducted against several banks (not including the Bank) in the matter of the removal of pledges securing credit that had been repaid, Bank of Israel has performed a sample test in the matter at the defendant banks, in order to determine the scope of the issue, which, on the face of it, contradicts the provisions of Section 9(a) of the Banking Act (Customer service), 1981.

On August 31, 2015, Bank of Israel published a letter regarding the findings of the sample test. These findings indicate the existence of pledges that had not been removed, in contradiction to Section 9(a) of the Act, and the existence of collateral remaining in effect despite the fact that the debts secured by them had been long repaid. Accordingly, banks are required to improve their collateral data base, and take action to remove, by the end of 2016 at the latest, all pledges securing debts that had been repaid.

(n) Draft letter of the Supervisor of Banks in the matter of "the activity of Israeli resident customers of banks and their foreign extensions – compliance with Israeli tax laws"

Following the measures adopted in recent years by the Tax Authority in order to intensify enforcement of tax laws, Bank of Israel published on December 14, 2015, a draft letter instructing banks to apply measures with the aim of reducing reputation, legal, operating and other risks, stemming from the opening or management of accounts, the funds deposited therein may originate in tax evasion by the customer or in income not reported to the tax authorities, as required.

In accordance with the draft letter, banks are required to take action in order to minimize the said risks and integrate them into the risk management framework of the bank, including: definition of the risk management manner in the policy of the bank, holding discussions on the matter by the board of directors, integrating the assessment of risk in respect of the non-compliance by customers to tax laws into the general risk assessment by the bank, examination of the manner of operation in accordance with the schedule of operations presented in the Addendum to the Prohibition of Money Laundering Order, while focusing on the manner of operation stated inn the draft letter, and verify that the manner of operation is included in procedures determined in Proper Conduct of Banking Business Directives Nos. 411 and 308.

Management of the Bank estimates that the guidelines contained in the draft letter, if finally approved, would require special preparations for their implementation, in view of the complexity of the requirements.

(o) Annual report regarding public complaints

Further to Proper Conduct of Banking Business Directive No. 308A in the matter of "the handling of public complaints", Bank of Israel published on August 2, 2015, an amendment to the public reporting instructions, requiring banks to publish an annual report containing information regarding complaints received from the public in that year and the status of dealing with them.

The guidelines contained in the Directives apply as from the report for the year 2015 and thereafter. However, within the framework of the transitional provisions, banks are permitted to relate in the first report to a period of at least six months ended December 31, 2015.

The Bank is preparing to implement the provisions contained in the Amendment as from their effective date.

(p) Letter in the matter of "the closure of branches and reduction in the number of teller positions – providing service to a variety of customers"

In recent years, the banking sector shows a trend of expanding bank services provided to customers by online means (including: use of ATM machines for the drawing of cash, use of the Internet, use of cellular phone applications, and more), as an alternative to services provided in the traditional manner through the branch layout. Following this trend, a number of banks have started to adapt their branch layout to the new situation, by reducing the number of teller positions as well as the number of branches, replacing the teller counters by electronic instruments

As a general rule, Bank of Israel supports the change to online banking services, in view of the potential for the lower cost involved in this manner of service.

Notwithstanding the above, the said change is not suitable for a part of the customer population (such as: old persons), who require the traditional manner of service.

In view of the above, the Supervisor of Banks published on December 6, 2015, a letter requiring banks, which reduce the scope of services provided in the traditional manner (accompanied by the reduction in the number of branches and teller positions), to provide an appropriate response to customers having difficulty in using the electronic means. In addition, banks are required to form a branch policy for the coming years, and report such policy to Bank of Israel until January 30, 2016.

The Bank applied the requirement of Bank of Israel and submitted the required report on the due date.

(6) Legislation regarding competition in the banking sector

The issue of competition in the banking sector has been on the public agenda in recent years. In this respect, a Committee for the Examination of Competition in the Banking Sector" was appointed in 2011, the recommendations of which were issued on March 19, 2013. The implementation of these recommendations was reflected in different legislation, including the amendment of the "commission rules" and other Proper Conduct of Banking Business Directives issued by Bank of Israel.

Additional legislation and regulations were implemented during the reported period, including:

(a) The Committee for increased competition in prevalent banking and financial services

The Minister of Finance and the Governor of Bank of Israel appointed on June 3, 2015, the Committee for increased competition in prevalent banking and financial services ("the Strom Committee").

The letter of appointment, under which the Committee operates, requires the Committee to examine the possibility of allowing additional entities entering the banking services market, including the possibility of separating the credit card companies from banks.

Furthermore, the Committee was required to examine measures for the reduction of barriers preventing competition in the banking sector.

On December 14, 2015, the Committee published an interim report, which contained recommendations for structural changes in the financial services field, including:

- Proposal requiring the two large banks ("Poalim" and "Leumi") to sell their interest in the credit card companies held by them within a period of three years.
- Furthermore, it is proposed to examine a possible change in the ownership of ICC (held at present by Discount bank and the First International Bank), following an experimental period of four years.
- Proposal prohibiting the issue by banks of new credit cards for a period of four years, while allowing the banks to continue the distribution of credit cards.
- Capital requirements shall be lowered in respect of credit associations wishing to engage in the granting of credit in a limited scope.

- Proposal establishing a price comparison system for the credit field, enabling the consumer to elect, in an intelligent manner, the credit provider most beneficial to him.
- Proposal allowing the formation of new credit companies that would raise funds on the capital market.
- Proposal allowing (with the consent of the customer) the daily transfer of information regarding overdrawn accounts of customers, to off-banking companies, with the aim of enabling such companies to compete with banks by providing alternative credit to such overdrafts.
- Proposal requiring banks to insure deposits of the public by means of an insurance agency regulated by the Ministry of Finance and Bank of Israel.

At this stage, a public discussion of the interim conclusions of the Committee has not as yet been held; accordingly it is unclear as to whether the recommendations contained in the interim report shall be included in the final recommendations of the Committee.

Furthermore, implementation of the recommendations requires legislation proceedings, which have not as yet begun. Accordingly, it is not possible to assess, at this early stage, the implications, which these recommendations might have on the operations of the Bank and on its financial results.

(b) Credit Data Bill, 2015

The Bill passed its first reading by the Knesset on October 13, 2015. It adopts the conclusions of the Dorfman Committee, which recommended changes in the matter of consumer credit, with a view of improving the information presented to the public in this respect.

According to the guidelines contained in the Bill banks would be required to expand their reports regarding the credit data at their disposal and gather both positive and negative information for the purpose of assessing the financial stability of the customer, in accordance with the international standard ("Metro 2"), in contrast to the situation prevailing at present, where only negative information is being gathered. In accordance with the guidelines contained in the Bill, Bank of Israel is to assume responsibility for the establishment of a central credit data base. The data base would include information regarding households and small businesses, gathered from financial bodies and public bodies alike (the judicial system, debt execution offices, etc.).

The said guidelines are intended to take effect at the end of two years from date of publication of the Act.

Further to these legislation proceedings, a preliminary discussion was held by Bank of Israel in December 2015, regarding the preparations required for the implementation of the Act, including the need for the establishment of a central data base.

Further to this discussion, Bank of Israel published on December 24, 2015, a draft instruction in the matter of "gathering of information regarding credit". In accordance with the provisions of the draft instruction, banks would be required to maintain in their information systems, on a monthly basis, a data base containing information on transactions and on customers involved in such transactions, as required by Section 115(b) of the Credit Data Act, 2016.

No binding instruction has as yet been issued in the matter, and its effective date has not yet been determined. The Bank is studying the provisions of the draft instruction and is preparing for their implementation.

(c) Regulation of off-banking loans Bill (Amendment No. 3), 2015

This Bill passed its first reading by the Knesset on July 27, 2015. The Bill proposes to apply the provisions of the Act also to banking corporations and their auxiliary corporations, in addition to the regulation applying to them in this matter according to Bank of Israel instructions.

In addition, it is proposed to define any type of credit granting as a "loan", including applying a maximum rate of interest to the retail credit market, which would be binding also on banks.
To date the legislation proceedings in this matter have not yet been completed, therefore it is not possible to assess the implications of the provisions of the Bill on the operations of the Bank and its income in the future.

(7) Legislation in the matter of leveraged loans

In November 2014, the Committee for the Examination of Debt Arrangements in Israel published its conclusions, which included recommendations relating to certain aspects in the matter of "the raising of debt from the public and the treatment of debtors in financial difficulties" (including certain aspects relating to banking corporations).

In view of these recommendations it has been required to revise certain guidelines contained in the proper conduct of banking business directives relating to leveraged loans and the waiver of debts.

Accordingly, Bank of Israel published on April 28, 2015, amendments to certain of these directives, as follows:

(a) Amendment of Proper Conduct of Banking Business Directive No. 311 in the matter of credit risk management

The Amendment contains certain guidelines regarding leveraged loans and the waiver of debts, including:

- Banks are required to determine internal limits regarding leveraged loans and the granting of credit to borrowers having leverage levels exceeding those accepted in the sector.
- The credit policy should include reference to exposure in respect of "syndication loans" organized by the bank but not yet marketed by it. Banks are also required to maintain their own evaluation processes also as regards syndication loans organized by others.
- Banks are required to include, as part of the credit underwriting process regarding large loans (in amounts exceeding NIS 50 million) granted to corporations, also credit granted to the controlling interests in such corporations for the purpose of acquiring the controlling stake therein.
- The process of waiver of a debt in respect of a borrower in financial difficulties shall be established in detailed procedures, including reference to possible alternatives, prior to the waiver of the debt.

(b) Proper Conduct of Banking Business Directive No. 327 in the matter of the management of leveraged loans

The Directive regulates the overall framework of risks relating to leveraged loans and contains detailed guidelines in the matter, including:

- The definition of a leveraged loan, including loans financing the acquisition of means of control and loans to borrowers characterized by a high ratio of leverage loan level to equity capital.
- Definition of certain aspects relating to leveraged loans that should be reflected in the policy and credit procedures of banks.
- The board of directors of a bank is required to discuss at least once in every year, the policy of the bank regarding leveraged loans.
- Banks are required to establish in writing clear and measurable loan underwriting procedures, reflecting the risk appetite of the bank with respect to leveraged loans.
- Banks are required to maintain constant monitoring of leveraged loans and reporting to management at least once in each quarter.
- The credit control function is required to assess the performance of the leveraged loan portfolio in a more frequent and stricter manner than that applied to other parts of the loan portfolio.
- Banks have to form and apply stress tests and periodic sensitivity analyses to the leveraged loan portfolio.

(c) Amendment to Proper Conduct of Banking Business Directive No. 323 in the matter of limitations applied to the financing of capital transactions

Within the framework of these regulation measures, Proper Conduct of Banking Business Directive No. 323, which in its former format, had included limitations only on loans financing the acquisition of means of control, has now been amended to include all loans used for the financing of capital transactions (as defined in the amended Directive).

Accordingly, new guidelines are now prescribed in the amended Directive, including:

- "Capital transaction" has been defined as a transaction for the financing of the acquisition of an equity right in a corporation, or the financing of a distribution of capital, in order to increase value to the shareholders.
- The scope of the credit granted for the purpose of capital transactions, has been limited to a maximum amount of 70% of the equity capital of the banking corporation.
- The scope of credit granted for the acquisition of an equity right in another banking corporation (and financing of at least 30% of the cost of acquisition), has been limited to a rate not exceeding 5% of the equity capital of the banking corporation granting the credit, or of the equity capital of the banking corporation being acquired (whichever is lower).

The new guidelines contained in the Directive apply to new credit granted as from January 1 2016 and thereafter. The Bank applies the guidelines included in the amendment to the rules, as detailed above, as from their effective date.

(8) Amendment of Proper Conduct of Banking Business Directive No. 313 in the matter of limitations on indebtedness of a single borrower or of a borrower group

Further to the regulations issued by Bank of Israel with the aim of reducing concentration in credit portfolios of the banking sector, an on background of the recommendations published by the Basel Committee in the matter of "large exposures", Bank of Israel published on Jun 9, 2015, an amendment to Proper Conduct of Banking Business Directive No. 313 in the matter of limitations on indebtedness of a single borrower or of a borrower group, which contains guidelines imposing additional restrictions on the concentration of credit in the banking sector, including:

- The definition of capital comprising a component in the measurement of credit concentration has been reduced, in accordance with the Basel Committee recommendations, from: "the comprehensive qualified capital"(determined by the previous version of the Directive) to: "Tier I equity capital".
- The permitted maximum indebtedness of a banking borrower group (as defined in the Directive), has been reduced from a rate of 25% of the equity capital to only 15% of the capital.
- The method for the measurement of amounts deductible from the amount of indebtedness has been adjusted to the definitions stated in Proper Conduct of Banking Business Directive No. 203 ("the Basel Rules").

The amendment to the Directive took effect on January 1, 2016. However, the Directive contains transitional provisions, which permit banks to compute the limitations on the initial application date (January 1, 2016) based on the "comprehensive qualified capital" (instead of the "Tier I equity capital"). This relief shall be gradually reduced during the period of twelve consecutive quarters, until its complete elimination on December 31, 2018.

The Bank has applied the guidelines contained in the amendment to the Directive as from their effective date.

(9) Amendment of Proper Conduct of Banking Business Directive No. 308 in the matter of compliance and the compliance function in a banking corporation

Within the framework of the revision of the Proper Conduct of Banking Business Directives and their adaptation to the framework and standards determined by the Basel Committee, Bank of Israel published on June 3, 2015, an amendment to Proper Conduct of Banking Business Directive No. 308 in the matter of compliance and the compliance function in a banking corporation.

This amendment expands the application of the previous Directive (which had applied only to compliance aspects relating to consumer instructions) to all laws, regulations and instructions applying to banking corporations (including legislation applying to banking services to customers, to the activity of functions in the "second line of defense" and to other compliance instructions), and contains new guidelines and rules, including:

- The board of directors is required to supervise the compliance risk management, by approval of a compliance policy and supervision over its implementation (including assessment of the extent of effectiveness of such policy and determination of proper reporting channels).
- Management has the responsibility for the effective management of the compliance risk by way of formation of a policy in writing (including supervision of deviations from such

policy by applying corrective measures). Supervision over the work of the compliance function and maintenance of reporting channels to the board of directors.

- The characteristics of the compliance function have been detailed, including the requirement for the independence of the function in respect of the operations being examined by it, its independent status within the banking corporation, the requirement for the allocation of proper staff and the professional qualification of the staff of the function.
- The duties of the compliance function have been defined, including the areas of its operation, inter alia, banks are required to include in the area of responsibility of the compliance function at least the compliance risks deriving from the core banking business instructions (such as: fairness to customers, money laundering and the finance of terror, consulting services to customers, privacy protection, tax aspects relevant to products or services offered to customers, etc.).
- The compliance officer shall be a member of senior Management of the banking corporation (or subject to a member of Management who is not engaged in business activity) and he may not fulfill an additional function in the banking corporation.

The above mentioned guidelines became effective on January 1, 2016.

The Bank has applied the said guidelines on their due date.

(10) Legislation regarding taxes

(a) Reduction in the rates of profit tax and payroll tax

Following an updated evaluation as to the state of the State revenues from taxes performed by the Minister of Finance, the Value Added Tax rate has been reduced from 18% to 17% as from October 1, 2015.

Following this change, the Knesset passed on October 12, 2015, the VAT Order (Rate of tax applying to not-for-profit organizations and financial institutions)(Amendment), 2015, reducing the rates of profit tax and payroll tax applying to financial institutions from 18% to 17%.

The Amendment took effect retroactively on October 1, 2015.Following the said Amendment, the Bank has recalculated in the fourth quarter of 2015, its liabilities for the payment of employee rights (subject to payroll tax) and the provisions for deferred taxes, in accordance with the updated statutory tax rates (which include profit tax), applying to it in the future.

The updating of the payroll tax, as stated, has reduced the liabilities of the Bank in respect of employee rights by approximately NIS 4 million. In contrast, the updating of the provisions for deferred taxes in respect of the change in the statutory tax rate increased the tax expense of the Bank in the last quarter of the year, by approximately NIS 4 million.

(b) Income Tax Ordinance Amendment Act

The Income Tax Ordinance Amendment Act (No. 216), 2016, was published on January 5, 2016. The Act lowered as from January 1, 2016 (the "determining date"), the tax rate applying to corporations in Israel, fro 26.5% to 25.0%. Accordingly, the statutory rate of tax applying to the bank is expected to decrease, as from the determining date, from 37.18% to 35.90%.

Following the amendment to the law, as stated, the Bank will update in the first quarter of 2016 the provisions for deferred taxes in accordance with the updated statutory tax rate applying to it in the future.

The updating of the tax rate, as stated, is expected to increase the tax expense of the Bank in the first quarter of 2016, by approximately NIS 8 million.

(c) Intensification of Tax Collection and Increasing Compliance Bill (Means for Enforcement of Tax Collection and Deterrence of Money Laundering)(Legislation amendments), 2015

The Bill was published on August 31, 2015, with the aim of intensifying tax collection and reducing tax evasion by tax offenders. In this respect it is proposed to impose a special reporting duty on financial institutions (banks, provident funds, insurers securities portfolio managers, stock exchange members, etc.) and clearing agents, which would include data regarding activities of their customers in their business accounts.

It is further proposed to authorize the Tax Authority to obtain specific information in certain cases, through a mechanism supervised by the Attorney General for the Government. The information so obtained shall be stored in a classified data base of the Tax Authority.

The Bill passed its first reading by the Knesset on October 12, 2015, but the legislation proceedings have not as yet been concluded.

(11) Proper Conduct of Banking Business Directive No. 361 in the matter of cyber risk management

The activity of banking corporations is based on advanced technological infrastructures and technological innovations, including "open" computer infrastructure and obtaining computer services from third parties, enabling banks to provide customers with timely banking services "at any time and at any place".

These advanced infrastructures, expose banking corporations to cyber risks, the realization of which may disrupt their orderly operations and lead to impairment to their reputation, decline in public confidence, and even, in extreme cases, impair their stability.

Bank of Israel is of the opinion that in the recent period banking corporations have experienced the constant growth of exposure to cyber threats (in Israel and abroad). This has been reflected in an increase in the ingenuity of cyber attacks, in the vigor of the potential damage and in the difficulty to identify these attacks. In view of the high importance attributed by Bank of Israel to this issue and to the potential risks inherent therein, Bank of Israel published on March 16, 2015, a new Proper Conduct of Banking Business Directive No. 361 in the matter of cyber risk management, which regulates the requirements from banks made by the Supervisor of Banks in this respect, and includes a structured framework for the management of this risk. The Directive states basic principles and guidelines for the management of defense against cyber threats, including:

- Banks are required to define a defense strategy and framework for the management of cyber risks, including:

- The concept of cyber defense, including: identification of the area of operation, all factors relevant to this issue, emphasizing the discovery layouts, protection of customer privacy and safety of their assets.
- Approach of the bank to cyber management, including: goals, operating principles and implementation.
- A framework for the management of cyber risk, including: structure of corporate governance, description of the tools and methodologies for the assessment of risk, and description of the main defense processes.
- The cyber defense policy relating to cyber defense goals, definition of areas of responsibility, monitoring and response layouts and details of the required controls and the framework for their implementation.
- The cyber defense strategy shall be updated at least once in every three years.

- The cyber risk management process should include the following components:

  - Assessment of the cyber risk and of the control environment should be performed at least once yearly.
  - Identification and assessment of the cyber risks should be based on the findings of audits and surveys, on the gathering and analysis of internal events, on the mapping of business processes, analysis of scenarios and on the use of quantitative indices.
  - Assessment of existing controls, including: analysis of the status of the controls in relation to the relevant threats, weaknesses and risks, according to the different segments of operation.
  - Maintaining a regular reporting layout to Management and to the Board of Directors in the matter of cyber risk, including: data regarding up-to-date risk indices, details of risk or material damage events, development of events having a potential for the realization of cyber risks.

- Banks are required to establish an effective control layout to lower the level of cyber risks, including:

  - Mapping the operation environment of the banks in order to identify factors, systems and critical processes, including weakness points.
  - Forecast and survey of threats based on the independent gathering of information and assessment and analysis capabilities.
  - Development of the ability to effectively and quickly respond to a cyber event and the management thereof.
  - Development of the ability to withstand a cyber event and to restore business activity following such an event.
  - Reducing exposure to cyber attacks by means of "enforced systems" and curtailing user authorizations.
  - The implementation of a "multi-layer" security based on extensive controls, which might compensate weaknesses discovered in certain of the processes.
  - Maintaining an effective monitoring and control layout, which is manned consistently at all hours of the day and night, and receives real-time reports from the different units and groups.
  - Implementation of a proper format for the management of a cyber event, which includes: identification of the event by a designated staff as part of a "situation room". Recording and monitoring the overall data, decisions and actions through an "event record" and performing an interrogation and reporting at the end of the event.
  - Maintaining a reporting layout for cyber events (or cyber events warning), which includes: internal reporting to the relevant functions, to Management and to the Board of Directors, and reporting to the Supervisor of Banks in certain circumstances.

- Maintaining proper corporate governance for the management of cyber risks, which includes the following organs:

  - The board of Directors is responsible for the outlining of the cyber defense strategy, for the approval of the framework for the management of cyber risks and for the supervision over senior Management.
  - The bank's Management determines an overall framework for the management of cyber risks, forms a defense policy against cyber risks, and assesses the effectiveness of the cyber risk defense layout by obtaining current reports as to existing threats, risk assessment results and periodic reports regarding cyber events.
  - Definition of the duties of the cyber defense manager, who heads the cyber defense layout and is responsible for all aspects of cyber risk management, including: integration of all aspects of cyber defense management, assistance to management in the formation and implementation of a cyber defense policy, formation of a corporate methodology for the management of cyber risk, and control over the management of cyber events as well as forming the reporting framework for the different units.

The guidelines contained in the Directive took effect on September 1, 2015. The Bank is implementing these guidelines as from their due date.

(12) Compensation of officers and central employees

(a) Amendment of Proper Conduct of Banking Business Directive No. 301A in the matter of the compensation policy of a bank

Following the regulations issued by Bank of Israel in 2014 with respect to the compensation policy of a bank (Proper Conduct of Banking Business Directive No. 301A), and in the light of the experience gathered in this respect, Bank of Israel published on August 13, 2015, an amendment to the said Directive in the matter of the compensation policy of a bank. The Amendment imposes additional limitations on the compensation of officers, including:

- The compensation agreements shall include refunding arrangements applying to all variable compensation payable to officers and central employees, which will take effect according to criteria determined in advance, and would at least include exceptional circumstances as determined in the Directive (including: significant losses, non-compliance with proper norms and material failure in risk management).
  The said refunding arrangements shall be in effect during a period of between seven and ten years from date of granting the variable compensation.

- Banking corporations may not include in the compensation payable to the chairman of the board components comprising "variable compensation". Furthermore, the format for determining the scope of compensation payable to the chairman of the board should be based on the format of compensation payable to other members of the board of directors. Nevertheless, the compensation should take into account other relevant parameters, such as: the size of the banking corporation, the complexity of its operations and the scope of the position held by the chairman of the board.

The guidelines contained in the Amendment apply to all new compensation arrangements approved as from date of publication of the said amendment and thereafter (including compensation arrangements renewed as from that date). Notwithstanding the above, the Amendment contains transitional arrangements, permitting the postponement to December

31, 2017 at the latest, of the date of implementation of the new rules, with respect of compensation arrangements approved in the past.

(b) Compensation of Officers of Financial Intuitions Bill (Special approval and the non-deductibility tax wise of exceptional compensation), 2014

The Bill passed its first reading by the Knesset on July 21, 2014. Inter alia, the Bill proposes to limit the amount of expense in respect of compensation of officers of financial institutions that would be deductible tax wise, to an amount not exceeding NIS 3.5 million per year.

The provisions of the Bill shall apply to all engagements with officers approved after date of approval of the Act, and to all other engagements at the end of one year from date of approval of the Act.

In January 2016, the Knesset Committee started discussions towards the second and third readings of the Bill.

(13) Guidelines in the matter of risk management in a cloud computing environment

Following the development of the "cloud computing" technology (making use of outside servers for the purpose of the storage of software and large data files), many corporations have adopted this technology in ever-growing volumes. With a view of determining guidelines and restrictions respecting the adoption of this technology by banking corporations in Israel, Bank of Israel published on September 10, 2014, a draft letter in the matter of risk management in a cloud computing environment. Following the above, Bank of Israel published on June 29, 2015, a final letter in the matter, which includes guidelines designed to reduce exposure to risks involved in the use of this technology, including:

- Infrastructure and computer processes related to the core banking business shall be excepted and the said technology may not be implemented in their respect.
- The storage of information or data relating to customers by use of this technology shall be permitted only by means of servers installed in Israel, or in countries maintaining the level of protection as determined by the European Union.

The guidelines contained in the letter took effect upon its publication. Notwithstanding, banking corporations were required to apply to Bank of Israel for a preliminary approval, at least sixty days prior to the planned date for the implementation of the technology. The technology may be implemented only after obtaining the said approval.

At this stage, the Bank has no intention of making use of this technology.

(14) Legislation amendments and regulation in the matter of prohibition of money laundering and the finance of terror

- **Intensification of Tax Collection and Increasing Compliance Bill (Means for Enforcement of Tax Collection and Deterrence of Money Laundering)(Legislation amendments), 2015**

With a view of combating "black capital", including the intensification of tax collection and increasing enforcement of tax laws, and whereas tax offences are frequently accompanied by international movement of funds in order to complicate the discovery of the source of the funds and evade the payment of taxes, the above Bill passed its first reading by the Knesset on October 12, 2015.

The Bill proposes to amend the Prohibition of Money Laundering Act, 2000, and to define serious tax offenses (including fraud offence under the Income Tax Ordinance) as offences of origin, according to this Act. This would authorize enforcement and investigative agencies to carry out investigation, entry and seizure actions with respect to money laundering offences and assets originating in such offences. It is also proposed to permit the transfer of information from a data base managed by the Money Laundering Authority to a customs investigation officer, under terms detailed in the Bill.

Determination of tax offences as offences of origin under the Money Laundering Act is in line with the international requirements regarding money laundering.

- **Letter in the matter of management of risk involved in the voluntary disclosure plan in Israel**

In recent years, the Tax Authority has initiated regulation designed to intensify tax collection in Israel, including: "voluntary disclosure plan regarding income that had not been reported in the past to the Tax Authority". The plan permits taxpayers to amend the amount of income reported by them in the past, without being subject to criminal proceedings. Debt arrangements made between such taxpayers and the Tax Authority, involve, sometimes, significant transfers of funds from abroad to Israel.

Whereas the voluntary disclosure plan grants immunity from criminal proceedings only in respect of offences under the Income Tax Ordinance and not in respect of offenses under other Acts, such as the Money Laundering and Finance of Terror Act, Bank of Israel published on January 26, 2016, a letter requiring banks to continue and maintain all duties imposed on them by the relevant laws with respect to the said fund movements, including clarifications as to the origin of such funds.

In addition, banks were required to revise their policies and procedures regarding this issue and submit by March 27, 2016, a detailed report to Bank of Israel regarding the action taken by them. Following these guidelines, the Bank published a provisional instruction in the matter, which includes appropriate guidelines to all Bank employees.

- **Prohibition of Money Laundering Bill Memorandum, 2015**

The Bill Memorandum contains new guidelines intended to assist the combat against money laundering and adapt existing legislation to the international standards in the matter, including:

- Proposal to apply the definition of "Money" to all means of payment to bearer.
- Proposal to apply all duties imposed on banking corporations also to auxiliary corporations of the banking corporations.
- Proposal to enlarge the quantitative test of "prohibited assets offenses" to include also transactions in amounts exceeding NIS 50,000.
- Proposal to include in the definition of "beneficiary" in addition to corporations also the controlling shareholders thereof.

- Proposal to authorize the Committee to impose monetary sanctions on providers of business services (accountants and lawyers) as well as non-registered providers of currency services.
- Proposal to determine rules for the delivery of documents to investigative and enforcement agencies, subject to approval of the function in charge of the implementation of the Act.
- Proposal to reduce the minimum amount of money, which requires reporting at border crossings.

The Bank is studying the new guidelines of the Bill Memorandum and is preparing for their implementation on the date effective date, once the Bill is approved.

C. 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.

D. Changes in critical accounting assessments

(1) Adoption of US accepted accounting principles in the matter of employee rights

In accordance with the amendment to the public reporting instructions published by Bank of Israel on April 9, 2014, banks were required to adopt as from January 1, 2015, the US accepted accounting principles in the matter of employee rights.

The guidelines contained in the amendment to the instructions, changed the measurement rules relating to employee rights from those which were in practice until December 31, 2014, as regards certain significant aspects, including:

- The future liability of the bank for the payment of certain employee rights (mainly: liabilities for severance pay, "jubilee" awards, and liability for the payment of post-retirement rights), is discounted to present value at a discount rate based on returns on Israel government bonds, with the addition of a margin derived from the difference between the return on high quality corporate bonds traded in the US, and the return on US government bonds (until December 31, 2014, the liabilities had been discounted at a fixed discount rate of 4%).

- Current income derived from the deposits made for severance pay, is reflected in profit and loss on the basis of assumptions as to the expected return on the assets of the severance pay deposits.
  In accordance with guidelines of Bank of Israel in this matter, assessments in respect of the expected return should be based upon historical rates of return over a long period, measured for each of the components included in the severance pay deposits.

The calculation of the provisions for employee rights in accordance with the new accounting principles involves the use of parameters and assessments based in part on past experience (including with respect to the cost of money relevant to the Bank) and in part on future forecasts (including with respect to expected rates of return on the capital markets).

Accordingly, the provisions for employee rights stemming from the new measurement rules are sensitive to changes in parameters and in the forecasts lying at their base, in a manner that a possible deviation in these factors may materially shift the amounts of the liabilities for employee rights stated in the financial statements of the Bank.

The bank applied the new measurement rules as prescribed by Bank of Israel, as from January 1, 2015, and applied them by way of a retroactive application as from January 1, 2013.

The change in the measurement rules increased the Bank's provisions for employee rights at the initial date of application (January 1, 2013) by an amount of NIS 98 million.

(2) Capitalization of in-house software development costs

As stated in Note 1D(8) to the financial statements, the Bank capitalizes certain costs of in-house software development, reflecting them in the "Fixed assets" item. These costs include also the proportionate part of the Bank in the payments to the parent company in respect of computer services, relating to the component of costs incurred by the parent company in the in-house development of software, and accordingly capitalized by it to the "Fixed assets" item.

Measurement of the costs incurred in the in-house development of software, as well as the expected future benefits of such costs is based on significant assessments that involve a high level of uncertainty (including with respect to the period of benefit expected from the use of such software) and on subjective evaluations (including the scope of work that is investment in developing the software).

Accordingly, a change in the assessments and evaluations mentioned above may have a material effect upon the scope of payroll costs or the capitalized computer costs taken to fixed assets as well as the future amortization cost charged in their respect.

In view of the materiality of this issue and the wide range of the considerations involved in the matter, and whereas Bank of Israel audits performed at several banks had discovered deficiencies in the internal control over the capitalization of software development costs – Bank of Israel published on March 31, 2015, a letter requiring the parent company to apply uniform rules, comprising guidelines for the process of capitalization of in-house software development costs (thereby binding on all member companies of the banking group of the parent company, including the Bank), which included:

- Member corporations of the parent company's banking group are required to determine a minimum "materiality threshold" for software development costs classified to fixed assets of between NIS 450 thousand and NIS 600 thousand. Investment in in-house software development in amounts lower than the "materiality threshold" amount must be charged to profit and loss and not capitalized.
- The amortization period of software development costs classified to assets shall not exceed five years.
- Payroll costs capitalized to fixed assets shall take into consideration the "economic inefficiency" and possible deviations in reporting work hours.
- Investment in projects for the in-house development of software capitalized to fixed assets should include only expenses in respect of the staff devoting most of its time to the actual development of the software.

The letter required the parent company (as well as the Group companies) to adopt these measurement rules as from the quarterly report as of June 30, 2015, and include them in their financial statements by way of retroactive application.

The principal information systems serving the Bank are based upon the core systems of the parent company, which provides the Bank with computer services (including software development) under agreements signed between the Bank and the parent company regarding this issue.

Accordingly, software costs capitalized by the Bank and charged to fixed assets include also the proportionate part of the Bank in the investments of the parent company in in-house software development, both for the parent company and for the bank.

The Bank applies as from April 1, 2015, the measurement rules prescribed by the guidelines of Bank of Israel, by way of retroactive application.

The change in measurement rules, as stated, decreased the balance of investments capitalized to fixed assets at January 1, 2015, by an amount of NIS 16 million.

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

A. Income and profitability

Profits before taxes amounted in 2015 to NIS 344 million, as compared to NIS 239* million in 2014, an increase of 43.9%.

In 2015, the return of profit before taxes on net shareholders' equity was 17.0%, as compared to 12.7*% in 2014.

The provision for taxes on the income amounted to NIS 136 million in 2015, as compared to NIS 84* million in the previous year. The tax provision was 39.5% of the gross income, as compared to 39.3*% in 2014.

Net income amounted in 2015 to NIS 210 million, as compared to NIS 147* million in 2014, an increase of 42.9%.

The return of net income on gross shareholders' equity in 2015 was 10.4%, as compared to 7.8*% in 2014.

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

	2015	2014	2013	2012	2011
	%				
Annual return	**10.4**	78*	9.9*	10.7*	9.5*

In 2015, **net earnings per share of NIS 0.1 par value** amounted to approximately NIS 1.69 thousand per share as compared to approximately NIS 1.18* thousand per share in the previous year. Net earnings per share of NIS 0.01 par value amounted in 2015 to approximately NIS 0.17 thousand, as compared with NIS 0.12* thousand in the previous year.

The business results of the Bank for the year 2015, as compared with the results for 2014, were mainly affected by the following factors:

- A rise of NIS 72 million in net interest income reflecting a growth of 9.0%.
- A decrease of NIS 5 million in non-interest financing income reflecting a decline of 11.9%.
- An increase of NIS 52 million in credit loss expenses, reflecting a growth of 346.7%.
- A decrease of NIS 3 million in commission income, reflecting a decline of 1.0%
- An increase of NIS 32 million in other income comprising capital gains recognized in the reported period.
- A decrease in other operating expenses of NIS 61 million, reflecting a decline of 6.8%.
- An increase in the effective tax rate from 39.3*% in 2014 to 39.5% in 2015.

* Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights and the retroactive application of the instructions of the Supervisor of Banks in the matter of capitalization of software costs (see Note 1D(7-9) to the financial statements).

B. Income and expenses

In 2015, **net interest income** amounted to approximately NIS 872 million, as compared to approximately NIS 800 million in 2014, an increase of approximately 9.0%. The increase in net interest income is explained by the following:

- An increase of 0.28 percentage points in the interest spread, from 2.91% last year to a spread of 3.19% in 2015.
- A decrease of NIS 13 million in the negative timing differences item ("deferred income"), stemming from interest income classified from commission income and which will be recognized in profit and loss in the future (following the application of US accepted accounting principles regarding the measurement of interest income [Standard FAS-91], as detailed below). The impact of these factors has been moderated by a decrease of 5.1% in the average balance of income producing assets.

Following are details regarding the implications of the application of the FAS-91 principles on the Bank's interest income in 2015, as compared with the last year:

	Year ended December 31, 2015	2014	Change
	NIS (millions)		%
Interest income prior to the application of the FAS-91 rules	**796**	740	7.6
Effect of application of the FAS-91 rules:			
• Income reclassified from "commissions"	**86**	83	3.6
• Net income deferred to future periods	**(10)**	(23)	(56.5)
Total effect of the FAS-91 rules	**76**	60	26.7
Interest income following the application of the new rules	**872**	800	9.0

(*) In addition to the above, premature repayment commission income in the amount of NIS 10 million, was recognized in 2015 (2014 – NIS 8 million).

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 2015, in comparison with 2014:

Linkage	2015 Volume of operations %	Interest spread %	Net interest income NIS millions	2014 Volume of operations %	Interest spread %	Net interest income* NIS millions
Prior to application of FAS-91						
- Non-linked	**81**	**3.25**	**736**	77	3.26	692
- CPI linked	**12**	**0.94**	**25**	16	0.33	18
- In or linked to foreign currency	**7**	**2.13**	**35**	7	1.84	30
	100	**2.90**	**796**	100	2.68	740
Effect of application of FAS-91	**-**	**0.29**	**76**	-	0.23	60
Total	**100**	**3.19**	**872**	100	2.91	800

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

The non-linked shekel segment

Total assets in this segment comprised approximately 81% of the total Bank's assets in 2015, as compared with 77% in the previous year. The segment's contribution to the Bank's interest income amounted to approximately NIS 812 million (prior to the application of the FAS-91 rules – NIS 736 million), as compared to approximately NIS 744* million in the previous year (prior to the application of the FAS-91 rules – NIS 684* million), comprising approximately 93.1% of total interest income of the Bank.

* Reclassified

The increase in interest income in this segment stems from the rise in the volume of operations.

In 2015, 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%, in comparison with 76% last year. In total, the volume of assets in this segment (not including derivative financial instruments) increased in 2015 by 7.8%, due mainly to a growth of 13% in credit facilities extended to the general public.

The interest spread in this segment in 2015 was 3.61% (prior to the application of the FAS-91 rules – 3.25%) as compared to an interest spread of 3.52*% recorded last year (prior to the application of the FAS-91 rules – 3.22*%). The increase recorded in the interest spread (prior to the application of the FAS-91 rules) despite the real-term increase in the cost of raising funds (derived from the lowering of the interest rate of the daily monetary tender in 2015) is the result of both the increase in the credit component (carrying a higher rate of return) in this segment and the increase in returns on credit facilities.

The CPI-linked shekel segment

Total assets in this segment comprised on an average approximately 12% of the total assets of the Bank in 2015, as compared with 16% in the previous year. The segment's contribution to the Bank's interest income totaled NIS 25 million, as compared to NIS 26* million in the previous year, approximately 2.9% of total interest income of the Bank. The reduction in interest income in this segment is principally explained by a net reduction in the volume of assets, as stated, and by the reduction in income from linkage differences on the surplus application of funds in this segment.

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 2015, 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 61%, in contrast to 52% in the previous year.

As stated above, the segment interest spread in 2015 was a rate of 0.94%, as compared to a rate of 0.51*% in the previous year. The increase in the interest spread is, explained by the change in the mix of application of funds, as stated (a decline in the component of securities investment producing low rates of

Foreign currency segment (including linkage to foreign currency)

Total assets in this segment comprised an average of approximately 7% of the Bank's total assets in 2015, similarly to that of the previous year. The segment's contribution to the Bank's interest income totaled NIS 35 million as compared to NIS 30 million in the previous year, approximately 4.0% of the Bank's total interest income.

*Reclssified

The stability recorded in the average volume of operations in this segment stems from an increase in the component of investments in securities, on the one hand, offset by a decline in the deposits with banks component, on the other hand.

The increase in net interest income of this segment stems from an increase of 0.29% in the interest spread, from 1.84% last year to a rate of 2.13% in 2015. The increase in the interest spread is explained, mainly, by the increase in return on application of funds in respect of the credit to the public component, and an increase in the application of funds producing higher returns.

In 2015, the inclusive **interest spread**, comprising the ratio of interest income (before expenses for credit losses) to the average balance of financial assets – amounted to 3.19% (prior to the application of the FAS-91 rules – 2.90%), in comparison with 2.91% in the previous year (prior to the application of the FAS-91 rules – 2.68%).

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).

* Reclassified

Non-interest financing income, net, amounted in 2015 to approximately NIS 37 million, as compared with NIS 42 million in the previous year.

The decline in non-interest financing income stems mostly from a decrease of NIS 7 million in income from exchange differences (explained by a moderate devaluation of 0.3% in the exchange rate of the shekel as against the US dollar in 2015, as against a devaluation at a higher rate of 12% recorded in 2014. This was offset by a net increase of NIS 4 million, in gains on sale of securities (following the deduction of loss on securities of NIS 9 million from previous years (see Note 24B(6)(b) to the financial statements).

In addition, the Bank recorded in the reported year a decline of NIS 7 million in income from adjustment to fair value of derivative financial instruments. The income 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,		
	2015	**2014**	**Change**
		NIS (millions)	
Exchange differences:			
- Derivative instruments	**(24)**	100	(124)
- Other	**31**	(86)	117
Total exchange differences	**7**	14	(7)
Net expenses from derivative instruments activity(1) (2)	**(25)**	(23)	(2)
Gains on sale of securities, net	**55(4)**	51(3)	4
Total	**37**	42	(5)

(1) Not including exchange differences.
(2) Of which: expenses regarding adjustment to fair value of derivative instruments amounting in 2015 to NIS 10 million (2014 – NIS 3 million).
(3) Including a loss of NIS 2 million on impairment of securities in 2014, classified as "other than temporary".
(4) Including a charge of NIS 9 million, which 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 within the framework of proceedings for settlement of that debt, following the financial difficulties of that debtor (see further details in Note 24B(6)(b) to the financial statements).

Expenses in respect of credit losses, net, amounted in 2015, to NIS 67 million, as compared to NIS 15 million in the previous year. In 2015, the expense for credit losses comprised 7.7% of net interest income, as compared to 1.9% 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 0.33%, as compared to 0.08% in the previous year.

Following are data regarding the development of expenses for credit losses in 2015, in comparison with the previous year:

	Year ended December 31,	
	2015	**2014**
	NIS (millions)	
Expenses regarding credit losses:		
• On a specific basis	**49**	46
• On a collective basis*	**18**	(31)
Total	**67**	15

* Including accounting write-offs in the amount of NIS 10 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 16 million (2014 – NIS 6 million and NIS 21 million, respectively).

The increase in expenses for credit losses stems mostly from the increase in the provision for credit losses on a collective basis (due to the rise in the volume of credit, generally and in the volume of troubled debts, in particular).

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

The increase in expenses for credit losses in the small business segment is partly explained (as to NIS 25 million) by an increase in provisions measured on a collective basis in respect of performing debts, in contrast to a decrease recorded in this provision in 2014, in respect of the troubled debts component.

The decline in provisions for credit losses in the corporate banking segment stemmed from a decline in provisions for credit losses recorded last year in respect of a small number of borrowers whose repayment ability had been impaired.

The cumulative balance of the provision for credit losses measured on a collective basis amounted at December 31, 2015 to NIS 282 million, comprising 1.09% of the total credit to the public risk at that date (December 31, 2014 – NIS 257 million and 1.05%, respectively).

For additional details regarding the volume of troubled debts at the Bank as of December 31, 2015 and their classification, as well as regarding quality indices of the credit portfolio of the Bank – see Chapter 12B below.

Commission income in 2015 amounted to NIS 310 million, as compared with NIS 313 million in 2014, a decrease of approximately 1.0%. On the one hand, an increase of NIS 5 million was recorded in income of the Bank from commissions on customer credit card activity, and in respect of commission on the handling of credit, which was offset by a decline in the amount of NIS 13 million in income from ledger fees, due partly to the implementation of regulations taking effect in the second quarter of 2014 and in the third quarter of 2015, and which have reduced the Bank's income from this item (for additional information in this regard – see Chapter 6B(3)(b) above).

For additional details regarding changes in the Bank's income from current account ledger fees stemming from legislation amendments taking effect on Fevbruary1 2015 and on July 1, 2015, and regarding other legislation amendments – see Chapter 6B(3) above.

Other income amounted in the reported period to NIS 33 million. The income stems from gain on the sale of buildings in transactions entered into by the Bank in the reported period. For details regarding these transactions – see Note 24B(10) to the financial statements.

In 2015, **operating and other expenses** totaled NIS 841 million as compared to NIS 902* million in the previous year, a decrease of 6.8%.
The decrease in operating costs stems mostly from a decrease of 11.5% in payroll and related expenses, stemming from the implementation of the labor agreement signed by the Bank on April 28, 2015 (see Chapter 8C in the corporate governance report).

The **provision for taxes on the pre-tax income** amounted to NIS 136 million in 2015, as compared to NIS 94 million in the previous year. In 2015, the ratio of the tax provision in relation to income from ordinary operations was approximately 39.5%, as compared to 39.3*% in the previous year.

The increase in the ratio of tax provisions is explained by the updating of the provisions for deferred taxes in an amount of NIS 4 million, recorded in 2015, due to a 1% reduction in the profit tax rate (see Chapter 6B(10)(a) above) and to the rise in the tax expense component in respect of prior years.

The impact of such factors was offset by tax expenses at preferential rates in respect of income from the sale of buildings recognized in the reported period (see Note 24B(10) to the financial statements).

For additional information as to changes in tax legislation hat took effect as from January 1, 2016, and their expected implications on the tax expense of the Bank – see Chapter 6B(10)(b) above and Note 8(b) to the financial statements.

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(8) to the financial statements.

* Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights and in respect of the retroactive application of the guidelines of the Supervisor of Banks regarding capitalization of software costs - see Note 1D(7-9) to the financial statements.

The Bank's involvement in the central information systems, jointly used by the Bank and the parent company, addressed in 2015 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, 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**

	Year ended December 31, 2014			
	Software	Hardware	Other	Total
	NIS millions			
Payroll and related expenses	-	-	-	-
Depreciation	29[(1)]	6	-	35
License fees	5	1	-	6
Payments to parent company	-	-	41[(1)]	41
Other	1	1	5[(1)]	7
Total	35	8	46	89

- **Assets relating to the information technology systems[(2)]**

	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**

(1) Restated in respect of the retroactive application of the guidelines of the Supervisor of Banks regarding capitalization of software costs (see Note 1D(8) to the financial statements.

(2) The above data is included in the balance sheet of the Bank in the item "Buildings and equipment" (see Note 15 to the financial statements).

	December 31, 2014			
	Software		Hardware	
	Purchases	Capitalized costs	Computer systems	Total
	NIS millions			
Cost				
Balance at beginning of year	202	181[(2)]	70	453
Additions	6	22[(2)]	4	32
Disposals	-	-	-	-
Balance at end of year	208	203	74	485
Accumulated depreciation				
Balance at beginning of year	169	132[(2)]	58	359
Depreciation for the year	8	21[(2)]	6	35
Disposals	-	-	-	-
Balance at end of year	177	153	64	394
Depreciated cost	31	50	10	91

(1) The above data is included in the balance sheet of the Bank in the item "Buildings and equipment" (see Note 15 to the financial statements).

(2) Restated in respect of the retroactive application of the guidelines of the Supervisor of Banks regarding capitalization of software costs (see Note 1D(8) to the financial statements.

D. Developments in other comprehensive income

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

	Year ended December 31,		
	2015	2014	Change
Adjustments regarding available-for-sale securities			
- Unrealized net gains from adjustments to fair value	**12**	24	(12)
- Gains reclassified to profit and loss	**(61)**	(51)	(10)
Total adjustments regarding available-for-sale securities	**(49)**	(27)	(22)
Employee rights			
- Actuarial income (loss) for the period	**2**	(41) [(1)]	43
- Loss reclassified to profit and loss	**11**	-	11
Total adjustments regarding employee rights	**13**	(41)	54
Total before taxes in income	**(36)**	(68)	32
Tax effect	**13**	25	(12)
Total changes in other comprehensive income	**(23)**	(43)	20

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights, see Note 1D(7) to the financial statements.

The decline in actuarial losses in 2015, in comparison to the previous year, amounted to NIS 43 million and is explained by the decrease of between 0.6% and 0.7% recorded in the discount rate in 2014.

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
	2015	**2014**	**change**
	NIS (millions)		**%**
Total assets	**30,076**	28,570[(1)]	5.3
Cash and bank deposits	**5,502**	4,994	10.2
Securities	**3,432**	3,831	(10.4)
Credit to general public, net	**20,417**	18,915	7.9
Deposits from general public	**25,388**	24,060	5.5
Subordinate debt notes	**672**	681	(1.3)
Shareholders' equity	**2,103**	1,916[(1)]	9.8

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights and in respect of the retroactive application of the guidelines of the Supervisor of Banks regarding capitalization of software costs - see Note 1D(7-9) to the financial statements.

Cash and bank deposits

	December 31		Rate of
	2015	**2014**	**change**
	NIS (millions)		**%**
Shekel (non-linked)	**5,015**	4,274	17.3
Shekel (CPI-linked)	**100**	190	(47.4)
Foreign currency	**387**	530	(27.0)
Total	**5,502**	4,994	10.2

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 growth in cash balances and deposits with banks in the non-linked shekel segment stems from the diversion of funds from investment in the securities portfolio of the Bank to deposits with Bank of Israel, and from the growth in the volume of deposits in this segment in excess of credit usages. The diversion of cash balances and deposits with banks from the foreign currency segment to the non-linked shekel segment stems from the growing use of derivative instruments for hedging the base exposure in foreign currency.

Securities

	December 31		Rate of
	2015	**2014**	**change**
	NIS (millions)		**%**
Bonds held to maturity	**310**	313	(1.0)
Securities available-for-sale	**3,110**	3,510	(11.4)
Securities held for trading purposes	**12**	8	50.0
Total	**3,432**	3,831	(10.4)

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, 2015, the fair value of the available-for-sale portfolio exceeded its written-down cost by NIS 43 million (in contrast to NIS 80 million at December 31, 2014). This sum, after adjustment for the tax effect, increased the Bank's shareholders' equity as of the reporting date by approximately NIS 27 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, 2015 amounted to NIS 22 million and NIS 5 million, respectively (December 31, 2014 – NIS 23 million and NIS 317 million, respectively).

The decrease in the balance of the available-for-sale securities portfolio is explained, inter alia, by the shifting of applications from this item to 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 2015, the average value of the portfolio was approximately NIS 27 million (2014 – NIS 30 million), which constitutes approximately 2.9% 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, 2015			
		Adjusted cost	**Fair value**	**Accumulated gains**	**Unrealized losses**
	Bond rating[(1)]	**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[(2)]		**2,554**	**2,587**	**34**	**1**
Total available-for-sale bonds		**3,057**	**3,098**	**45**	**4**

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

		Year ended December 31, 2014			
		Adjusted cost	**Fair value**	**Accumulated gains**	**Unrealized losses**
	Bond rating**	**NIS millions**			
A. Corporate bonds					
(1) Marketable bonds					
Financial and business services	AAA to AA-	453(1)	457(1)	4	-
Commerce	A+	29	30	1	-
Electricity and water	AAA	192	194	2	-
Communication and computer services	AA to BB-	22	23	1	-
Industrial	AA- to A	35	37	2	-
Other	AA- to BBB+	18(1)	18(1)	-	-
Total marketable bonds		749	759	10	-
(2) Non-marketable bonds					
Electricity and water	AAA to AA	82	87	5	-
Real estate	AA	8	8	-	-
Industrial	-	21	19	-	2
Other	A	20	19	-	1
Total non-marketable bonds		131	133	5	3
Total corporate bonds		880	892	15	3
B. Government bonds(2)		2,528	2,604	68	2
Total available-for-sale bonds		3,418	3,496	83	5

(1) Reclassified
(2) The balance mainly includes Israeli government bonds.
(3) 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 2015 (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, 2015, contains unrealized losses in an negligible amount (NIS 4 million) comprising only 0.1% of the outstanding balance of the portfolio (at December 31, 2014 – NIS 5 million and 0.1%, respectively). In general, Management is of the opinion that these losses mainly reflect general changes in interest trends in the bond market, and therefore it considers that most of 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 classified in 2014 losses accrued on such bonds in the amount of NIS 2 million as "losses of a nature other than temporary" and recorded a provision for impairment in their respect in profit and loss (no such provision in this respect was recorded in 2015).

For additional details regarding 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, 2015	**December 31, 2014**	**Rate of change**
	NIS millions		**%**
Non- linked Shekel	**17,694**	15,906	11.2
CPI-linked Shekel	**1,832**	2,013	(9.0)
Foreign currency or linked thereto	**891**	996	(10.5)
Total	**20,417**	18,915	7.9

Total borrowings by the general public increased in 2015 by 7.9%, in comparison to an increase of 6.3% in the previous year. The increase in the non-linked shekel borrowing is explained by the expansion in the activity of the retail segment in 2015, 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:

	31.12.2015			31.12.2014		
	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(5)	**8,005**	**127**	**71**	7,272	121	67
Construction and real estate	**5,571**	**186**	**54**	5,219	176	58
Commerce	**4,512**	**145**	**102**	4,477	119	101
Industry	**2,539**	**70**	**44**	2,424	67	36
Other commercial services(5)	**1,418**	**42**	**22**	1,149	40	21
Transportation and storage	**986**	**42**	**32**	899	41	19
Financial services	**360**	**6**	**7**	307	1	2
Other (less than 5%)	**1,980**	**48**	**34**	1,791	55	30
	25,371	**666**	**366**	23,538	620	334

(1) Credit risk includes off-balance sheet credit risk.
(2) The data has been reclassified in order to adjust the distribution of credit risk by economic sectors to the new classification of economic segments determined by Bank of Israel on April 9, 2014 and which became effective on January 1, 2014.
(3) The growth in the private individuals sector in the amount of NIS 743 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 retails sector, including the private individuals sector.
(4) The growth in the real estate and construction segment in the amount of NIS 352 million stems from credit granted to housing construction projects, conducted under the "closed rolling finance' method.
(5) The growth in the other business services segment in the amount of NIS 269 million stems mainly from credit granted in small amounts to companies in the retail sector.
(6) The increase in the volume of troubled debts in the commercial sector in the amount of NIS 26 million stems mostly from a small number of large business customers whose repayment ability had deteriorated.

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

	DECEMBER 31		
	2015	2014	**Change**
	NIS millions	NIS millions	%
Impaired debts	**347**	344	**0.9**
Substandard credit risk(3)	**60**	42	**42.9**
Credit risk under special supervision(2)	**259**	234	**10.7**
Total	**666**	620	**7.4**

(1) The data relates to the stated balance of troubled debts in respect of credit risk to the public.
(2) The growth in volume of credit risk under special supervision in 2015, stems from the classification of a small number of large business customers in the industrial and real estate and construction segments, whose repayment ability had deteriorated.
(3) The growth in the substandard credit risk, stems from the reclassification of housing loans in default amounting to NIS 8 million from the small business customers segment.

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						
	2015			2014			
	On demand	Fixed Term	Total	On demand	Fixed Term	Total	Rate of change
	NIS (millions)						%
Shekel (non-linked)	**5,518**	**14,282**	**19,800**	4,334	13,286	17,620	12.4
Shekel (CPI-linked)	**-**	**2,854**	**2,854**	-	3,208	3,208	(11.0)
Shekel (linked to foreign currency)	**-**	**35**	**35**	-	47	47	-
Foreign currency	**1,546**	**1,153**	**2,699**	1,612	1,573	3,185	(14.2)
Total	**7,064**	**18,324**	**25,338**	5,946	18,114	24,060	5.5

Deposits from the general public within the non-linked segment increased by 12.4%, from NIS 17,620 million at the end of 2014 to NIS 19,800 million at the end of 2015. 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 corporate-middle-market division), decreased during 2015 by 11.0%. The reduction in the volume of deposits in this segment is explained, among other things, by the low inflationary environment prevailing in 2015, which caused changes in the savings preferences of the public and the diversion of financial assets to the marketable channels on account of the more solid channels (bank deposits).

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

	December 31		Rate of change
	2015	2014	
	NIS (millions)		%
Mutual funds	**3,765**	3,816	(1.3)
Bonds	**4,087**	5,258	(22.3)
Shares	**2,456**	2,726	(9.9)
Total	**10,308**	11,800	(12.6)

The reduction in the volume of the securities portfolio held by the general public is mainly explained by the withdrawal of a large securities deposit managed by the Bank for a large institutional body

Subordinate debt notes

	December 31		Rate of change
	2015	2014	
	NIS millions		%
Shekel (CPI-linked)	**672**	681	(1.3)

The subordinate debt notes of the Bank are being rated by Ma’alot (hereinafter – “the rating company”). On December 12, 2015, the rating company decided, to ratify the rating of the debt notes of the Bank determined in 2014 "AA-" (with a stable rating horizon). 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, 2015, the subordinate debt notes of the Bank comprise only 21.3% 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		אייקר דןשנןדןאןקדO	
	DECEMBER 31		DECEMBER 31	
	2015	2014	**2015**	2014
	NIS millions	NIS millions	**NIS millions**	NIS millions
Interest contracts:				
- Shekel/CPI	**-**	-	**16**	7
- Foreign currency	**-**	1	**26**	22
Foreign currency contracts	**27**	24	**73**	72
Contrast in respect of shares	**8**	8	**8**	8
Total	**35**	33	**123**	109

The fair value of the net liabilities of the Bank in respect of derivative instrument transactions as of December 31, 2015, amounted to NIS 88 million, comprising an increase of 15.8% in comparison with the net liabilities as of December 31, 2014.

The reduction in the net fair value of derivative instruments stems from a growth in the scope of transactions effected in derivative instruments for the swapping of shekel interest contracts (in an amount of NIS 100 million) for shekel/CPI contracts (in the amount of approximately NIS 750 million), accompanied by changes in market variables used for the computation of the fair value of such instruments, such as: inflationary expectations (an increase by a rate of 2.1%) and the fixed shekel long-term interest rate (a reduction of 0.3%).

Other assets

	December 31		Rate of
	2015	2014	change
	NIS millions		%
Current taxes – excess advance payments	**22**	19	15.8
Deferred tax assets	**265**	288*	(8.0)
Other assets	**54**	85	(36.5)
Total	**341**	392	(13.0)

* Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights and in respect of the retroactive application of the guidelines of the Supervisor of Banks regarding capitalization of software costs - see Note 1D(7-9) to the financial statements.

The reduction in the balance of deferred taxes in the amount of NIS 23 million stems from the implications of labour agreements signed in the reported period between the Bank, the Federation of Labour and the employees' representative committee, leading to a reduction in the provisions for employee rights in the amount of NIS 75 million (see Chapter 8C to the corporate governance report.

In addition, a reduction of NIS 4 million was recorded in the reported period ni the balance of deferred taxes stemming from the change in the profit tax rate as from October 1, 2015, from 18% to 17% (see Chapter 6B(10)(a) above and Note 8(e) to the financial statements).

Other liabilities

	December 31		Rate of
	2015	2014	change
	NIS millions		%
Liabilities in respect of employee rights:			
- Liability in respect of "jubilee" awards	**78**	138*	(43.5)
- Excess provision for severance pay, net	**304**	285*	6.7
- Post retirement benefits	**44**	63*	(30.2)
- Liability in respect of vacation pay	**27**	25	8.0
- Liability for unutilized sick pay	**7**	-	-
- Provisions for payroll and related benefits	**53**	45	17.8
Total liabilities for employee rights	**513**	556	(7.7)
Creditors in respect of credit card transactions	**511**	465	9.9
Provision for credit losses in respect of off-balance sheet items	**29**	15	93.3
Other	**128**	137	(6.6)
Total	**1,181**	1,173	0.7

* Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights – see Chapter 19G(2) below and Note 1D(7) to the financial statements.

The reduction recorded in 2015 in the liabilities for employee rights stems, inter alia, from the implications of the new labor agreements signed in 2015.

Within the framework of the understandings reached, the parties have agreed to reduce certain employee rights in the amount of NIS 75 million, see Chapter 8C in the corporate governance report.

Off-balance sheet items

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

	December 31 2015	December 31 2014	Rate of change
	NIS millions		%
Documentary credit[1]	**68**	87	(21.8)
Guarantees securing credit	**299**	315	(5.1)
Guarantees for purchasers of housing units[2]	**984**	919	7.1
Miscellaneous guarantees and liabilities	**677**	648	4.5

(1) The reduction in the item "documentary credit" stems from a decline in the trading volume and the strengthening of foreign currencies exchange rates in relation to the shekel.

(2) 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.

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, 2015, to a rate of 9.06% (the minimum comprehensive capital requirement amounted to 12.56%). A calculation made by the Bank, based on the housing loan portfolio data as of December 31, 2015, shows that the said guidelines are expected to increase the minimum capital requirements of the Bank as at January 1, 2017, by approximately 0.10

additional percent, to a rate of 9.16% (for the minimum equity capital requirement) and to 12.66% (for the minimum comprehensive capital requirement.

(2) Capital (in NIS millions)

	Year ended December 31, 2015	2014	Change
Capital and capital reserves	**203**	203	-
Other cumulative comprehensive loss	**(45)**	(22) [(1)]	(23)
Retained earnings	**1,945**	1,735[(1)]	210
Total	**2,103**	1,916	187

The shareholders equity of the Bank as of December 31, 2015, amounted to NIS 2,103 million, an increase of 9.8% in comparison with the balance as of December 31, 2014. 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 23 million in the other comprehensive profit component (mostly due to a reduction of NIS 30 million in the "adjustments in respect of the presentation of available-for-sale securities at fair value" component).

The ratio of shareholders' equity to total assets as of December 31, 2015, amounted to 7.0% in comparison to 6.7% [(1)] on December 31, 2014.

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights and in respect of the retroactive application of the guidelines of the Supervisor of Banks regarding capitalization of software costs - see Note 1D(7-9) to the financial statements.

(3) Capital adequacy

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

	31.12.2015	31.12.2014
	NIS millions	NIS millions
Capital components used in computing the capital adequacy ratio:		
Equity capital	**2,103**	(3)1,916
Differences between equity capital and Tier I capital and regulatory adjustments	**25**	(4)91
Tier I capital, net of deductions	**2,128**	2,007
Tier II capital, net of deductions	**680**	730
Total comprehensive capital	**2,808**	(4)2,737
Average balances of risk assets:		
Credit risk	**18,110**	3)(4)17,023
Market risk	**31**	15
Operating risk	**1,871**	1,837
Total average balances of risk assets	**20,012**	18,875

	31.12.2015	31.12.2014
	%	%
Ratio of capital to risk assets:		
Ratio of Tier I equity capital to risk assets	**10.63**	(4)10.63
Ratio of comprehensive capital to risk assets	**14.03**	(4)14.50
Ratio of Tier I equity capital required by the Supervisor of Banks	(2)(1)**9.06**	7.50
Minimum comprehensive capital ratio required by the Supervisor of Banks	(2)(1)**12.56**	9.00

(1) The minimum capital ratios determined by Bank of Israel became effective on January 1, 2015.

(2) The minimum equity capital requirement determined for the Bank according to instructions of Bank of Israel, amounts to 9.0%. However, according to the amendment to Proper Management of Banking Business Directive No. 329, the minimum capital requirement for the Bank was raised as from April 1, 2015, by 0.02% per quarter. In accordance with these guidelines, this rate is expected to continue and rise gradually up to the maximum addition of 0.16% on January 1, 2017. In view of the above, the minimum comprehensive equity capital ratio of the Bank as of December 31, 2015 (based on the housing loan portfolio data as of December 31, 2015) amounts to 12.56% (the minimum Tier I equity capital ratio amounts to 9.06%).

(3) Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights and in respect of the retroactive application of the guidelines of the Supervisor of Banks regarding capitalization of software costs - see Note 1D(7-9) to the financial statements.

(4) According to Bank of Israel instructions, the comparative data regarding the capital adequacy ratio as of December 31, 2015, are stated before adjustments stemming from the application of US accepted accounting principles in the matter of employee rights.

(4) 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, 2015, 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 2016, the Bank would not be required to raise further regulatory capital in order to comply with the comprehensive capital goals for the year 2016.

(5) Leverage ratio

On April 28, 2015, Bank of Israel published a new Proper Management 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, 2015**
Tier I equity capital	2,218
Total exposure	32,454
Leverage ratio (%)	**December 31, 2015**
Leverage ratio	6.6
Minimum leverage ratio required by the Supervisor of Banks	5.0[(1)]

(1) As from January 1, 2018

(6) Dividends

The distribution of dividends by the Bank is subject to certain restrictions determined in the Companies Act and in Proper Management of Banking business Directive No. 218, dealing with dividend distribution by banking corporations. Following are details regarding the dividends distributed by the Bank in the past two years:

2015 – No dividend distribution
2014 – NIS 45 million.

(7) 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. Operating segments

A. Regulatory operating segments

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, take effect as from January 1, 2016.

The data regarding the distribution of credit to the public and deposits of the public by regulatory operating segments as of December 31, 2015, are as follows:

	Credit to the public	**Deposits of the Public**
	NIS (millions)	
Households	**6,836**	9,947
Private banking	**14**	1,786
Small and minute businesses	**9,215**	6,599
Middle market businesses	**2,556**	1,048
Corporate businesses	**1,741**	1,519
Institutional bodies	**55**	4,489
Total	**20,417**	25,388

B. Operating segments according to Management's approach

(1) General

Reporting of operating segments according to the Management's approach is based on subjective definitions determined by the Bank and stemming from the organizational structure of the business units of the Bank.

According to the organizational structure of the Bank, its business activity had been classified into six segments of operation, as detailed below:

- **Segments under the responsibility of the Retail Division**

Household segment - this segment includes the services provided by the Bank with respect to banking and capital market activities of the private customers of the Bank, the nature of their activity resembles that of a household, including credit in amounts not exceeding NIS 300 thousand, and deposits in amounts not exceeding NIS 500 thousand. Also included in this segment is the housing loan activity of the Bank.

Small business segment – this segment includes the services provided by the Bank with respect to banking and capital market activities of business customers (individuals and corporations), the volume of credit granted to them ,generally, does not exceed NIS 7 million.

Private banking segment - this segment includes the services provided by the Bank with respect to banking and capital market activities of customers (individuals and corporations) having medium and above financial wealth (generally, customers the savings and investments of whom exceed NIS 500 thousand), excluding certain operations concerning risk exposure management, mostly attracting deposits from corporations (mainly institutional bodies).

- **Segments under the responsibility of the Corporate-Business Division:**

  Middle market banking segment - this segment includes the services provided by the Bank with respect to banking activities of business customers (individuals and corporations) having a medium volume of operations and the volume of credit granted to them exceeds NIS 7 million, but who do not belong to the corporate banking segment.

  Corporate banking segment - this segment includes the services - provided by the Bank with respect to banking activities of large corporations, the volume of credit granted to them generally exceeds NIS 40 million, and of public companies. The segment includes also the activity of the Bank in the real estate sector (construction contracting and income producing properties), regarding customers the volume of credit granted to them generally exceeds NIS 7 million, and operations regarding "close finance" projects (including the financing of "acquisition groups" the volume of their operations exceeds NIS 10 million or then housing units). In addition, this segment includes certain activity regarding risk exposure management, mostly attracting deposits from corporations (mainly institutional bodies).

- **Other activity**

  Financial management segment - This segment covers financial operations not involving customers of the Bank (such as, for example, transactions involving the Bank’s securities portfolio).

(2) 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 are allocated.

Operating expenses - 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.

(3) Summarized financial data

The following tables present information regarding the business activity of the

- **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:

Operating segment			
	December 31, 2015	**December 31, 2014**	**Rate of change**
	NIS millions		**%**
Households	**6,734**	6,000	12.2
Small businesses	**6,410**	6,012[(1)]	6.6
Middle-market banking	**2,753**	2,513[(1)]	9.6
Corporate banking	**4,431**	4,293[(1)]	3.2
Private banking	**89**	97	(8.2)
Total	**20,417**	18,915	7.9

(1) Reclassified

For additional details regarding the scope and classification of the troubled debts at the Bank as of December 31, 2015 – see Chapter 12B below and Notes 13 and 29 to the financial statements.

Deposits from the public

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

Operating segment			
	December 31, 2015	**December 31, 2014**	**Rate of change**
	NIS millions		**%**
Households	**5,741**	5,534	3.7
Small businesses	**3,799**	3,576	6.2
Middle-market banking	**1,447**	1,806	(19.9)
Corporate banking	**6,504**	5,365	21.2
Private banking	**7,897**	7,779	1.5
Total	**25,388**	24,060	5.5

- **Income data**

Income

The following data presents developments in income in 2015 as compared with 2014, by segments of operation:

Year ended December 31,

	2015			**2014**		
	Previous Format(1)	**Change in rules(2)**	**New format(3)**	**Previous Format(1)**	**Previous format(2)**	**New format(3)**
	NIS millions					
Households	**347**	**(5)**	**342**	332(5)	(3)	329
Small businesses	**519**	**(5)**	**514**	495(5)	(15)	480
Middle-market banking	**103**	**(1)**	**102**	95	(2)	93
Corporate banking	**155**	**1**	**156**	149	(3)	146
Private banking	**56**	**-**	**56**	62(5)	-	62
Financial management	**82**	**-**	**82**	46	-	46
Total	**1,262**	**(10)**	**1,252**	1,179	(23)	1,156

(1) Prior to the application of FAS-91 rules.
(2) Effect of application of the FAS-91 rules.
(3) Following the application of the FAS-91 rules
(4) Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights and in respect of the guidelines of the Supervisor of Banks in the matter of capitalization of software development costs – see Chapter 19 below and Note 1D (7-9) to the financial statements.

(3) Following is a detailed description of operating segments:

A. Household segment

Structure of the segment

This segment provides a range of banking services and financial products, including capital market services and housing loans, to private customers who engage in operations that are typical of those of a private household. These services are provided to segment customers through a nationwide network of 79 branches, geographically divided into five regions.

Most of the Bank's customers assigned to this segment receive banking services through the branches situated, from an organizational standpoint, within the Acre and Nazareth regions (31 branches). These branches are located in areas comprising a majority of the country's non-Jewish population. The Bank's income produced by operations of customers belonging to this sector and who receive services in such regions amounted in 2015 to NIS 163 million, comprising 48% of total income of the Bank from household customers.

The Bank regards the retail sector as a central target in its business development and is continuing to increase the activity of the Bank branches in this segment and improve the service to customers of the segment.

The banking products and services provided to these customers include the following: current account management, credit products (including loans for housing purposes), investment products (including deposits denominated in Israel currency and foreign currency) and investment in securities.

Legislative restrictions, regulation and special constraints applying to the segment

The Bank operates within a framework of laws, regulations, guidelines and directives applying to the banking industry imposed by legislative and supervisory authorities: including the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings and the Antitrust Commissioner.

- For further details regarding changes in legislation initiated by Bank of Israel in 2015 with respect to bank commissions, including legislation amendments proposed by Bank of Israel in this field and their possible implications on the financial results of the Bank in this segment – see Chapter 6B(5) above.

- For further details regarding legislation amendments with respect to "bank/customer relations" and their possible implications on the Bank's operations in this segment – see Chapter 6B(5) above.

- For further details regarding legislation and regulation as regards competition in the banking sector and their possible implications on the Bank's operations in this segment – see Chapter 6B(6) above.

Developments in segment markets

The following developments in 2015 relevant to this segment may be mentioned:

- a continuation of the practice that has already existed for a number of years whereby segment customers make use of modern technological aids, such as communication via the Internet (desktop and laptop computers) and communication by means of the service centers;

- the continued preparations by various financial entities (mainly insurance companies and credit card companies) for the offer of various financial services to segment customers (particularly, credit services), as an alternative to the services that have been traditionally supplied primarily by the banking sector;

- during 2015, Bank of Israel continued its policy of lowering the interest rates determined by in the monetary tender. Accordingly, the interest spreads of the Bank were also reduced;

- competition by banks over customers belonging to this segment intensified in 2015, as regards credit, bank deposits and capital market advisory services. In this respect, certain banks have developed deposit products enabling the general public to enjoy preferred interest rates regarding such products without having to transfer all their banking operations to these banks, and significant resources have been invested in the development of technological information systems enabling customers of this segment to obtain information and available and handy banking services.

Significant technological changes

In recent years most banks have invested considerable resources in the development of interface and technological applications enabling customers easy accessibility to available banking information and basic banking services by means of personal computes, telephones and other mobile means of communication at their disposal.

Alongside these technological developments, customers belonging to the household sector integrate in recent years advanced technologies within the framework of the online banking applications being developed for their use.

In 2015, the Bank has integrated a credit rating system, the development of which had begun already in 2014. The system provides automatic credit rating systems, which rates the credit risk of private customers, based on their risk characteristics. This system comprises a decision making support tool in the credit granting process to private customers of the Bank and contributes to the simplification of these processes.

Principal entry and exit barriers

The services provided by the Bank to customers of this segment are many and varied, and include current account management services, credit services, deposit account services, capital market services, financial services (i.e., credit cards and standing orders) etc. The provision of these services involves an intricate system of contracts, agreements and procedures as between the Bank and its customers.

The technical difficulty that arises when changes are to be made in this array of agreements, in the event that a customer considers the transfer his banking operations to another bank, may, in the case of a customer of this segment, create a barrier for such a transfer.

As part of the regulatory measures in this respect, intended to increase competition and reduce the barriers limiting mobility of customers between banks in the industry, Bank of Israel published in 2015 instructions expanding the information which banks would be required to provide to their customers, in a manner enabling them to take intelligent decisions as regards the preferred bank for doing their business with. In addition, the instructions enable customers to deliver their instructions for the transfer of their accounts (or their closure) by varied communication means, including electronic mail or by telephone, as well as the possibility of opening accounts via the Internet.

New products

The products and services offered to segment customers are similar to those on offer from the other banks in the banking sector.

Also in 2015, the Bank placed an emphasis on the widening of its scope of operations in a variety of areas involving segment customers. In this framework, the Bank introduced in recent years special credit products for the student population, adjusted to the needs and ability of this class of customers.

Competition

This segment is one of the Bank's most prominent segments, and is therefore a central focus for the Bank's business development. The segment is characterized by a relatively low rate of risk, in view of the wide spread amongst its customers of the credit facilities extended to them. Accordingly, the individual (household) segment provides an attractive target for expansion amongst the other banks in the banking sector (both the large banks and the medium-sized banks), despite the relatively high inputs required for its operation. Intense competition therefore exists amongst all the banks for this slice of the customer base.

In order to withstand the competition for this slice of the customer base, the Bank approaches customers through the various media channels, stressing the Bank's commitment to the provision of a quality and personal service to customers of the segment.

Moreover, as stated above, there are thirty-one branches of the Bank situated in the Acre and Nazareth regions, the majority of whose customers (insofar as they are assigned to this operating segment) live in areas comprising the greater part of the country's non-Jewish population. In addition to the Bank, other banks also operate in these regions and amongst this population, such as, for example, the Bank Leumi, Bank Hapoalim etc.

The Bank is in competition with the above banks for the custom of this population, and endeavors to provide a personal and dedicated service through Bank staff who understand the customs and culture of these customers and who are able to provide them with service that matches their unique requirements.

From time to time the Bank also introduces targeted advertising campaigns through the local media, which are aimed directly at the populations living in these areas, using local media.

Customers

The customers allocated to this segment are private customers with relatively modest financial means at their disposal, and who conduct a range of financial operations commensurate with those of a private household. Since the extent of the credit extended to each of these customers is relatively low, and the total amount of the credit extended to all the segment customers is diffused amongst a large number of individuals, this segment is characterized by a relatively low risk factor.

As stated above, most of segment customers obtaining banking services in the Acre and Nazareth regions live in areas where the absolute majority of the population is non-Jewish.

Marketing and distribution

Approaches are made to the segment's customers by various means, including advertising in the media and the launching of advertising campaigns specifically directed towards the customers of this segment, which campaigns present the personal, professional and dedicated service that is a hallmark of the Bank as a key factor in the cementing of relations between the Bank and segment customers. In addition, through an assortment of special offers and benefits, the Bank seeks to persuade members of potential customer-bases, such as wage-earners, students, and young people, serving and demobilized soldiers etc. to join the ranks of the segment's customers.

With a view of increasing the bank's customer population belonging to this segment, the Bank launched over 200 marketing campaigns directed at the student population and at young couples.

The Bank also initiates approaches to selected target populations such as employees of large companies or institutions. The approaches are made by the staff of the local branches through telemarketing, the posting of marketing messages on the Bank's website, the mailing of circulars, and the positioning of signposts and the distribution of leaflets in the local branches.

Human capital

In 2015, the average number of Bank employee positions assigned to the individual (household) segment was approximately 636, including approximately 56 employees engaged in managerial functions.

The number of staff employed directly in the segment was approximately 497. In addition, 139 other positions were indirectly attached to the segment, drawn mainly from Management and other head office departments, with their staff costs being charged to the segment.

Condensed financial results

The condensed financial results of the household segment for 2015, and an analysis of the principal items therein, together with comparative data for 2014, are set out below:

For the year ended December 31, 2015
Household Segment

	Banking and finances	Housing loans	Capital market	Total	Proportion of total results
	NIS millions				%
Interest income, net:					
• From external sources	**169**	**90**	**-**	**259**	
• Inter-segment	**31**	**(56)**	**-**	**(25)**	
	200	**34**		**234**	**26.8**
Non-interest financing income	**-**	**-**	**1**	**1**	**2.7**
Total financing income	**200**	**34**	**1**	**235**	**25.8**
Commission income	**96**	**3**	**8**	**107**	**34.5**
Total income	**296**	**37**	**9**	**342**	**27.3**
Credit loss expenses	**6**	**3**	**-**	**9**	**13.4**
Operating and other costs	**248**	**37**	**17**	**302**	**35.9**
Income (loss) before taxes	**42**	**(3)**	**(8)**	**31**	**9.0**
Provision for taxes	**20**	**(2)**	**(3)**	**15**	11.0
Net profit (loss)	**22**	**(1)**	**15)**	**16**	**7.6**
Return on capital (%)	**7.8**	**-**	**-**	**3.2**	
Average balance of assets	**3,253**	**3,230**	**14**	**6,497**	**23.2**
Average balance of credit to the public	**3,058**	**3,201**	**-**	**6,259**	**31.8**
Average balance of deposits	**5,926**	-	**-**	**5,926**	**25.2**
Average balance of risk assets	**2,878**	**1,831**	**27**	**4,736**	**24.2**
Average balance of securities	**-**	-	**1,172**	**1,172**	**10.1**
Components of interest income					
Interest spread from credit operations					
- Prior to application of FAS-91 rules	**175**	**33**	**-**	**208**	
- Application of FAS-91 rules	**2**	**1**	**-**	**3**	
Total interest spread from credit operations	**177**	**34**	**-**	**211**	
Interest spread from deposit	**23**	**-**	**-**	**23**	
Total interest income	**200**	**34**	**-**	**234**	

* Not relevant

For the year ended December 31, 2014

Household Segment

	Banking and finances	Housing loans	Capital market	Total	Proportion of total results
	NIS millions				%
Interest income, net:					
• From external sources	134	90	-	224	
• Inter-segment	49	(60)	-	(11)	
	183	30	-	213	26.6
Non-interest financing income	-	-	1	1	2.4
Total financing income	183	30	1	214	25.4
Commission income	107	2	6(2)	115	36.7
Total income	290	32	7	329	28.5
Credit loss expenses (income)	(8)	(1)	-	(9)	-
Operating and other costs	261(1)	39(1)	19(1)	319	35.4
Income (loss) before taxes	37	(6)	(12)	19	7.9
Provision for taxes	14(1)	(2)	(5) (1)	7	7.4
Net profit (loss)	23	(4)	(7)	12	8.2
Return on capital (%)	8.6	*	*	2.7	
Average balance of assets	2,751	2,967	8	5,726	20.9
Average balance of credit to the public	2,631	2,949	-	5,580	31.0
Average balance of deposits	5,808	-	-	5,808	25.2
Average balance of risk assets	2,487	1,565	19	4,071	22.3
Average balance of securities	-	-	1,068	1,068	8.7
Components of interest income					
Interest spred from credit operations					
- Prior to application of FAS-91 rules	146	29	-	175	
- Application of FAS-91 rules	1	1	-	2	
Total interest spread from credit operations	147	30	-	177	
Interest spread from deposit operations	36	-	-	36	
Total interest income	183	30	-	213	

The income of the household segment amounted in 2015 to NIS 342 million, as compared with NIS 329million in the previous year, an increase of 4.0%. The growth in income stems mostly from an increase of NIS 21 million in net financing income due to an increase of NIS 34 million in interest spreads relating to credit operations, including an increase in the interest spreads relating to housing loans, which was offset by a reduction of NIS 13 million in the interest spreads relating to deposits.

In total, the profit for 2015 of the household segment totaled NIS 16 million as compared to NIS 12[(1)] million in the previous year. The increase in net profit stems from the said increase in income and from a reduction of 5.3% in operating expenses (see Chapter 7B above). The impact of these factors was moderated by a reduction of NIS 18 million in expenses for credit losses. In 2014 expenses for credit losses in this segment were reduced by NIS 9 million, stemming from a reduction in the collective provision for credit losses.

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" - see Chapter 19 below and Note 1D (7-9) to the financial statements.

(2) Reclassified
* Not relevant

B. Small business segment

Structure of segment

This segment provides a range of banking services and financial products to owners of small businesses (both individuals and companies). Service is provided to segment customers through the nationwide network of 79 branches. In addition, direct banking services are provided through the Internet and through the Bank's telephone call center.

The main services supplied to the Bank's customers in this segment are varied credit products that are adapted to meet the particular requirements of the customer's business. The segment also provides a range of investment products, including deposits in Israel currency and foreign currency, and derivative instruments.

About half the Bank's customers assigned to this segment live in areas having an absolute majority of non-Jewish population. These customers receive banking services from the thirty-one branches organizationally belonging to the Acre and Nazareth regions. Income of the Bank from customers assigned to this segment and who receive services in the said areas amounted in 2015 to NIS 215 million, comprising about 42% of the total income of the Bank from the "small business" segment.

As part of the implementation of the Bank's policy, which regards the retail sector as a central target in the business development of the Bank, the Bank is acting to improve the service provided to customers belonging to this segment.

Legislative restrictions, regulations and special constraints

The Bank operates within a framework of laws, regulations, guidelines and directives imposed upon the banking industry by legislative and supervisory bodies, including the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings, and the Antitrust Commissioner.

- For further details regarding changes in legislation in 2015 with respect to bank commissions, including those initiated by Bank of Israel, and their possible implications on the financial results of the Bank in this segment – see Chapter 6B(3) above.

- For further details regarding changes in legislation regarding bank/customer relations, including the changes expected in matters relating to troubled debts, such as: "debt collection processes", "pledges" and "insolvency proceedings" their possible implications on the operations of the Bank in this segment – see Chapter 6B(5) above.

- For further details regarding legislation and regulation Israel applying to competition in the banking sector and their possible implications on the Bank's operations in this segment – see Chapter 6B(6) above.

Technological changes that may significantly affect the segment

In the last few years, the Bank, as well as other banks in the banking sector, has been engaged in a continuing program of adoption of advanced technological tools designed for a variety of mobile communication and information systems (such as: cellular phones and electronic tablets), offering segment customers available information and rapid execution of banking operations at any hour of the day or night and at a reduced cost.

Within the framework of efforts made by the Bank to enlarge its activity in this segment and to simplify the credit granting process in respect of retail customers, the Bank developed in 2015 a decision supporting information system designed to provide automatic credit rating in respect of the credit risk of business customers of this segment based upon their risk characteristics.

The data produced by this system is expected to simplify the credit granting process and serve as a decision making support tool in the credit granting process.

Principal entry and exit barriers

The services supplied by the banking sector to its customers involve a series of contracts and agreements (such as account management agreements, general terms of business, mortgage deeds the offsetting of collateral, etc.) which are designed to regulate the continuing business relationship between the bank and its customers.

The complexity of the financial operations undertaken by customers through the banking industry and the complexity of the system of contracts underlying those operations may occasionally render cumbersome the procedure whereby a customer transfers his business from one bank to another.

As part of the regulatory measures in this respect, intended to increase competition and reduce the barriers limiting mobility of customers between banks in the sector, Bank of Israel published in 2015 instructions which enlarge the information that banks would be required to provide their customers, in order to enable them to make intelligent decisions regarding the preferred bank for doing business with. In addition, the instructions enable customers to deliver their instructions for the transfer of their accounts (or their closure) by varied communication means, including electronic mail or by telephone, including the opening of bank accounts via the Internet.

Alternatives to segment products and services

The products and services provided by the Bank to its segment customers are similar to those offered by other banks. For most of these services, no alternatives formats exist on the off-banking market.

The above notwithstanding, the fact that other financial entities (principally insurance companies and credit card companies) intend to supply certain services (particularly credit services) to those customers who require such services, may lead to the development of new products that do not currently exist.

Competition

This segment is one of the Bank's most prominent segments, and is therefore a central focus for the Bank's business development. Customers of the segment are exposed to competition from all the other banks, including both the large and the medium-sized banks.

Since the type of operations conducted in this segment are desired by the other banks in relation to their own business development programs, competition by the other banks for this slice of the customer base has intensified.

Moreover, as stated above, there are thirty-one branches of the Bank situated in the Acre and Nazareth region, the majority of whose customers (insofar as they are assigned to this operating segment) live in areas comprising the greater part of the country's non-Jewish population.

In addition to the Bank, other banks also operate in these regions and amongst this population, such as, for example, the Arab Bank, Bank Leumi, Bank Hapoalim etc.

With a view to withstanding the competition for customers of this operating segment, the Bank has invested resources in advertising, the formation of personal ties with customers, the provision of a personal service, and the proposal of financial solutions appropriate to all of a customer's business requirements.

The Bank is in competition with the other banks operating in the Acre and Nazareth areas for the custom of the local non-Jewish population, and endeavors to provide banking services through Bank staff who understand the customs and culture of these customers and who are able to provide them with service that matches their unique requirements.

With the aim of developing competition in the customer sector belonging to this segment, The State published in 2015 a public tender for the granting of credit to customers of this segment through a "small business fund" with the partial guarantee of the State. The tender was referred jointly to the banking corporations and to institutional bodies, within the framework of which, the banks successful in the tender were required to share the credit risk granted to the successful bank with institutional bodies that would be granted access to applications and income, being hitherto the domain of the banking sector exclusively.

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 volume of credit, which the Bank (jointly with the institutional body), would be able to provide its customers, within the framework of the tender, amounts to approximately NIS 650 million.

Customers

The customers in this segment are characterized by retail business activity in a variety of economic sectors.

Marketing and distribution

Segment customers are approached through a variety of different channels, including advertising in the media (particularly television, radio and the press), personal approaches made by the staff at the local branch, approaches made through the Bank’s telephone call center, the conveying of marketing messages through the Bank’s Internet site, the mailing of circulars to customers, and the positioning of signposts and the distribution of leaflets in the local branches.

Human capital

In 2015, the average number of employees assigned to the small business segment was approximately 628, including approximately 58 employees engaged in managerial functions

The number of direct employee positions assigned to the segment was approximately 498. In addition, 130 other positions were indirectly attached to the segment, constituting mainly management and other head office departments' staff, with their costs being charged to the segment.

Condensed financial results

The condensed financial results of the small business segment for 2015, and an analysis of the principal items therein, together with comparative data for 2014, are set out below:

For the year ended December 31, 2015

Small Business Segment

	Banking and finances	Commercial mortgage loans	Capital market	Total	Proportion of total results
	NIS millions				%
Interest income, net:					
• From external sources	**391**	**15**	**-**	**406**	
• Inter-segment	**(9)**	**(5)**	-	**(14)**	
	382	**10**	**-**	**392**	**45.0**
Non-interest financing income	**-**	**-**	**-**	**-**	**-**
Total financing income	382	**10**	**-**	**392**	**43.1**
Commission income	**118**	**-**	**4**	**122**	**39.4**
Total income	**500**	**10**	**4**	**514**	**41.1**
Credit loss expenses (income)	**38**	**(1)**	-	**37**	**55.2**
Operating and other costs	**315**	**7**	**6**	**328**	**39.0**
Income (loss) before taxes	**147**	**4**	**(2)**	**149**	**43.3**
Provision for taxes	60	**2**	**(1)**	61	44.9
Net profit (loss)	**87**	**2**	**(1)**	**88**	**41.9**
Return on capital (%)	**16.8**	**7.0**	**-**	**15.9**	
Average balance of assets	**6,202**	**402**	**5**	**6,609**	**23.6**
Average balance of credit	**5,952**	**397**	**-**	**6,349**	**32.3**
Average balance of deposits	**3,809**	**-**	**-**	**3,809**	**16.2**
Average balance of risk assets	**5,004**	**348**	**12**	**5,364**	**27.4**
Average balance of securities	**-**	**-**	**686**	**686**	**5.9**
Components of interest income:					
Interest soread from credit operations					
- Prior to application of FAS-91	**310**	**9**	**-**	**319**	
- Application of FAS-91	**57**	**1**		**58**	
Total interest spread from credit operations	**367**	**10**	**-**	**377**	
Interest spread from deposit operations	**15**	**-**	**-**	**15**	
Total interest income	**382**	**10**	**-**	**392**	

* Not relevant

For the year ended December 31, 2014

Small Business Segment

	Banking and finances	Commercial mortgage loans	Capital market	Total	Proportion of total results
	NIS millions				%
Interest income, net:					
• From external sources	362	14	-	376	
• Inter-segment	(11)	(6)	-	(17)	
	351	8	-	359	44.9
Non-interest financing income	-	-	-	-	-
Total financing income	351	8	-	359	42.6
Commission income	117	-	4(2)	121	38.7
Total income	468	8	4	480	41.5
Credit loss income	(15)	-	-	(15)	-
Operating and other costs	340(1)	5	7	352	39.0
Income (loss) before taxes	143	3	(3)	143	59.8
Provision for taxes	56(1)	1	(1)	56	59.6
Net profit (loss)	87	2	(2)	87	59.2
Return on capital (%)	19.6	4.5	*	18.2	
Average balance of assets	5,519	416	3	5,938	21.7
Average balance of credit	5,362	413	-	5,775	32.0
Average balance of deposits	3,687	-	-	3,687	16.0
Average balance of risk assets	4,281	375	14	4,670	25.6
Average balance of securities	-	-	593	593	4.8
Components of interest income:					
Interest spread from credit operations					
- Prior to application of FAS-91	281	8	-	289	
- Application of FAS-91	47	-	-	47	
Total interest spread from credit operations	328	8	-	336	
Interest spread from deposit	23	-	-	23	
Total interest income	351	8	-	359	

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" - see Chapter 19 below and Note 1D (7-9) to the financial statements.

(2) Reclassified

* Not relevant

Income of the small business segment in 2015 amounted to NIS 514 million, as compared with NIS 480 million in the previous year – an increase of 7.1%. This increase stems from a growth of 9.2% in interest income (of which NIS 11 million in respect of the effect of applying the provisions of FAS 91 rules).

In total, the net income for 2015 of this segment totaled NIS 88 million, as compared with NIS 87 million in the previous year – representing a growth of 1.1%. The increase in net income stems from the growth in income, as stated, which was offset by a growth of NIS 52 million in credit loss expenses.

C. Middle market banking segment

Structure of segment

This segment provides a range of banking services and financial products to middle market companies. The products and banking services supplied by the Bank are adapted to the particular business needs of these customers, and include the range of credit products (loans, guarantees and letters of credit), investment products, and capital market services including deposits through various channels and securities. In addition, the segment also provides services in the field of commercial mortgage loans, thus providing finance to business customers for the acquisition of commercial real estate.

Service is provided to segment customers through the nationwide network of 79 branches. Customers assigned to this segment are the responsibility of the Corporate-Business Division.

Legislative restrictions and regulations

The Bank operates within a framework of laws, regulations, guidelines and directives imposed upon the banking system by legislative and supervisory bodies, including the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings, and the Antitrust Commissioner.

- For further details regarding changes in legislation in 2015, including changes initiated by Bank of Israel with respect to bank commissions and their possible implications on the financial results of the Bank in this segment – see Chapter 6B(3) above.

- For further details regarding changes in legislation regarding bank/customer relations, including the changes expected in matters relating to troubled debts, such as: "debt collection processes", "pledges" and "insolvency proceedings" their possible implications on the operations of the Bank in this segment – see Chapter 6B(5) above.

Developments in segment markets

Segment customers are business customers who operate principally in the industrial, commercial and business service sectors. Accordingly, the macro-economic processes at work in the economy, which affect the level of economic activity in the country as a whole and in the above-mentioned sectors in particular, have a direct impact on the markets in which segment customers operate.

Significant technological changes

The business characteristics of the operations of segment customers require the use of advanced technological tools.

Accordingly, the Bank has placed at the disposal of segment customers such tools as meet their varied requirements. Amongst the facilities available are systems for managing foreign trade operations, advanced dealing rooms etc.

The constant updating and upgrading of these systems is an important factor in the maintenance of the quality of the service provided to segment customers, and is an essential factor with respect to the expansion of the Bank's operations with these customers.

Critical segment success factors

Amongst the required factors for success in this segment are the following:

- recognition of the customer's needs and the adaptation of products and services so as to meet those needs;

- the provision of professional and timely service for the changing needs of segment customers;

- the ready availability of the appropriate technological platform for satisfying the customer's needs;

- the maintenance of an efficient control system that monitors the business developments of customers, so as to detect, as early as possible, any signs of impending default.

Entry and exit barriers

The existing stiff competition in the banking industry for customers attached to this segment, combined with the relatively high level of sophistication of these customers, reduces to a minimum the difficulties that may arise in the transfer of a customer's operations from one bank to another.

Products

The products offered to segment customers are mainly comprised of credit instruments adapted to meet the particular requirements of customers, and other financial instruments including derivative instruments for the hedging of risks etc.

Competition

Segment customers are characterized by a relatively high level of business acumen. This fact, when combined with the absence of effective transfer barriers for these customers, creates conditions for buoyant competition between all the banks.

Competition is reflected both in the area of charges (interest margin and commission rates) and in the higher levels of credit risk exposure that a competitor might accept.

The means by which the Bank attempts to withstand the competition include: improvements in the service to the customer, the maintaining of personal ties with the customer, and, occasionally, the granting of discounts on bank charges.

Customers

The customers attached to this segment are middle market commercial companies with authorized credit facilities, which generally exceed NIS 7 million (the annual revenues of which do not usually exceed NIS 250 million).

Business customers with credit facilities for the purchase of commercial real estate for use in their business operations are also attached to this segment.

Marketing and distribution

The marketing of banking services and products to segment customers (both existing and potential customers) is based on the Bank's branch network and the availability of professional advisors at the commercial-corporate banking division, including business managers in the middle-market group

Neither advertising materials nor external marketing consultants are used in relation to marketing operations aimed at potential segment customers.

Human capital

In 2015, the average number of employees assigned to the middle-market banking segment was approximately 77, including approximately six employees engaged in managerial functions.

The number of direct employee positions assigned to the segment in 2015 was approximately 66. In addition eleven other indirect positions were allocated to the segment, drawn mainly from management and other head office departments, with their costs being charged to the segment.

Condensed financial results

The condensed financial results of the middle-market banking segment for 2015, and an analysis of the principal items therein, together with comparative data for 2014, are set out below:

For the year ended December 31, 2015
Middle-market Banking Segment

	Banking and finances	Commercial mortgage loans	Capital market	Total	Proportion of total results
	NIS millions				%
Interest income, net:					
• From external sources	**81**	**4**	**-**	**85**	
• Inter-segment	**(1)**	**(1)**	**-**	**(2)**	
	80	**3**	**-**	**83**	**9.5**
Non-interest financing income	**-**	**-**	**-**	**-**	**-**
Total financing income	**80**	**3**	**-**	**83**	**9.1**
Commission income	**18**	**-**	**1**	**19**	**6.1**
Total income	**98**	**3**	**1**	**102**	**8.1**
Credit loss expenses	**15**	**-**	**-**	**15**	**22.4**
Operating and other costs	**48**	**3**	**1**	**52**	**6.2**
Income (loss) before taxes	**35**	**-**	**-**	**35**	**10.2**
Provision for taxes	**14**	**-**	**-**	**14**	**10.3**
Net profit	**21**	**-**	**-**	**21**	**10.0**
Return on capital (%)	**8.6**	**-**	**-**	**8.1**	
Average balance of assets	**2,392**	**144**	**1**	**2,357**	**9.1**
Average balance of credit	**2,355**	**141**	**-**	**2,496**	**12.7**
Average balance of deposits	**1,567**	**-**	**-**	**1,567**	**6.7**
Average balance of risk assets	**2,405**	**149**	**2**	**2,556**	**13.1**
Average balance of securities	-	-	**221**	**221**	**1.9**
Components of interest income:					
Interest spread from credit operations					
- Prior to application of FAS-91 rules	**66**	**3**	**-**	**69**	
- Application of FAS-91 rules	**8**	**-**	**-**	**8**	
Total interest spread from credit operations	**74**	**3**	**-**	**77**	
Interest spread from deposits	**6**	**-**	**-**	**6**	
Total interest income	**80**	**3**	**-**	**83**	

* Not relevant

For the year ended December 31, 2014
Middle-market Banking Segment

	Banking and finances	Commercial mortgage loans	Capital market	Total	Proportion of total results
	NIS millions				%
Interest income, net:					
• From external sources	74	6	-	80	
• Inter-segment	(4)	(2)	-	(6)	
	70	4	-	74	9.3
Non-interest financing income	1	-	-	1	2.4
Total financing income	71	4	-	75	8.8
Commission income	17	-	1	18	5.8
Total income	88	4	1	93	8.0
Credit loss expenses	14	-	-	14	93.3
Operating and other costs	51*	3	2	56	6.2
Income (loss) before taxes	23	1	(1)	23	9.6
Provision for taxes	9	1	(1)	9	69.
Net profit	14	-	-	14	9.5
Return on capital (%)	5.7	-	-	5.7	
Average balance of assets	2,222	153	1	2,376	8.7
Average balance of credit	2,198	152	-	2,350	13.0
Average balance of deposits	1,307	-	-	1,307	5.7
Average balance of risk assets	2,363	151	1	2,515	13.8
Average balance of securities	-	-	609	609	4.9
Components of interest income:					
Interest spread from credit operations					
- Prior to application of FAS-91 rules	60	4	-	64	
- Application of FAS-91 rules	6	-	-	6	
Total interest spread from credit operations	66	4	-	70	
Interest spread from deposit	4	-	-	4	
Total interest income	70	4	-	74	

* Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" - see Chapter 19 below and Note 1D (7-9) to the financial statements.

** Not relevant

In 2015, income in the middle market banking segment amounted to approximately NIS 102 million, as compared to NIS 93 million in the previous year – an increase of 9.7%. The increase in income derives from an increase of 10.7% in interest income, mostly due to the increase in interest income from credit operations.

In total, 2015 recorded a net profit of NIS 21 million for the middle-market segment, as compared to NIS 14 million in the previous year, an increase of 50%. The increase in net profit stems from the increase in income, as stated, and from the reduction of NIS 4 million in operating expenses explained, inter alia, by high provisions for severance pay recorded last year in respect of the voluntary retirement plan, and in respect of the reduction in payroll expenses in 2015 stemming from the new labor agreement (see Chapter 8B to the corporate governance report).

D. Corporate banking segment

Structure of segment

This operating segment provides a range of banking services and financial products to the country’s leading large corporations (the corporate market). The businesses of these customers are highly complex and sophisticated, and the Bank therefore makes available to these customer's financial products (mainly in the credit sector) that are adapted to their specific operations and needs, after having assessed the totality of the customer’s operations.

The Bank’s Corporate-Business Division is responsible for the provision of services to these customers. The Division is divided into two specialist sub-divisions, as follows:

- **Corporate group** – responsible for the large corporate customers excluding those relating to the real-estate sector) having a credit facility of over NIS 40 million – includes five specialist areas, each headed by a manager who has specialized expertise in the particular field. Banking services are provided to these customers through several branches.

- **Real estate group** – responsible for all real estate corporations which transact business with the Bank, the credit facility of which exceeds NIS 7 million, as well as for acquisition groups of at least ten housing units or having a credit facility of over NIS 10 million.. Such corporations engage in promoting real estate projects including construction projects under the closed rolling finance system, mainly residential buildings for sale, including through "acquisition groups" (handled by the rolling finance department), construction contract work, income producing property and property holdings (handled by the real estate department). The continuing services required by these customers are provided by a number of Bank branch.

Legislative restrictions and regulations applying to the segment

The Bank operates within a framework of laws, regulations, guidelines and directives imposed upon the banking industry by legislative and supervisory bodies, including the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings, and the Antitrust Commissioner.

In view of the fact that the credit facilities in the corporate banking sector are distributed among a relatively small number of customers, and further, that credit risk is one of the principal risks within the banking sector, the Supervisor of Banks has published a number of directives that are particularly relevant to corporate banking:

- Proper Management of Banking business Directive No. 313 which limits the amount of the credit facilities that a bank can extend to any one single borrower, group of borrowers (as defined in the Directive) and large borrower groups (the volume of indebtedness of each such group exceeds 10% of the capital resources of the bank);

- Proper Management of Banking Business Directive No. 323, which limits the amount of the credit facilities that a bank can extend to purchasers of companies for the acquisition of controlling interests (as defined in the Directive);

- Proper Management of Banking Business Directive No. 312 which limits the amount of the credit facilities that a bank can extend to a related party (as defined in the Directive);

- Proper Management of Banking Business Directive No. 326, which regulates work procedures, reporting and legal agreements concerning the financing of residential construction work under the closed rolling finance system;

- Proper Management of Banking Business Directive No. 327, which regulates work procedures, policy and underwriting regarding the granting of leverage loans.

- For further details regarding changes in legislation initiated by Bank of Israel with respect to bank commissions and their possible implications on the financial results of the Bank in this segment – see Chapter 6B(3) above.

- For further details regarding changes in legislation regarding bank/customer relations, including the changes expected in matters relating to troubled debts, such as: "debt collection processes", "pledges" and "insolvency proceedings" their possible implications on the operations of the Bank in this segment – see Chapter 6B(5) above.

Developments in segment markets

Segment customers are drawn from amongst the leading big corporations in the country. Accordingly, the macro-economic processes at work in the economy, which affect the level of economic activity in the country, such as the growth rate, changes in domestic demand and in overseas markets, changes in the terms of trade etc., have a direct impact on the markets in which segment customers operate.

Several significant credit default events occurred in recent years, both in the banking and off-banking credit market, on the part of borrowers operating in countries affected by the global crisis and in markets that have recently opened to significant competition following regulatory measures instituted by the local regulators (in particular in the fields of communication, foods and pension savings).

Many companies operating in these fields have financed their operations (or their investments in companies operating in these fields) by the issue of bonds on the capital markets.

Following the harm caused to the structure of income and business plans of these companies, many companies reported deterioration in their financial position (requiring even a "going concern" disclosure note in their financial statements), several of which even reporting the inability to repay their debt to bondholders. In the absence of alternative financial resources, these companies and their creditors were forced to form alternative arrangements, including a massive waiver of debts and deferment of the balance of the debt for longer periods. In certain cases, the ownership of companies in financial difficulties was even transferred to the creditors.

These developments had an adverse effect on activities in the local capital market causing increased concern as to the ability of other companies experiencing similar difficulties to restore their business activity and honor their obligations towards their bondholders. Accordingly, a steep deterioration was recorded in the years 2012 - 2015 in the market prices of bonds issued by such companies, which were traded at returns reflecting actual concern for insolvency of such companies. These developments result in many corporations being unable to recycle their debts on the capital market, or to obtain additional bank credit. In view of the above, there is increased concern that additional companies would be forced to reach debt arrangements that would include serious impairment of the rights of bondholders.

If the above scenarios materialize, these negative developments will impact the ability of these companies to repay their debts to the banks.

In view of the above, and in view of the implementation of the Basle III instructions, which include stricter requirements as regards the minimum capital adequacy of banks, the banking sector recorded in the years 2014-2015 a reduction in the volume of business credit granted, shifting credit applications to other segments having lower capital requirements. Notwithstanding these developments, the Bank has recorded moderate increases in the volume of credit in the corporate segment, with a growth in the diffusion of this credit (and a reduction in its ratio to total credit granted by the Bank).

Significant technological changes

The business characteristics of the operations of segment customers require the use of advanced technological tools to service their complex banking operations.

The Bank has placed at the disposal of segment customers such tools as meet their varied requirements. Amongst the facilities available are systems for managing foreign trade operations, dealing rooms for financial derivative instruments operations, capital market trading systems etc.

The constant updating and upgrading of these systems is an important factor in the maintenance of the quality of the service provided to segment customers, and is an essential factor in relation to the expansion of the Bank's operations with these customers.

Critical segment success factors

Amongst the required factors for success in this segment are the following:

• understanding of the customer's operations and a comprehensive recognition of his needs, and the adaptation of banking products and services so as to meet those needs;

• the provision of professional and timely service, and the adaptation of services and products so as to meet the changing needs of the customer;

• the ready availability of the appropriate technological platform for satisfying the customer's needs;

• the establishing of an efficient control system that monitors the business developments of customers, so as to detect, as early as possible, any signs that may indicate the possibility of credit failure.

Entry and exit barriers

As a rule, there is stiff competition in the banking industry for customers attached to this segment due to the wide scope of banking services available in this segment. This fact, combined with the high level of sophistication of these customers, reduces to a minimum the difficulties that may arise in the transfer of a customer's operations from one bank to another.

The above notwithstanding, certain regulatory provisions, such as Proper Management of Banking Business Directive No. 313, which is designed to limit the concentration of the big borrowers and big groups of borrowers within the banking sector and the expected intensification in the requirement for a minimum capital adequacy ratio, have become obstacles to the enlargement of the volume of credit facilities of certain big borrowers attached to this segment at those banks where the granting of the additional facilities would lead to a contravention of the limitations imposed by the Directive. In certain instances, such as, for example, a merger between two big groups of borrowers, the Directive may even compel a bank to reduce the total credit facilities available to those same borrowers.

Products and alternatives to products and services of segment

The products offered by the Bank to its segment customers are mainly credit instruments adapted to meet the specific requirements of the customer, and other financial instruments which include derivative instruments for the hedging of risks, 'bond-lending' transactions (as an alternative to the standard credit products that could lower the cost to customers of obtaining credit, depending on developments regarding bond yield in the capital market).

In recent years, there has been a marked trend amongst segment customers to reduce their volume of bank credit and to seek sources of finance in the capital market (raising of capital through public and private share offerings, issuances of bonds and other securities). This trend originates in several factors:

- stricter limitations imposed by Bank of Israel with respect to 'single borrower' and 'group of borrowers' compelled a number of banks to reduce the credit facilities that had been made available to certain groups of borrowers whose indebtedness, under the new definitions, now exceeded the allowable credit ceiling;

- the desire of companies to improve and vary the structure of their sources of finance, by transferring from short-term sources to long-term sources;

- a growing attraction to the raising of funds through the capital market for a number of reasons, including the lower cost of raising capital, greater flexibility vis-à-vis collateral etc.

- a decrease in credit facilities granted to customers of this segment by the banking sector as part of the measures taken by banks in order to reduce the volume of their risk assets, in view of the stricter capital requirements included in the Basle III rules, which took effect on January 1, 2014.

Competition

Segment customers are characterized by the highest level of business acumen in relation to that of customers of all the other operating segments. As against this fact, and in the absence of effective transfer obstacles, stiff competition exists as between all the banks for the type of customer attached to this segment. Competition is reflected both in the area of charges (interest spread and commission rates) and by the level of service.

Customers

Segment customers are, for the most part, corporations that rank amongst the foremost companies in the country, public companies, large commercial customers and residential construction promoters. Segment customers are serviced directly by the Bank's Corporate-Business Division and receive regular banking services from several branches of the Bank.

Marketing and distribution

The marketing of services and products to segment customers is undertaken by the staff of the Corporate-Business Division, the business managers in the business group and real-estate group, who maintain constant contact with customers in order to provide solutions for their financial needs and monitor their commercial operations, as well as by the network of branches.

Human capital

In 2015, the average number of employee positions assigned to the corporate-business banking segment was approximately 89, including approximately ten "managerial functions". The number of positions employed directly by the segment was approximately 77. In addition, 12 indirect positions were allocated to this segment, drawn mainly from management and other head office departments, with their staff costs being charged to the segment.

Condensed financial results

The condensed financial results of the corporate banking segment for 2015, and an analysis of the principal items therein, together with comparative data for 2014, are set out below:

For the year ended December 31, 2015					
Corporate Banking Segment					
	Banking and finances	**Real estate**	**Capital market**	**Total**	**Proportion of total results**
	NIS millions				**%**
Interest income, net:					
• From external sources	**71**	**64**	**-**	**135**	
• Inter-segment	**-**	**(12)**	**-**	**(12)**	
	71	**52**	**-**	**123**	**14.1**
Non-interest financing income (expenses)	**4**	(1)	**-**	**3**	**8.1**
Total financing income	**75**	**51**	**-**	**126**	**13.9**
Commission income	**8**	**21**	**1**	**30**	**9.7**
Total income	**83**	**72**	**1**	**156**	**12.5**
Credit loss expenses (income)	**11**	**(5)**	**-**	**6**	**9.0**
Operating and other costs	**33**	**29**	**4**	**66**	**7.8**
Income (loss) before taxes	**39**	**48**	**(3)**	**84**	24.4
Provision for taxes	**15**	**20**	**(1)**	**34**	**25.0**
Net profit (loss)	**24**	**28**	**(2)**	**50**	**23.8**
Return on capital (%)	**8.1**	**9.6**	*****	**8.6**	
Average balance of assets	**2,718**	**1,780**	**3**	**4,501**	**16.1**
Average balance of credit	**2,692**	**1,757**	**-**	**4,449**	**22.6**
Average balance of deposits	**4,568**	**568**	**-**	**5,136**	**21.9**
Average balance of risk assets	**2,764**	**2,856**	**5**	**5,625**	**28.7**
Average balance of securities	-	**-**	**4,732**	**4,732**	**40.7**
Components of interest income:					
Interest spread from credit operations:					
- Prior to application of FAS-91 rules	**62**	**48**	**-**	**110**	
- After application of the FAS-91 rules	**4**	**3**	**-**	**7**	
Total interest spread from credit operations	**66**	**51**	**-**	**117**	
Interest spread from deposit operations	**5**	**1**	**-**	**6**	
Total interest income	**71**	**52**	**-**	**123**	

(*) Not relevant

For the year ended December 31, 2014					
Corporate Banking Segment					
	Banking and finances	Real estate	Capital market	Total	Proportion of total results
	NIS millions				%
Interest income, net:					
• From external sources	50	66	-	116	
• Inter-segment	16	(15)	-	1	
	66	51	-	117	14.6
Non-interest financing income	1	-	-	1	2.4
Total financing income	67	51	-	118	14.0
Commission income	8	19	1	28	8.9
Total income	75	70	1	146	12.6
Credit loss expenses	19	6	-	25	166.7
Operating and other costs	40*	28	4	72	8.0
Income (loss) before taxes	16	36	(3)	49	20.5
Provision for taxes	6	14	(1)	19	20.2
Net profit (loss)	10	22	(2)	30	20.4
Return on capital (%)	3.7	7.6	**	5.3	
Average balance of assets	2,552	1,707	2	4,261	15.6
Average balance of credit	2,534	1,694	-	4,228	23.5
Average balance of deposits	4,457	516	-	4,973	21.5
Average balance of risk assets	2,648	2,753	4	5,405	29.6
Average balance of securities	-	-	5,294	5,294	43.0
Components of interest income:					
Interest spread from credit operations:					
- Prior to application of FAS-91 rules	57	47	-	104	
- After application of the FAS-91 rules	3	2	-	5	
Total interest spread from credit operations	60	49	-	109	
Interest spread from deposit operations	6	2	-	8	
Total interest income	66	51	-	117	

* Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights and in respect of the guidelines of the Supervisor of Banks in the matter of capitalization of software development costs – see Chapter 19 below and Note 1D (7-9) to the financial statements.

** Not relevant

In 2015, the income of the corporate banking segment amounted to approximately NIS 156 million as compared to NIS 146 million in the previous year, an increase of 6.8%. The increase in income stemmed mainly from the growth of NIS 6 million in interest spread on the credit granted.

In total, 2015 recorded a net profit of NIS 50 million in this segment, as compared to NIS 30 million in the previous year, an increase of 66.7%. This increase in net profit stems from the increase in income, as stated, and from the reduction of NIS 19 million recorded in expenses for credit losses.

E. Private banking segment

Structure of segment

This operating segment provides a range of banking services to customers, both private individuals and companies, who have relatively medium to considerable financial wealth at their disposal. The extent of these customers' savings and investments generally exceeds NIS 0.5 million, excluding certain activity regarding risk exposure management, pertaining mostly to the raising of deposits from corporations (generally, institutional bodies).

The banking products and services offered by the Bank to private banking segment customers cover a range of investment products, including investment portfolio management, deposits, investments in securities, etc.

Segment customers are serviced by the Bank's branch network as well as by "specialized consultants" at the private banking centers, which provide specialized banking services to segment customers.

Legislative restrictions and regulations applying to the segment

The Bank operates within a framework of laws, regulations, guidelines and directives imposed upon the banking system by legislative and supervisory bodies, including the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance, the Antitrust Commissioner, the Securities Authority, the Tel Aviv Stock Exchange and so forth.

- For additional details regarding legislation processes in the United States in the matter of "enlarging the reporting by foreign financial institutions to the US tax authorities", and its possible implication on the operations of the Bank in this segment, see Chapter 6B(1) above.
- For further details regarding changes in legislation regarding bank/customer relations, and their possible implications on the operations of the Bank in this segment – see Chapter 6B(5) above.
- For additional details regarding legislation amendments introduced in 2015 with respect to bank commissions, including those initiated by Bank of Israel in this respect and their possible implications on the financial results of the Bank in this segment, see Chapter 6B(3) above.
- For further details regarding legislation and regulation Israel applying to competition in the banking sector and their possible implications on the Bank's operations in this segment – see Chapter 6B(6) above.

Developments in segment markets

The main products offered to segment customers relate to the field of investment. The products include deposits, securities, investment management, etc.

Despite the global financial crisis that was accompanied by high volatility on the capital market and a rise in the uncertainty level as to anticipated developments in the capital market, a shifting of customer funds was recorded in 2015 from the safer investment channels (including bank deposits) to the capital market. This followed the monetary measures adopted by Bank of Israel during 2012-2015 (within the framework of which, the non-linked interest rates of the monetary tenders were reduced by a cumulative rate of 2.65%) which reduced the attractiveness of investment in safe channels and bank deposits.

The low interest rate environment prevailing in the economy (in view of the continued lowering of the interest rates by Bank of Israel, as stated) and the shifting of funds from the riskless market (bank deposits) to the capital market, led to a deterioration in supply of financial resources for banks and to a significant reduction in the profitability of products in this market.

Critical segment success factors

Critical segment success factors include:

- providing professional and personal service tailored to ensure that the service and products meet the customer's preferences;
- keeping the customer informed of changing market conditions and adapting investment products accordingly;
- use of technological tools permitting the provision of professional advice and the receipt of considered decisions from customers.
- putting advanced tools at the disposal of customers of this segment, including an information system and applications enabling customers to receive information and conduct banking operations by means of mobile hardware (cellular telephones, tablet computers)

Entry and exit obstacles

As a general rule, this segment is marked by stiff competition between the banks for these customers who have financial wealth at their disposal, a high degree of sophistication, and who bear very low risk since customers in this segment have little, if any, need for credit products.

The above factors reduce transfer obstacles to a minimum for segment customers wishing to transfer their business from one bank to another.

In addition, the capital market reform legislation, in the wake of which the banks have sold some of the investment products (viz. the provident and mutual funds) utilized by segment customers and managed by the banks, has led to the exit of customers, most of whom had been attached to the private banking segment, from the banking sector, and the transfer of their custom to the banks' competitors, thereby severely aggravating the competition issue.

The above notwithstanding, the complexity of the financial operations executed by customers through the banking industry and the complexity of the legal setup supporting these operations, may complicate at times the movement of customers from one bank to another.

Within the framework of the regulation being applied to this segment, intended to increase competition and reduce barriers restricting the mobility of customers between banks, Bank of

Israel issued in 2015 instructions which enlarge the information that banks would be required to provide to customers so as to enable them to make intelligent decisions regarding the preferred bank for their financial activity.

Furthermore, the said instructions allow customers to deliver instructions for the transfer of their accounts (or their closure) by way of varied means of communication (including e-mail and telephonic instructions), as well as the possibility of opening bank account via the Internet.

Products and alternatives to products and services of segment

The legislation enacted within the framework of the Capital Market Reform prohibited the banks from marketing and managing some of the products in the investment arena, such as mutual funds, provident funds and ETF certificates, forming part of the investment products of the segment customers.

Accordingly, during 2015, the Bank intensified its activity in the investment consulting field, new consultants have been engaged and this service is now available in wider geographical areas.

Following are developments that have taken place in the products offered to segment customers, both by the Bank and by the banking industry at large:

Competition

As mentioned above, the hallmark of customers attached to this segment is a high degree of sophistication and a requirement for professional service of the highest order. This fact, combined with the absence of effective transfer obstacles, is reflected by the intense competition between all the banks for this slice of the customer base.

This competition is expressed by the relative levels of bank charges (commission and the costs of raising deposits) and the quality of the service. In addition to the competition within the banking industry itself, there is also competition for this class of customer from other entities that operate in the capital market, such as portfolio management companies, private brokers, etc.

The Bank faces the increasing competition in this segment both by developing and updating the technological, professional and human infrastructure provided to customers, by offering attractive solutions and terms and by cooperating with institutional bodies in this area, including the signing of distribution agreements with mutual fund management companies.

Furthermore, agreements signed by banks in recent years, as part of their preparation for the implementation of the legislation enacted with respect to the capital market reform, which included the sale of assets and investment products of customers mostly assigned to this segment to insurance companies and other financial entities outside the banking sector, intensified the competition for this slice of the customer base also on the part of insurance companies and other financial institutions. Against the background of competition with these institutions, the Bank is investing considerable resources in the improvement of customer service, the raising of professional standards of investment advisors, the improvement of the technological infrastructure, and the enhancement of investment products offered to customers.

Customers

The customers attached to this segment are customers with medium-sized to considerable financial wealth at their disposal. These customers are marked by sophistication, knowledge of the range of existing investment instruments and products in the banking industry and the capital market, and expect to receive a professional service at the highest level.

Within the framework of the endeavors to intensify operation of the Bank with segment customers, on the one hand, and with a view of providing optimal service to preferred customers of this segment, on the other hand, the Bank has established service centers which specialize in providing professional and prompt service to customers of this segment.

Marketing and distribution

Segment customers are approached through a variety of different channels, including advertising in the media (particularly television, radio and the press), personal approaches made by the staff at the local branch, approaches made through the Bank's telephone call center, the conveying of marketing messages through the Bank's Internet site, the mailing of circulars to customers, and the positioning of signposts and the distribution of leaflets in the local branches.

Human capital

In 2015, the average number of employee positions assigned to the private banking segment was approximately 130, including approximately 13 managerial functions.

The number of employees assigned directly to the segment was approximately 100. In addition, 30 other positions were indirectly allocated to the segment, drawn mainly from management and other head office departments, their staff costs being charged to the segment.

Condensed financial results

The condensed financial results of the private banking segment for 2015, and an analysis of the principal items therein, together with comparative data for 2014, are set out below:

For the year ended December 31, 2015

Private Banking Segment

	Banking and finances	Capital market	Total	Proportion of total results
	NIS millions			%
Interest income, net:				
• From external sources	(41)	-	(41)	
• Inter-segment	64	-	64	
	23	-	23	2.6
Non-interest financing income	-	1	1	2.7
Total financing income	23	1	24	2.6
Commission and other income	16	16	32	10.3
Total income	39	17	56	4.5
Credit loss expenses	-	-	-	-
Operating and other costs	44	23	67	8.0
Loss before taxes	(5)	(6)	(11)	-
Provision for taxes	(2)	(6)	(4)	-
Loss	(3)	(3)	(7)	-
Return on capital (%)	*	*	*	
Average balance of assets	133	18	151	0.5
Average balance of credit	98	-	98	0.5
Average balance of deposits	7,064	-	7,064	30.1
Average balance of risk assets	161	44	205	1.1
Average balance of securities	-	4,825	4,825	41.5
Components of interest income:				
Interest spread from credit operations:				
- Prior to application of FAS-91 rules	3	-	3	
- After application of the FAS-91 rules	-	-	-	
Total interest spread from credit operations	3	-	3	
Interest spread from deposit operations	20	-	20	
Total interest income	23	-	23	

* Not relevant

For the year ended December 31, 2014

Private Banking Segment

	Banking and finances	Capital market	Total	Proportion of total results
		NIS millions		%
Interest income, net:				
• From external sources	(63)	-	(63)	
• Inter-segment	94		94	
	31	-	31	3.9
Non-interest financing income	-	-	-	-
Total financing income	31	-	31	3.7
Commission and other income	15	16(2)	31	9.9
Total income	46	16	62	5.4
Credit loss expenses	-	-	-	-
Operating and other costs	47	25(1)	73	8.1
Loss before taxes	(2)	(9)	(11)	-
Provision for taxes	(1) (1)	(3) (2)	(4)	-
Loss	(1)	(6)	(7)	-
Return on capital (%)	*	*	*	
Average balance of assets	111	12	123	0.4
Average balance of credit	89	-	89	0.5
Average balance of deposits	7,309	-	7,309	31.7
Average balance of risk assets	158	34	192	1.1
Average balance of securities	-	4,746	4,746	38.6
Components of interest income:				
Interest spread from credit operations:				
- Prior to application of FAS-91 rules	3	-	3	
- After application of the FAS-91 rules	-	-	-	
Total interest spread from credit operations	3	-	3	
Interest spread from deposit operations	28	-	28	
Total interest income	31	-	31	

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Chapter 19 below and Note 1D (7-9) to the financial statements.

(2) Reclassified

* Not relevant

In 2015, income in the private banking segment amounted to approximately NIS 56 million as compared to NIS 62 million in the previous year, a reduction of 9.7%. The reduction in income is explained by a reduction of NIS 8 million in interest income, stemming from the decline in interest spreads on deposits.

In total, the year 2015 recorded a loss of NIS 7 from this segment, similar to the loss recorded in 2014. The stability recorded in the financial results despite the reduction in income, as stated, is explained by a reduction of NIS 6 million in operating expenses (mainly in payroll costs), stemming from the implications of the labor agreements signed in 2015 (see Chapter 8C to the corporate governance report).

F. Financial management segment

Structure of segment

This segment centralizes all the financial activity of the Bank is not attributed to customers, including transactions with other banks and transactions relating to the securities portfolio of the Bank.

The following areas of financial operations are included in this framework:

- Management of the active capital of the Bank with a view of maximizing the profits of the Bank by an initiated and controlled management of the Bank's surplus financial assets that is exposed to market risks, subject to compliance with "risk appetite" restrictions and restrictions on exposure to market and liquidity risks determined by the Board of Directors.
- Bank's assets and liabilities management (ALM).
- Management of exposure to market risk (including linkage base and interest exposure) and to liquidity risk.
- Management of the "capital means" component included in the planning of the capital adequacy goals of the Bank, including the raising of funds through public issuance and private placement of subordinate debt notes.
- Management of costing at the Bank - by means of determining transfer costs for all segments of operation and financial products of the Bank and the costing of special financial transactions.
- Development of financial instruments.
- Management of financial activity (in financial instruments and derivative financial instruments) with banking institutions in Israel and abroad, while complying with restrictions determined by the Board of Directors.

The financial activity in this segment, as described above, is the responsibility of the Finance Division of the Bank, operating through groups and sub-units, including: the financial group, foreign currency dealing room, securities dealing room, and the foreign currency center.

Products

As part of the financial activity of this segment, as described above, the Finance Division makes use of the following products and operations:

- Trading in securities through the management of the Bank's securities portfolio, which includes marketable investment products (mostly government bonds) and nonmarketable products (mostly corporate bonds).
- Financial instrument transactions with banks and institutional bodies, mostly by means of short-term deposits in all linkage segments.
- Derivative financial instruments transactions, used, among other things, as a central tool for the management of exposure to market and liquidity risks, and which is conducted through operations of the foreign dealing room, which is subject to the Finance Division.

The introduction of new financial instruments is subject to "risk appetite" restrictions of the Bank and requires the prior approval of the Board of Directors.

Business strategy

The business strategy in respect of the financial operations of the Bank is derived from the "risk appetite" level and is subject to limitations set by the Board of Directors in the matter of "capital adequacy" and "market risk exposure" (see extended discussion in Chapter 11B below).

The restrictions on market risk exposure set by the Board of Directors reflect a low level of "risk appetite" and allow the Bank limited freedom of action in initiating exposure.

Legislative restrictions - Regulation and special constraints applying to the segment

The Bank operates within a framework of laws, regulations, guidelines and directives imposed upon the banking industry in general and on the financial activity in particular, by legislative and supervisory bodies, including Bank of Israel the Supervisor of Banks, the Commissioner of the Capital Market, Insurance and Savings at the Ministry of Finance, the Antitrust Commissioner and the Securities Authority.

- The risk management activity in this segment is performed within the framework of the guidelines published in Proper Management of Banking Business Directive No. 310 in the matter of "risk management", which states rules for risk management, including: types of methodology, methods and procedures regarding the management of market and liquidity risks at banking corporations.
- The risk management activity in this segment is performed within the framework of the guidelines published in Proper Management of Banking Business Directive No. 333 in the matter of "interest risk management", which states rules regarding the principles and work methods which should be applied with respect to interest risk management.
- The planning of capital (including determination of the capital goals), the measurement of capital and measurement of market risk at the bank, are based on the rules and guidelines determined in Proper Management of Banking Business Directives Nos. 201-202 and 208 ("Basle III rules"). Additional information regarding the rules determined in the above Directives and their implications on capital measurement and market risk management, are 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

- For further details regarding the new rules determined in the "Dodd Frank Reform" and "Emir" approved in the United States and in Europe and their possible implications on the format of operation of dealing rooms engaged in derivative financial instruments transactions, see Chapter 6B(1), above.
- Management of the short-term liquidity risk is, inter alia, based on the rules prescribed by Proper Management of Banking Business Directive No. 221 in the matter of "liquidity coverage ratio".
- Further details regarding the provisions of the above Directive and their implications on the liquidity risk management at the Bank, are 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

- Supervision over stability indices, including risk appetite, is based, inter alia, on the principles determined in Proper Management of Banking Business Directive No. 218 in the matter of "leverage ratio". Additional information regarding the guidelines determined by this Directive and their implications on the management of the stability ratios at the Bank, 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

Developments in the markets and the business environment of the segment

Ma'alot S&P rating company published on December 23, 2015 an updated rating for the liabilities of the Bank. This rating ratified the rating published last year regarding the liabilities of the Bank, viz.: "AA".

Critical success factors

Among the factors essential for the proper operation of this segment may be mentioned:

- Maintenance of an advanced technological infrastructure, which includes information systems relating to financial and risk management, including: information systems for the measurement and reporting market risks, systems for the trading, management, measurement and reporting the activity in derivative financial instruments, systems for the trading, management, measurement and reporting the activity in securities, advanced systems for communicating with institutions engaged in currency, securities and derivative instruments trading, etc.
- The activity in this segment is marked by high competition on the one hand and by activity in sophisticated financial products on the other hand. Therefore it is required to engage in this activity quality staff that is aware of the business and economic developments occurring now and again in this segment, and to maintain the quality and relative advantages of the staff by training sessions, engagement of outside consultants and issue of professional publications and articles.
- Determination of clear limitations on exposure to risk in this segment that would reflect the "risk appetite" of the Bank.

- Determination of an updated methodology for work processes and measurement of exposure to market risk by means of the risk management function of the Bank.
- Strict and frequent control by the Risk Management Committee and by the Board of Directors over the results of operation and compliance with limitations set on exposure to market and liquidity risks, through obtaining reports from the Finance Division and the risk management unit.

Customers

Customers belonging to this segment are among the entities active in banking and capital market areas including commercial banks in Israel and abroad, brokers trading in foreign currency and securities, foreign currency dealing rooms and other institutional bodies active in the capital market.

Human capital

In 2015, the average number of employee positions assigned to the financial management segment was approximately 40, including approximately 4 managerial functions.

The number of employees assigned directly to the segment was approximately 38. In addition, 2 other positions were indirectly allocated to the segment, drawn mainly from management and other head office departments, their staff costs being charged to the segment.

Financial results of the segment

As stated above, this segment centralizes all financial operations that are not attributed to customers of the Bank. In addition, included in the income of the segment is the net interest income on the financial resources provided by the segment for credit operations, after deduction of the interest cost to the segment of deposit activity (determined by the transfer price mechanism). Furthermore, in accordance with the methodology for the measurement of the financial results of the Bank by segments of operation, the results of the Bank's exposure to market risk are also charged to this segment (while the results of credit risk are charged to the other operating segments of the Bank).

Accordingly, the financing income components of this segment include:

- Net interest income in respect of the difference between the yield on assets and the cost of the financial resources of the Bank in terms of "transfer prices", namely – this component reflects the yield on the active capital of the Bank in terms of "transfer prices".
- The results of exposure to linkage base risks, comprising the net income from linkage increments and exchange differences accrued on the active capital
- Financial results stemming from adjustment to fair value of derivative financial instruments balances and securities in the trading portfolio.
- Results of exposure to interest risk stemming from changes in interest rates occurring during the period and from period to maturity gaps between assets and liabilities exposed to such interest rate changes.
- Financial results stemming from trading in the securities portfolio of the Bank.
- Dividend income from the Bank's investments in securities (including in venture capital funds).

- Provisions for impairment of securities classified as "losses of a nature other than temporary".

In 2015, the profit from operations of the financial management segment amounted to NIS 42 million as compared to a profit of NIS 11 million in the previous year. The growth in net profit stems both from a growth of NIS 4 million in financing income and fro the growth of NIS 32 million in other income.

The growth in financing income stems mostly from two components having opposite impacts, as follows:

- On the one hand, a growth of NIS 11 million in interest income, stemming mainly from the growth in contribution of the active capital.
- And on the other hand, a reduction of NIS 7 million in non-interest financing income, stemming mainly from two factors having opposite impacts, as follows:
  - On the one hand, a growth of NIS 7 million in loss on adjustment to fair value of derivative financial instruments.
  - And on the other hand, a growth of NIS 4 million in realized and unrealized gains on securities.

In addition, income from the sale of buildings in the amount of NIS 33 million was classified to this segment, increasing the net profit of the segment by NIS 25 million (see Note 24B(10) to the financial statements).

(4) Activity with respect to products

A. Capital market activity

Services provided by the Bank to its capital market customers include mainly securities advisory services (including mutual funds distribution). The services in this area of operations are provided through the branch network of the Bank. The professional support for the products and services offered in this field is the responsibility of the Retail Banking Division.

The development of new products, information systems (including trading systems) and more in this area is the responsibility of the Finance Division. For further details as to the activity of the Bank in the capital market, see Chapter 8A above.

Legislative restrictions, regulations and special constraints applying to this segment

The activity of banks in this field is regularized by legislation enacted by the Knesset and by proper management instructions issued by Bank of Israel in this respect.

- For further details regarding legislation and regulation Israel applying to competition in the banking sector and their possible implications on the Bank's operations in this segment – see Chapter 6B(6) above.

- For additional details regarding US legislation regarding compliance with US tax laws (FATCA) and their possible implications on the operations of the Bank in this respect – see Chapter 6B(1), above.

- For additional details regarding legislation amendments introduced in 2015 with respect to bank commissions, including those initiated by Bank of Israel in this respect and their possible implications on the financial results of the Bank in this segment, see Chapter 6B(3) above.

New products

During the course of 2015, the Bank continued the development and integration of an advanced Internet based information system that allows customers active on the capital market, to trade and obtain detailed and up-to-date information regarding everything pertaining to capital markets events and trends in general, and in particular with respect to their investments, and personally make changes in their investment portfolio.

Competition

The activity in most of the products in this field (securities advisory services and investment portfolio management) faces stiff competition between the banks and institutional factors (investment houses and other financial institutions).

Such competition is intensified by a wealth of information being published by the various media means, to which customers at large are exposed. This information includes data as to return on investments, risks and other segment information regarding each of the investment and savings channels, as well as ratings of the various entities managing assets in these channels.

Within the framework of this competition, the Bank invests many resources in the improvement of the service and the enhancement of the professional level of the staff engaged in this field.

Customers

Most of the customers active in this field come from the private banking segment and are typified by medium and above financial wealth, awareness of the variety of investment opportunities and products existing in this field and require service at the highest level.

Marketing and distribution

The marketing of products in this field is made through a variety of different channels, including advertising in the media, including television, the press and the Internet.

In addition, personal approaches to customers are made by the staff of the branch network, approaches made through the Bank’s telephone call center, the mailing of circulars to customers, and the positioning of signposts and the distribution of leaflets in the local branches.

Condensed financial results

The condensed financial results of the capital market activities for 2015, presented according to segments of operation and an analysis of the principal items therein, together with comparative data for 2014, are set out below:

For the year ended December 31, 2015
The Capital Market

	Household	Small business	Middle market banking	Corporate banking	Private banking	Total
	NIS millions					
Interest income, net:						
• From external sources	-	-	-	-	-	-
• Inter-segment	-	-	-	-	-	-
Non-interest financing income	-	-	-	-	1	2
Total financing income	-	-	-	-	1	2
Commission income	8	4	1	1	16	30
Total income	-	4	1	1	17	32
Credit loss expenses	-	-	-	-	-	-
Operating and other costs	17	6	1	4	23	51
Loss before taxes	(8)	(2)	-	(3)	(6)	(19)
Provision for taxes	(3)	(1)	-	(1)	(2)	(7)
Loss after taxes	(5)	(1)	-	(2)	(4)	(12)
Return on capital (%)		*	*	*	*	*
Average balance of assets	14	5	1	3	18	41
Average balance of Credit	-	-	-	-	-	-
Average balance of deposits	-	-	-	-	-	-
Average balance of risk assets	27	12	2	5	44	90
Average balance of securities	1,172	686	221	4,732	4,825	11,636
Components of interest income:						
Interest spread from credit operations						
Interest spread from deposit	-	-	-	-	-	-
operations	-	-	-	-	-	-
Total interest income	-	-	-	-	-	-

* Not relevant

For the year ended December 31, 2014
The Capital Market

	Household	Small business	Middle market banking	Corporate banking	Private banking	Total
	NIS millions					
Interest income, net:						
• From external sources	-	-	-	-	-	-
• Inter-segment	-	-	-	-	-	-
	-	-	-	-	-	-
Non-interest financing income	1	-	-	-	-	1
Total financing income	1	-	-	-	-	1
Commission income	6(2)	4(2)	1	1	16(2)	28
Total income	7	4	1	1	16	29
Credit loss expenses	-	-	-	-	-	-
Operating and other costs	19(1)	7	2	4	25(1)	57
Loss before taxes	(12)	(3)	(1)	(3)	(9)	(28)
Provision for taxes	(5) (1)	1(2)	(1)	(1)	(3) (2)	(11)
Loss after taxes	(7)	(2)	-	(2)	(6)	(17)
Return on capital (%)	*	*	*	*	*	*
Average balance of assets	8	3	1	2	12	26
Average balance of Credit	-	-	-	-	-	-
Average balance of deposits	-	-	-	-	-	-
Average balance of risk assets	19	14	1	4	34	72
Average balance of securities	1,068	593	609	5,294	4,746	12,310
Components of interest income:						
Interest spread from credit operations	-	-	-	-	-	-
Interest spread from deposit	-	-	-	-	-	-
Total interest income	-	-	-	-	-	-

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Chapter 19 below and Note 1D (7-9) to the financial statements.
(2) Reclassified
* Not relevant

Income from capital market operations amounted in 2015 to NIS 32 million in comparison with NIS 29 million in the previous year, an increase of 10.3%.

In total, the year 2015 recorded a loss from this segment of NIS 12 million as compared to a loss of NIS 17 million in the previous year. The reduction in the loss stems both from the said growth in income and from the reduction of NIS 6 million in operating expenses (mostly payroll costs) stemming from the labor agreements signed in 2015 (see Chapter 7B, above).

B. Mortgage loan operations

The services provided by the Bank in this field include the granting of housing loans (to private customers) and commercial mortgages to the retail, middle-market and corporate sectors.

These services are given by the mortgage group within the Retail Banking Division, excluding services to the income producing real estate segment (commercial mortgages) to customers having a credit facility of over NIS 7 million.

Legislative restrictions, regulations and special constraints applying to this segment

Activity in the housing loan area is being regulated by the "Sales Act (Apartments) and by Proper Management of Banking Business Directives issued in this matter.

Against the background of the steep increases recorded in the prices of apartments in the years 2010 to 2015, and the growth in the leverage rates recorded in housing loans, which might adversely affect the stability of the banking sector, Bank of Israel has issued in recent years new proper management of banking business directives and amendments of existing directives intended to restrict the leverage level of this product and to reduce the possible exposure of the banking sector to possible credit failure (by updating the risk weights attributed to such loans).

Products

The products offered by the Bank are basically similar to the products offered by other banks.

Competition

The housing loan area is considered by most banks in this sector, an attractive target for the development of banking business, as it is characterized by a relatively low risk level and as having a potential for the development of additional banking business with customers who have been granted service in this field. Accordingly stiff competition has developed in this field reflected mostly in price levels (interest spreads and rates of commission).

The means employed by the Bank in facing competition in this field include: the improvement of customer service, maintaining personal contact with customers while granting price discounts at times.

Developments in the segment markets

A large growth in demand for housing loans was recorded in recent years leading to a growth in the volume of mortgage loans granted. This followed the growing demand in the housing market and the rising prices due to the shortage in supply of housing units in relation to demand. The growth in the volume of housing loans exceeds the growth rate of the economy and the growth rate in the standard of living and in the income of households. Accordingly, in view of the above, concern exists as to the possible deterioration in the quality of the housing loan portfolio and the increase in exposure of banks to credit risk. For additional details regarding credit risk exposure management relating to this product, see Chapter 12F, below.

Information regarding the activity of the Bank with respect to housing loans, including details regarding the characteristics of this portfolio, is set out below:

- Distribution of the housing loan portfolio of the Bank (including loans secured by a mortgage on a residential unit) by principal characteristics:

Distribution by linkage base:

	December 31, 2015		December 31, 2014	
Linkage base	**NIS millions**	**%**	**NIS millions**	**%**
Non-linked	**1,828**	**55.2**	1,419(1)	47.6
CPI linked	**1,223**	**36.9**	1,288(1)	43.2
In foreign currency or linked thereto	**259**	**7.9**	277	9.2
Total	**3,310**	**100.0**	2,984	100.0

Distribution by credit levels:

Level of credit (NIS thousands)		December 31, 2015		December 31, 2014	
From	**To**	**NIS millions**	**%**	**NIS millions**	**%**
-	600	**1,532**	**46.3**	1,428(1)	47.8
600	1,200	**1,108**	**33.5**	933(1)	31.3
1,200	4,000	**619**	**18.7**	567(1)	19.0
4,000	-	**51**	**1.5**	56(1)	1.9
Total		**3,310**	**100.0**	2,984	100.0

(1) Restated

Distribution by credit portfolio quality characteristics:

Quality characteristics	December 31, 2015 NIS millions	December 31, 2014 NIS millions	Rate of change %
Stated balance of debt	**3,310**	2,984(1)	10.9
Amount in arrears	**44**	22	100.0
Provision for credit losses	**16**	13	23.1
Balance of troubled debts	**57**	49	16.3
Rate of troubled debt (%)	**1.7**	1.6	6.2

- Distribution of housing loans (excluding loans secured only by a residential unit) granted in 2015, by principal characteristics, as compared with the previous year**:**

Distribution by value of collateral:

Collateral value (NIS thousands)		December 31, 2015		December 31, 2014	
		NIS millions	%	NIS millions	%
From	**To**				
-	800	**89**	**12.3**	77	16.3
800	1,200	**169**	**23.4**	103	21.8
1,200	3,000	**370**	**51.3**	222	47.0
3,000	-	**93**	**13.0**	70	14.9
Total		**721**	**100.0**	472	100.0

Distribution by level of financing (LTV):

Level of financing (LTV) – (%)		December 31, 2015		December 31, 2014	
		NIS millions	%	NIS millions	%
From	**To**				
-	45	**207**	**28.7**	156	33.0
45	60	**293**	**40.6**	193	40.8
60	-	**221**	**30.7**	123	26.2
		721	**100.0**	472	100.0

Distribution by repayment ability of borrower:

Ratio of repayment to income (%)		December 31, 2015		December 31, 2014	
		NIS millions	%	NIS millions	%
From	**To**				
-	30	**473**	**65.6**	322	68.2
30	40	**164**	**22.7**	89	18.9
40	60	**3**	**0.4**	8	1.6
60	-	**2**	**0.3**	5	1.0
Deferred loans (bullet)		**79**	**11.0**	48	10.3
		721	**100.0**	472	100.0

(1) Reclassified

Distribution by repayment periods

Repayment period (years)		December 31, 2015		December 31, 2014	
		NIS millions	%	NIS millions	%
From	**To**				
-	20	**321**	**44.5**	240	50.8
20	25	**361**	**50.0**	227	48.1
25	-	**39**	**5.5**	5	1.1
		721	**100.0**	472	100.0

Condensed financial results

The condensed financial results of the mortgage loan activities for 2015, presented according to segments of operation and an analysis of the principal items therein, together with comparative data for 2014, are set out below:

For the year ended December 31, 2015

Mortgage loans

	Households	Small businesses	Corporate banking	Total
	NIS millions			
Interest income, net:				
• From external sources	**90**	**15**	**4**	**109**
• Inter-segment	(56)	(5)	(1)	(62)
	34	**10**	**3**	**47**
Non-interest financing income	**-**	**-**	**-**	**-**
Total financing income	**34**	**10**	**3**	**47**
Commission and other income	**3**	**-**	**-**	**3**
Total income	**37**	**10**	**3**	**50**
Credit loss expense (income)	**3**	(1)	**-**	**2**
Operating and other expenses	**37**	**7**	**3**	**47**
Income (loss) before taxes	(3)	**4**	**-**	**1**
Provision for taxes	(2)	**2**	**-**	**-**
Net income (loss)	(1)	**2**	**-**	**-**
Return on capital (%)	*****	**7.0**	**-**	**0.3**
Average balance of assets	3,230	**402**	**144**	3,776
Average balance of credit	3,201	**397**	**141**	3,739
Average balance of deposits	**-**	-	-	-
Average balance of risk assets	1,831	**348**	**149**	2,328
Average balance of securities				
Components of interest income:				
Interest sperad from credit operations:				
- Prior to application of FAS-91 rules	**33**	**9**	**3**	**45**
- After application of the FAS-91 rules	**1**	**1**	**-**	**2**
Total interest spread from credit operations	**34**	**10**	**3**	**47**
Interest spread from deposit operations	**-**	-	-	-
Total interest income	**34**	**10**	**3**	**47**

* Not relevant

For the year ended December 31, 2014

Mortgage loans

	Households	Small businesses	Corporate banking	Total
	NIS millions			
Interest income, net:				
• From external sources	90	14	6	110
• Inter-segment	(60)	(6)	(2)	(68)
	30	8	4	42
Non-interest financing income	-	-	-	-
Total financing income	30	8	4	42
Commission and other income	2	-	-	2
Total income	32	8	4	44
Credit loss income	(1)	-	-	(1)
Operating and other expenses	39(1)	5	3	47
Income (loss) before taxes	(6)	3	1	(2)
Provision for taxes	(2)	1	1	-
Net income (loss)	(4)	2	-	(1)
Return on capital (%)	*	4.5	-	*
Average balance of assets	2,967	416	153	3,536
Average balance of credit	2,949	413	152	3,514
Average balance of deposits	-	-	-	-
Average balance of risk assets	1,565	375	151	2,091
Components of interest income:				
Interest spread from credit operations:				
- Prior to application of FAS-91 rules	29	8	4	41
- After application of the FAS-91 rules	1	-	-	1
Total interest spread from credit operations	30	8	4	42
Interest spread from deposit operations	-	-	-	-
Total interest income	30	8	4	42

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Chapter 19 below and Note 1D (7-9) to the financial statements.

* Not relevant

Income from mortgage loan operations amounted in 2015 to NIS 50 million, in comparison to NIS 44 million in the previous year, an increase of 13.6%,

In total for 2015, the Bank recorded a profit of NIS 1 million from operations in this field in contrast to a loss of NIS 2 million recorded last year. The improvement in the business results stemmed from the growth 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, 2015 to NIS 31 million and its shareholders' equity amounted to NIS 23 million (December 31, 2014 – NIS 45 million and NIS 36 million, respectively). The contribution of Tafnit to the net profits of the Bank in 2015 amounted to NIS 2 million, similarly to that of the previous year.
The scope of investment portfolios managed by Tafnit on December 31, 2015, amounted to NIS 6.6 billion, comprising a growth of 8.2% as compared with that of December 31, 2014.

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 – 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.

Environmental risk – defined as exposure of the Bank to possible sanctions due to damage to the environment caused by the Bank (directly or indirectly), as well as possible exposure to credit loss, due to potential sanctions that would be imposed on borrowers of the Bank due to environmental damage caused by them, and loss due to regulations relating to the environment and the enforcement thereof. The Bank may be exposed to environmental risks in the different aspects of its operations, and these risks might be included in the framework of the other risks (such as: credit risk, operating risk, legal risk and reputation risk, due to the possibility of the bank being linked to the factor causing the environmental risk).Examples for environmental risks are a decline in the value of realized collateral, or deterioration in the financial condition of a borr45ower due to impairment of his business or due to costs stemming from legislation and instructions relating to the protection of the environment.

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.

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.

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, generally in the position of 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: corporate-business 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 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 policy 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 Corporate-Business Division of the Bank deals both with the management, arrangement and collection of troubled debts handled by the Corporate-Business 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, 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**

	December 31, 2014		
	Balance sheet	**Off-balance sheet**	**Total**
		NIS millions	
Impaired debts	350	2	352
Substandard credit risk	42	-	42
Credit risk under special supervision	177	57	234
Total troubled credit risk* (2)	569	59	628
Less/- provision for credit losses	105	3	108
Net troubled credit risk*	464	56	520
* Of which: unimpaired debts in arrear for 90 days or over	20(3)	-	20

2. Nonperforming assets

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

	December 31, 2014		
	Balance sheet	**Off-balance sheet**	**Total**
		NIS millions	
Impaired debts(1)	279(3)	2	281
Assets received in settlement of debts	-	-	-
Total nonperforming assets	279	2	281

(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.
(3) Reclassified

(B) Developments in impaired debts:

	December 31,			
	2015		2014	
	Restructured	Other	Restructured	Other
	NIS millions			
Balance at beginning of year:				
- Stated debt balance	**137**	**205**	163	233
- Less provision for credit loss	**(8)**	**(70)**	(42)	(66)
Net balance	**129**	**135**	121	167
Changes in debts during the year:				
- Impaired debts	**54**	**90**	65	116
- Collections and write-offs	**(49)**	**(105)**	(75)	(160)
- Failed restructures	**(9)**	**9**		(16)
Total changes in debts	**(4)**	**(6)**	(26)	(28)
Changes in provisions for credit loss:				
- Addition to provisions	**4**	**28**	5	51
- Collections and write-offs	**(4)**	**(34)**	(39)	(47)
Total changes in provisions	**-**	**(6)**	(34)	4
Balance at end of year*	**125**	**135**	129	135
* **Composition:**				
Stated balance of debt	**133**	**199**	137	205
Provision for credit losses	**(8)**	**(64)**	(8)	(70)
Total at end of year	**125**	**135**	**129**	**135**

1390 debts were restructured by the Bank in 2015, in a total amount of NIS 81 million (2014 – 1,698 debts and NIS 103 million, respectively). In addition, 344 credit failures were recorded in 2015 in respect of debts that had been restructured in the previous year, in a total amount of NIS 5 million (2014 – 321 credit failures in a total amount of NIS 6 million, respectively).

(C) Financial ratios:

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 Bank of Israel Directives:

	December 31, 2015	December 31, 2014
	%	%
Ratio of balance of impaired credit to total credit to the public(1)	**1.6**	1.8(3)
Ratio of balance of credit(2) in arrears for 90 days or over (not impaired) to total credit to the public	**0.2**	0.1
Ratio of troubled credit risk(2) to total credit to the public	**2.7**	2.6
Ratio of credit loss expenses to average balance of credit(2)	**0.3**	0.1
Ratio of net write-offs to average balance of credit(2)	**0.2**	0.3

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

(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, 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**

	December 31, 2014			
	Private individuals			
	Commercial	Housing	Other	Total
	%			
Ratio of credit loss expense (income) to total credit	0.2	-	(0.3)	0.1
Ratio of impaired debts to total credit	2.3	-	1.2	1.8
Ratio of troubled debts to total credit	3.4	1.6	2.2	2.9
Ratio of debts in arrears for over 30 days to total credit	0.1	0.7	0.5	0.3

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 growth was recorded in 2015, in the ratio of credit loss expenses of the Bank to credit to the public, from 0.1% in 2014 to 0.3% in the reported period. Notwithstanding the above, and whereas other parameters (such as: rate of 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, 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**

	Year ended December 31, 2014					
	Credit to the public					
	Private					
	Commercial	Housing	Other	Total	Banks and governments	Total
	NIS millions					
Balance of provision at beginning of year	300	14	67	381	1	382
Credit loss expenses (income)	24	(1)	(8)	15	-	15
Accounting write-offs	(117)	-	(50)	(167)	-	(167)
Collection of debts written off in prior years	60	-	45	105	-	105
Net accounting write-offs	(57)	-	(5)	(62)	-	(62)
Balance of provision at end of year	267	13	54	334	1	335
* Of which: in respect of off-balance sheet credit instruments	13	-	2	15	-	15

(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		
	2015	**2014**	**Change**
	%	**%**	**Percentage points**
Ratio of provision for credit losses(2) to total credit to the public(1)	**1.6**	1.7	(0.1)
Ratio of provision for credit losses(2) to impaired credit	**21.7**	22.8	(1.1)
Ratio of net write-offs to balance of credit loss provision	**10.4**	19.4	(9.0)
Ratio of credit loss balance(2) to impaired credit and credit in arrears(3)	**19.8**	21.6	(1.8)

(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, 2015			December 31, 2014		
Economic sector	**Total credit risk(1)**	**Troubled debts**	**Credit loss provision**	**Total credit risk(1)**	**Troubled debts**	**Credit loss provision**
Private individuals(2)	**8,005**	**127**	**71**	7,272	121	67
Construction and real estate(3)	**5,571**	**186**	**54**	5,219	176	58
Trading(5)	**4,512**	**145**	**102**	4,477	119	101
Industry	**2,539**	**70**	**44**	2,424	67	36
Other business services(4)	**1,418**	**42**	**22**	1,149	40	21
Transportation and storage	**986**	**42**	**32**	899	41	19
Financial services	**360**	**6**	**7**	307	1	2
Other (less than 5%)	**1,980**	**48**	**34**	1,791	55	30
Total	**25,371**	**666**	**366**	23,538	620	334

* 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 743 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 352 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 269 million, recorded in the other business services sector stems mainly from credit in low amounts granted to companies and businesses in the retail sector.
(5) The growth in volume of troubled debts in the trading sector amounting to NIS 26 million stems mainly from the reclassification of a small number of large business borrowers, whose repayment ability has deteriorated.

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		
	2015	2014	Change
	NIS millions		%
Governments	**97**	19	410.5
Banks	**321**	484	(33.7)
Other	**301**	271	11.1
Total	**719**	774	(7.1)

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

Exposure of the Bank to foreign countries declined in 2015 by 7.1%.
On the one hand, a growth of NIS 78 million was recorded in exposure of the Bank to foreign governments (mainly from the purchase by the Bank of US Government bonds), which was offset by a reduction of 33.7% in exposure to foreign banks (mostly a decline in deposits with banks in the US and in Britain).

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, 2015, the credit exposure of the Bank to foreign financial institutions[1] amounted to NIS 363 million (December 31, 2014 - NIS 533 million) as detailed below:

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**

December 31, 2014

Independent credit rating	Balance sheet credit risk(2)	Off-balance sheet credit risk(3)	Total credit risk(4)
		NIS millions	
AA- to AAA	209	-	209
A- to A+	274	5	279
BB- to BBB+	4	-	4
With no rating	1	40	41
Total credit exposure to foreign financial institutions	488	45	533

(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, 2015, 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 8 million (December 31, 2014 – NIS 1 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, 2015, 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”. This exposure is included in the report on "total credit risk to the public according to economic sectors” included in Appendix No. 1

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, 2015, amounts to NIS 3,310 million (December 31, 2014 – NIS 2,984* million).

The volume of housing loans granted by the Bank in 2015, amounts to NIS 910 million, of which NIS 133 million in respect of recycled loans (2014 – NIS 625 million and NIS 87 million, respectively).

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

	December 31, 2015	**December 31, 2014**
	%	**%**
Ratio of housing loans financing over 75% of the value of the property(1)	**3.1**	4.2
Ratio of housing loans, the monthly repayment of each exceeds 35% of the borrower's income	**11.0**	11.3
Ratio of housing loans carrying variable interest to total housing loan portfolio(2)	**72.1**	77.5

* Reclassified

(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 developments in housing loans in 2015 – by rates of finance and by amounts of loan subject to changes in repayment (variable interest):

		December 31, 2015			**December 31, 2014**		
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%	**679**	**1,844**	**2,523**	516	1,829	2,345
	- Over 60%	**198**	**542**	**740**	103	485	588
Secondary pledge or no collateral		**47**	**-**	**47**	50	1	51
Total		**924**	**2,386**	**3,310**	669	2,315	2,984

(1) of which – loans which include deferred components ("bullets") the balance of which as at December 31, 2015 amounted to NIS 86 million (2014 – NIS 77 million).

The Bank's housing loan portfolio recorded in 2015 an increase of 10.9%, 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 78%) 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, an in accordance 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, 2015 to NIS 4 million. 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 that date.

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 increased the provisions for credit losses on a collective basis in 2015 by an immaterial amount, similarly to the previous year.

H. 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, 2015	**December 31, 2014**	**Change**
Economic sector	**NIS millions**		
Commerce	**73**	118	(45)
Real estate	**84**	117*	(33)
Transportation	**-**	56	(56)
Total exposure to leverage finance	**157**	291	(!#$)

* Reclassified

(1) Two new Proper Management 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". For additional information in the matter – see Chapter 6B (7) above.

I. 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. 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 December 28, 2015, 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) (previously – 2% and 4%, respectively).
- 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) (previously – 3.5% in both cases).
- for the foreign currency segment – up to 2% of the Bank's capital (previously – 1% 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 December 28, 2015, 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.

The Bank also applies an "interim stress test" in which it examines the effect on the Tier I equity capital. In addition, a restriction has been determined in this case, according to which the reduction in the equity capital of the Bank in such a case shall not exceed 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 redemptions 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 redemptions is based on past experience as regards premature redemptions in this type of loans. Furthermore, the Bank makes use of assumptions regarding the following:

- scope of premature withdrawals of savings deposits.
- scope 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.

As from January 1, 2015, the Bank applies the US accepted accounting principles regarding employee rights. In accordance with the measurement rules prescribed by the new 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. 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:
  Securities and subordinate debt notes - 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 27 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 65 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, 2015				
	Israeli currency		Foreign currency**		
	Non-linked	CPI linked	US dollar	Other	Total
Financial assets*	**24,878**	**2,951**	**1,341**	**466**	**29,636**
Receivables in respect of derivative and off-balance sheet financial instruments***	**1,095**	**1,285**	**2,454**	**578**	**5,412**
Financial commitments*	**(21,106)**	**(3,776)**	**(2,162)**	**(664)**	**(27,780)**
Payables in respect of derivative and off-balance sheet financial instruments***	**(3,294)**	**(204)**	**(1,639)**	**(393)**	**(5,530)**
Net fair value of financial instruments	**1,573**	**256**	**(6)**	**(13)**	**1,810**

	December 31, 2014				
	Israeli currency		Foreign currency**		
	Non-linked	CPI linked	US dollar	Other	Total
Financial assets*	22,709	3,804	1,242	502	28,257
Receivables in respect of derivative and off-balance sheet financial instruments***	606	531	3,264	822	5.223
Financial commitments*	(18,854)	(4,178)	(2,612)	(729)	(26,373)
Payables in respect of derivative and off-balance sheet financial instruments***	(2,631)	(181)	(1,917)	(586)	(5,315)
Net fair value of financial instruments	1,830	(24)	(23)	9	1,792

* Including hybrid financial instruments. Excluding stated amounts of derivative financial instruments and fair value of off-balance sheet financial instruments.

** Including Israeli currency linked to foreign currency

*** 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, 2015							
	Net fair value of financial instruments, after effect of interest rate changes*						Change in fair value	
	Israeli currency		Foreign currency**					
	Non-linked	CPI linked	US dollars	Other	Offsetting effects	Total	NIS millions	%
Immediate parallel increase of 1%	**1,557**	**297**	**1**	**(14)**	**-**	**1,841**	**31**	**1.7**
Immediate parallel increase of 0.1%	**1,571**	**261**	**(5)**	**(12)**	**-**	**1,815**	**5**	**0.3**
Immediate parallel decrease of 1%	**1,580**	**212**	**(14)**	**(12)**	**-**	**1,766**	**(44)**	**(2.4)**

	December 31, 2014							
	Net fair value of financial instruments, after effect of interest rate changes*						Change in fair value	
	Israeli currency		Foreign currency**					
	Non-linked	CPI linked	US dollars	Other	Offsetting effects	Total	NIS millions	%
Immediate parallel increase of 1%	1,812	19	(27)	7	-	1,811	19	1.1
Immediate parallel increase of 0.1%	1,829	(19)	(23)	9	-	1,796	4	0.2
Immediate parallel decrease of 1%	1,844	(71)	(19)	10	-	1,764	(28)	(1.6)

* 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.

** 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, 2015				
	Israeli currency		Foreign currency**		
	Non-linked	CPI linked	US dollar	Othe	Total
Financial assets*	**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*	**(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**

	December 31, 2014				
	Israeli currency		Foreign currency**		
	Non-linked	CPI linked	US dollar	Other	Total
Financial assets*	23,465	3,847	1,306	518	29,136
Receivables in respect of derivative and off-balance sheet financial instruments	574	529	3,204	759	5,066
Financial commitments*	(18,744)	(4,141)	(2,613)	(730)	(26,228)
Payables in respect of derivative and off-balance sheet financial instruments	(2,610)	(192)	(1,815)	(523)	(5,140)
Net fair value of financial instruments	2,685	43	82	24	2,834

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

** 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, 2015							
	Net fair value of financial instruments, after effect of interest rate changes**						Change in fair value	
	Israeli currency		Foreign currency*					
	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)**

	December 31, 2014							
	Net fair value of financial instruments, after effect of interest rate changes**						Change in fair value	
	Israeli currency		Foreign currency*					
	Non-linked	CPI linked	US dollars	Other	Offsetting effects	Total	NIS millions	%(2)
Immediate parallel increase of 1%	2,691	82	77	23	-	2,873	39	1.4
Immediate parallel increase of 0.1%	2,686	47	82	24	-	2,839	5	0.1
Immediate parallel decrease of 1%	2,681	1	88	25	-	2,795	(39)	(1.4)

* Including Israeli currency linked to foreign currency.

** 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.

Notes:

(1) 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 1.53%, 0.09% and 1.02% respectively (December 31, 2014 – 2.73%, 0.30% and 0.29%, respectively).

(2) 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%: 3.48%-1.12% (2014 – 2.4%-1.1%); in respect of a parallel increase of 0.1%: 0.37%-0.12% (2014 - 0.2%-0.1%); in respect of a parallel decrease of 1%: (-3.76%) – (-0.99%) (2014 - (-2.4)%-(-1.2)%).

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, 2015			December 31, 2014		
	Non-linked	**CPI-linked**	**Foreign Currency****	**Non-linked**	**CPI-linked**	**Foreign Currency****
Average maturity of assets (years)	**0.45**	**2.16**	**0.64**	0.51	2.73	0.47
Average maturity of liabilities (years)	**(0.39)**	**(3.26)**	**(0.79)**	(0.38)	(3.54)	(0.39)
Difference in average maturity (years)	**0.06**	**(1.10)**	**(0.15)**	0.13	(0.81)	0.08
Maximum loss in relation to capital (*) (percentages)	**0.2**	**4.2**	**0.3**	0.2	2.1	0.3

(*) For each 1% change in interest rates
(**) 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, 2015 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 foreign currency segment, the Bank executes interest rate swap (IRS) and forward rate agreements (FRA), thereby curtailing the risk exposure associated with changes in interest rates.

In the CPI-linked segment, as of December 31, 2015, the average maturity of liabilities exceeded the average maturity of assets by approximately 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 six 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 withdraws 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:

	31.12.2015			31.12.2014		
	Non-linked	**CPI linked**	**Foreign currency**	**Non-linked**	**CPI linked**	**Foreign currency**
Average period to maturity difference (years):						
	0.10	**(0.49)**	**0.95**	0.11	(0.52)	0.67
	(0.04)	**(0.61)**	**(1.10)**	0.02	(0.29)	(0.59)
Net average period to maturity difference	**0.06**	**(1.10)**	**(0.15)**	0.13	(0.81)	0.08
Maximum loss in relation To capital (%):						
Prior to transactions in derivatives	**(0.4)**	**4.1**	**(0.8)**	0.1	1.8	0.4
Effect of transactions in derivatives	**0.6**	**0.1**	**1.1**	0.1	0.3	(0.1)
Net maximum loss(1)	**0.2**	**4.2**	**0.3**	0.2	2.1	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% until December 28, 2015: (-20%) to 120%) 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, 2015, in comparison to last year and before and after the effect of transactions in derivative instruments (in NIS millions):

	Accounting exposure					
	31.12.2015			31.12.2014		
Linkage segment	**Before derivatives**	**Effect of derivatives**	**Net exposure**	**Before derivatives**	**Effect of derivatives**	**Net exposure**
Non-linked shekel	3,512	(2,173)	1,339	(2)3,409	(2,003)	1,406
CPI linked shekel	(726)	1,155	429	(279)	402	123
Foreign currency(3)	(1,027)	1,018	(9)	(1,614)	1,601	(13)
Total	1,759	-	1,759	1,516	-	1,516

	"Economic" exposure					
	31.12.2015			31.12.2014		
Linkage segment						
Non-linked shekel	4,175	(2,178)	1,997	3,850	(2,001)	1,849
CPI linked shekel	(1,325)	1,155	(170)	(284)	402	118
Foreign currency(3)	(1,016)	1,023	7	1,605) (	1,599	(6)
Total base exposure	1,834	-	1,834	1,961	-	1,961

(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) Restated in respect of the retroactive application of US accepted accounting principles in the matter of employee rights – see Note 1D (7) to the financial statements.

(3) Including linked to foreign currency.

As of December 31, 2015, the surplus liabilities in the CPI-linked segment totaled approximately NIS 170 million. The rate of investment of the active capital in the non-linked segment reached (-9)%, as compared to 94%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, 2015 to a negligible rate, similar to that of the previous year.

In 2015, due to the low inflationary environment and the preferential returns earned in the non-linked segment, the Bank shifted a considerable part of its surplus assets from the CPI-linked segment to the non-linked segment.

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

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, 2015, based on the balances of financial assets and liabilities in those currencies (including transactions in off-balance sheet instruments) as of December 31, 2015, 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	*	*	*	*
Euro	(1)	*	*	1
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, 2015, the marketable portfolio did not include any shares (December 31, 2014 – same).

- **Strategy and processes**

In principle, the Bank avoids in general financial investments in shares in its banking portfolio. As of December 31, 2015, 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. (17.8% stake in equity).
- Non-financial investments in negligible rates 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-Corporate 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-Corporate 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 in the banking portfolio of the Bank:

	December 31, 2015	**December 31, 2014**
	NIS millions	
Cost[(1)]	**15**	21
Adjustment to fair value	**2**	[(3)]2
Fair value[(2)]	**17**	23

(1) In respect of these shares, a provision for impairment of a nature other than temporary was recognized at December 31, 2015, in the amount of NIS 5 million (December 31, 2014 – NIS 10 million).

(2) Fair value data at December 31, 2015, do not include balances based on market quoted price (December 31, 2014 – identical).

(3) Reclassified.

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

	December 31, 2015	**December 31, 2014**
	NIS millions	
Non-marketable investments	**17**	23
Marketable investments	**-**	-
Total	**17**	23

(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. This target was approved by the Board of Directors in October 2013.

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 new 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 additions banks are required to maintain minimum liquidity coverage ratios, which take effect gradually, as follows:

- At the effective date of the Directive – a liquidity coverage ratio of not less than 60%.
- The relief will be gradually reduced in each year until the full elimination thereof on January 1, 2017.

Following are data used in the computation of the Liquidity coverage of the Bank:

	December 31, 2015
Quantitative data	**NIS millions**
High quality liquid assets	**7,266**
Net cash outflow	**6,268**
Liquidity rates	**%**
Liquidity coverage ratio	**116**

(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, 2015:

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 8.3 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 0.2 billion) is to be classified as an asset having no repayment date. A part of this deficit is covered by surplus of NIS 1.0 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, 2015, 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 3.3 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 0.9 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, 2015 to NIS 1.1 billion.

The Bank's volume of transactions in options at December 31, 2015 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) filed in November 2015, a draft prospectus for the raising of long-term resources through the issue of bonds in an amount of up to NIS 250 million.

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 2012-2015, 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 policy adopted by it in 2012, and also in 2015 reduced the monetary tender interest rate by 0.15 percentage points to the low rate of only 0.10% (December 31, 2014 – 0.25%)

  Following are data regarding the economic indicators, which marked the year 2015:

  - A moderated inflationary environment: in 2015, a reduction of 1.0% was recorded in the CPI, indicating a 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 the volatility at the rate of up to 4.6%, recorded in the exchange rate of the shekel as against the central foreign currencies.
  - An increase in the volume of debt raised by the Israeli Government by means of bond issues: in 2015, the Government raised funds from the public through bond issuance in a net amount of NIS 5.9 billion, in contrast to NIS 1.7 billion raised by the Government by bond issuance last year.
  - Reduction in the inflationary expectations of the public: these amounted to 0.1% at the end of 2015, in contrast to 0.6% at the beginning of the year.

  On background of the reduction in the monetary tender interest year in 2015, as stated, price increases were recorded in most investment channels in Israel. Following these developments, changes were recorded during 2015 in the composition of the asset portfolio f the public, as follows:

  - Reduction at the rate of 1.3% in the weight of mutual funds in the asset portfolio.
  - Stability in the weight of bank deposits in the asset portfolio.
  - Increase of 2.0% 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 marketable channels (mutual funds and shares), on account of the more solid channels (bank deposits).

- **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 2015 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 2015, by the various segments:

Non-linked deposits – The volume of these deposits increased in 2015 by 12.4%, amounting at December 31, 2015 to NIS 19,800 million. This increase in deposits stems from developments in the retail activity of the Bank in 2015, 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, 2015, to NIS 2,854 million, a reduction of 11.0% 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 2015.

Most of the funds raised in this segment in 2015 resulted from one-time deposits for periods of about two years, and from savings deposits by monthly standing orders.

Deposits in or linked to foreign currency– These deposits amounted at December 31, 2015, to NIS 2,734 million, a reduction of 14.2% 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, 2015, the outstanding balance of the subordinate debt notes of the Bank amounted to NIS 672 million (December 31, 2014 – NIS 681 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 rating of the subordinate debt notes was last updated on December 23, 2015, ratifying the rating granted to these debt notes last year.

For additional details regarding new restrictions that apply to the issuance of subordinate debt notes, following the application of the Basle III rules as from January 1, 2014 – see Chapter 8B above.

- **Liquid assets**

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

  - Approximately 18.0% of the Bank's assets are comprised of cash and deposits with banks for periods of up to three months. Approximately 94.1% of the deposits are deposited with Bank of Israel (December 31, 2014 – 17.1% and 83.4%, respectively).

  - Approximately 9.4% of the Bank's assets are marketable securities (December 31, 2014 – 13.0%).

  It will therefore be seen that approximately 27.4% of the Bank's assets can be realized at short notice (December 31, 2014 – 30.1%). 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, 2015	**December 31, 2014**
Depositor groups	**NIS millions**	**NIS millions**
Group "A"	**1,301**	902
Group "B"	**756**	789
Group "C"	**526**	774
Total	**2,583**	2,465

(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 reduces reliance on wholesale depositors, through endeavouring to diversify the resources and attain as wide as possible distribution of depositors, 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) Restriction in 2015

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, 2015, by size of deposit, and the change in composition of these deposits in comparison with the corresponding period last year:

Deposit size*		31.12.2015		31.12.2014		
		NIS millions	%	NIS millions	%	
-	1	**10,866**	**42.8**	10,428	43.3	4.2
1	10	**6,247**	**24.6**	6,065	25.2	3.0
Over 10		**8,275**	**32.6**	7,567	31.5	9.4
Total		**25,388**	**100.0**	24,060	100.0	5.5

* In NIS millions

(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 2015), 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, 2015, to 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, 2015, 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 Management 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, 2015, as compared with the corresponding data last year:

	December 31,		
	2015	2014	Change
	NIS millions		
Capital requirement	**235**	165	70
Exposure to operating risk	**1,871**	1,837	34

No material change was recorded in 2015 in the scope of operating exposure. The change in the capital requirement stemming from such exposure is explained by the implementation of the Basel Rules, within the framework of which, the requirement for comprehensive capital has been increased from 9% as of December 31, 2014, to 12.5% as from January 1, 2015.

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, 2015, 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. Environmental risk

On January 10, 2008, the Supervisor of Banks distributed a draft Proper Management of Banking Business Directive in the matter of "environmental risks".

The draft Directive imposes on banks the duty to evaluate their possible exposure to environmental risks and to manage such exposure by defining and establishing a policy in respect of this risk, instituting means for identification, assessing and managing such exposure, including the determination of persons responsible for its management. Within the framework of managing this risk, banks would be required to establish a mechanism for monitoring and control of exposure to environmental risks and to arrange for proper training and guidance of the staff involved in the process.

In addition, the draft Directive requires that the Board of Directors intensifies its involvement in this issue by holding discussions on the Bank's policy as well as on the means and methods employed by the Bank in managing, measuring and controlling exposure to environmental risks.

On June 11, 2009, the Supervisor of Banks issued an additional guideline on this subject. The guideline details various possible aspects for exposure of banks to environmental risks and stresses the need to address such risks on a specific basis. The guideline also clarifies that the identification and evaluation of the environmental risk comprises a part of the proper process of risk evaluation by a banking corporation, and accordingly, banks are required to act towards the integration of the environmental risk management within all the other risks managed by banks, including by way of integrating of procedures for the identification of a material risk upon granting of credit, and to include in the periodic evaluation of the quality of credit granted to customers, the evaluation of environmental risk.

In view of the said guidelines, the Bank had established a framework for environmental risk management in a designated Chapter in the credit risk management policy document that was approved by the Board of Directors.

The framework established also in internal procedures, states rules and actions for the monitoring of the environmental risk of Bank customers, based on the framework developed by the parent company, with modifications stemming from the characteristics of the Bank's operations and local circumstances.

The monitoring of deviations from restrictions applying to the environmental risk appetite is conducted by digital means, which segment several times a year, the exposure of customers to environmental risk.

Moreover, the credit rating of borrowers (over a certain level) includes also aspects of exposure to risk. Concurrently, the Bank also maps its exposure to environmental risk stemming from investment in non-governmental securities.

As part of the risk management, the Bank, accompanied by an external expert, follows developments in legislation applying to this field.

B. 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, to impairment of their stability.

Bank of Israel estimates that a constant increase has been recorded in the recent period in exposure of banking corporations (in Israel and the world over) to cyber threats, reflected in an increase in the ingenuity of these attacks, in the power of the potential damage and in the difficulty in identifying these attacks. In view of the great importance attributed by Bank of Israel to this issue and to the potential danger inherent therein, Bank of Israel published on March 16, 2015, a new Proper Management of Banking Business Directive No. 361 in the matter of "management of cyber defense", which regularizes the requirements in this field by the Supervisor of Banks addressed to banking corporations.

The technological infrastructure at the disposal of the Bank includes four areas of operation:

- The internal operating network (the central computer system) – serving the business operations of the Bank. This network is operated and maintained by the parent company (which, among other things, is responsible for reducing exposure to data protection risks) and is detached from the remaining areas of operation.
- An internal management network – used for communication between the various management functions in professional and administration matters, as well as use of different administrative technological means, also exposed to cyber risks.
- The external Internet network – used for electronic correspondence with outside entities.
- The Bank's Internet website – used by customers for transactions in their accounts, operated and maintained by the parent company (which, among other things, is responsible for reducing exposure to data protection risks in this website).

The internal operating and management networks are exposed to data protection risks and cybernetic incidents (including disconnection from the external networks), including: unauthorized access, transfer of "infected files" from outside sources by unauthorized applications or penetration into secured authorized sites and extraction of information by unauthorized means.

The external Internet network is exposed to cybernetic incidents, including infiltration and insertion of viruses through the communication lines of the network, unauthorized penetration, electronic mail surveillance and extraction of information through unauthorized applications.

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.

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 2015, causing financial or other damage.

C. 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".

D. 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". This Amendment requires banking corporations to form a policy in writing in the matter of "Compliance policy", to be approved by the Board of Directors.

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

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.

The Bank is applying the guidelines which took effect, as from their effective date, and is preparing to implement other guidelines as from the dates on which they will become effective.

Concurrently with these legislation and regulation proceedings, publications appeared in the media, according to which the US tax authorities has conducted an investigation against Bank Leumi, on suspicion of involvement in tax offenses of its customers holding US citizenship. According to these publications, Bank Leumi reached an agreement with the US tax authorities whereby, in exchange for foregoing criminal proceedings against it, Bank Leumi was charged with a fine.

Following these developments, and in accordance with requirements of Bank of Israel, the Bank and the parent company have conducted an internal audit, with the assistance of an outside accounting firm, in the matter of the management of exposure to cross-border risk relating to the activity of foreign resident customers. The audit examined the level of exposure of the Bank and the Group to such risks. The findings contained in the audit report were discussed by the Audit Committee on June 22, 2015, and by the Board of Directors of the Bank on June 30, 2015.

Following this audit and a group audit that had been conducted in this matter, the Bank was requested by Bank of Israel on April 20, 2015, to conduct a special audit in the matter of compliance with the tax laws of the United States Government, in order to examine the policy and procedures applied by the Bank in this matter, and to identify customers defines as "US persons", who had opened accounts with the Bank as from August 2010, this with a view of examining the appropriateness of the Bank's conduct with respect to these customers upon the opening of their accounts and thereafter.
The audit was performed by the Bank, as required, and its findings were included in an audit report discussed by the Audit Committee on August 4, 2015.

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)	Low to medium
4. Operating risk (9)	Medium
5. Data protection and cyber risk (10)	Medium to high
6. Legal risk (11)	Low
7. Reputation risk (12)	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 2015 the rate of the provisions for credit losses amounted to 0.33% of the outstanding credit balance, being an increase of 0.25% in comparison with the rate of the provisions recorded last year (0.08%). The increase in the rate of expense for credit losses stems, inter alia, from the increase in the credit loss expense on a collective basis, explained by assessments, according to which, credit risk had increased in the credit portfolios of banks relating to the financing of real estate transactions (mostly in credit to housing construction and loans), and in respect the financing granted to private individuals.

On background of these assessments, Bank of Israel published in 2015 a new reporting instruction in the matter of "collective provision in respect of credit to private individuals", requiring banks to increase the rate of collective provisions for credit losses in respect of qualitative adjustments in the private individuals segment to a rate of 0.75% (this requirement was applied by the Bank in 2014). In addition, banks were required to continue and act towards improving procedures regarding the management of risk involved in the credit granted to private individuals, including the quality of information existing at banks in everything relating to this credit.

In Management's opinion, these developments reflect a rise in the level of uncertainty prevailing in the activity of the local economy. Accordingly, and in view of the growth in the volume of troubled debts and in the rates of provisions for credit losses recorded by the Bank in 2015, 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, 2015, the rate of lending to borrowers in this sector, in comparison with the Bank's overall lending, was approximately 21.5% (December 31, 2014 –21.4%).
On the other hand, the ratio of credit granted to private individuals to the Bank's overall lending (30.9%) 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 (though in recent years the gap between the Bank and the other banks in the industry with respect of this item has decreased). 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, 2015, 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 4.3%, which is 73.1% below the limit determined by Bank of Israel (December 31, 2014 – 67.3% below the limit)

- to the largest group of borrowers – approximately 10.0%, which is 60.0% below the limit determined by Bank of Israel (December 31, 2014 – 45.6% below the limit)

- total indebtedness of the largest borrowers – 10.0%, approximately 91.7% below the limit determined by Bank of Israel – 10% of the capital of the Bank (December 31, 2014 – 80.3% below the limit).

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. Notwithstanding this, the long-term liabilities of the Bank in respect of employee rights are measured, as from 2015, in accordance with their fair value, based on updated interest rates (as required under the implementation of US accepted accounting principles in this respect, applied as from January 1, 2015). In view of the above, as from 2015, the Bank includes in computing exposure to interest rate, also the long-term liabilities for employee rights (to the tune of between NIS 600 and NIS 700 million). In view of the growth in volume of the components exposed to changes in interest rates, Management of the Bank's decided to raise in the reported period the evaluation of exposure with respect to this risk from "low" to "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 (120%) of the average liquidity coverage ratio for the fourth quarter of 2015, as defined improper Management of Banking Business Directive No. 221 (as of September 30, 2015, the average liquidity coverage ratio of the whole banking sector amounted to 102%). Notwithstanding the above, whereas other indices used to measure the level of liquidity of the Bank recorded a reduction in 2015 (such as: the liquid assets ratio to total assets which declined in 2015 by 2.7% to a level of 27.4%), Management decided in the reported period to raise the assessment of exposure of the Bank with respect to this risk component from "low" to a level of "low to medium".

(9) **Operating risk**

In 2014, the Bank began to introduce several central 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.

In view of the risk structured in the implementation of these processes, the assessment of the Bank's exposure to this risk was raised in the past to a level of "medium to high". Following the progress made in 2015 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.

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. In light of the above, and in view of the fact that the Bank operates various controls in order to minimize this risk as far as possible, Management considers that the Bank’s exposure with respect to this risk component as "low".

(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". In light of the developments in consumer awareness as regards the services provided by the banking sector and their cost, and the publications appearing in the media in this respect with growing frequency (including the publication of articles specifically criticizing the Bank), Management considers the Bank’s exposure with respect to this risk component as "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.

In addition, the Bank performed in 2015 special audits in this respect, as follows:

- Audit in the matter of exposure to cross-border risks, performed with the assistance of an outside accounting firm.
- Audit in the matter of the regularization of relations with customers defined as "US persons" in accordance with US tax legislation.

The findings of these audits were discussed in 2015 by the Bank's Audit Committee. An analysis of the findings contained in the said reports indicates that the exposure of the Bank to these issues is not high.

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".

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 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.

As of December 31, 2015, the total net balance of impaired debts examined on a specific basis included in the credit portfolio of the Bank amounted to approximately NIS 260 million, net, this amount representing approximately 1.6% of total outstanding borrowings examined on a specific basis as of that date. The provision for credit losses created in respect of these debts as of the date of the balance sheet amounted to approximately NIS 72 million. Of this sum, approximately NIS 6 million was recognized as income in 2015 in respect of the net collection of provisions.

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"). The decision coefficient represents the best assessment of losses inherent in the credit portfolio in respect of each economic sector, based on past experience.

- **"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 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.

As of December 31, 2015, the outstanding balance of the provision for credit losses on a collective basis amounted to NIS 282 million, comprising 1.09% of the stated balance of total credit risk at the Bank.

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) Adoption of US accepted accounting principles in the matter of employee rights

According to the amendment of the public reporting instructions issued by Bank of Israel on April 9, 2014, banking corporations were required to adopt as from January 1, 2015, the US accounting standard in the matter of employee rights. The guidelines contained in the amendment to the instruction have changed the measurement rules relating to employee rights in relation to those that had been in effect until December 31, 2014, with respect to several significant aspects, including:

- The future liabilities of the Bank for the payment of certain employee rights (mostly: liabilities for the payment of severance compensation and jubilee awards and the commitment for the payment of certain post-retirement benefits) are discounted to their present value at an interest rate based on returns on Israeli government bonds, with the addition of a spread derived from the difference between the return on high quality corporate bonds traded in the US and the return on US government bonds (until December 31, 2014 - these liabilities had been discounted at a fixed rate of 4%).

- Current income earned on deposits for the payment of severance compensation are recognized in profit and loss based on assessments regarding the expected return on the assets included in the deposits for severance compensation.

According to guidelines of Bank of Israel issued in this respect, the assessments regarding the expected return shall be based on long-term historical rates of return, measured for each of the components of the deposit for severance compensation.

Computation of the provisions for employee rights in accordance with the new 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.

The Bank applies the new measurement rules, as required by Bank of Israel instructions, as from January 1, 2015, by way of retroactive application in financial statements as of January 1, 2013. The change in the measurement rules increased the provisions of the Bank for employee rights upon initial application (January 1, 2013) by an amount of NIS 98 million.

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
Type of benefit	**NIS millions**
Liability for payment of severance compensation	62
Liability for payment of jubilee awards	6
Liability for payment of post-retirement benefits	8

(2) Actuarial assessments regarding the liability for severance compensation

According to US accepted accounting principles in the matter of employee rights initially applied in 2015 (see Note 1D (7) to the financial statements), the provisions for the liability of the Bank for the payment of severance compensation to Bank employees are computed on an actuarial basis, which includes assessments as to the rate of employees expected to retire at an earlier date than that determined in the employment agreements (due to whatever reason), and with respect to additional benefits that such employees expect to receive.

The computations of the provisions for the 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 retirement rates of employees are based on the average retirement rates observed in the years 2004-2010.
- The amounts of the additional benefits payable in the future have been discounted to present value using an annual interest rate of 1.7% per annum, stemming from the adoption of the US accepted accounting principles and guidelines of Bank of Israel, initially applied on January 1, 2015.
- 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, 2015, 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, 2015 amounts to NIS 537 million (December 31, 2014 – NIS 538* million).

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 severance compensation as of December 31, 2015:

	Increase in liabilities
Sensitivity test	**NIS millions**
• Increase of 1% in rate of employee retirement	21
• Increase of 10% in rate of severance compensation	22
• Increase of 0.5% in the annual real-term payroll	32

(3) Long service ("Jubilee") awards and post-retirement benefits

In accordance with the labour agreements existing at the Bank, employees are 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. Employees are also entitled to certain benefits payable to them after retirement. In accordance with accepted accounting principles, a provision has to be included that reflects the liability of the Bank with respect to these rights. However, such provision is subject to uncertainty, as the realization of the rights is conditional upon specified events the occurrence thereof in the future is uncertain. Accordingly, the evaluation of the provisions in respect of these anticipated liabilities involves probability tests for certain of the parameters used in the calculation, including:

- The number of employees who will complete the service period entitling them to the award.
- The number of employees who will retire on the due retirement date, and not earlier.
- 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 has 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 preparing the provisions.

The financial statements of the Bank as of December 31, 2015, 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 applied in 2015 (see Note 1D (7) to the financial statements). The balance of the provision for "Jubilee awards" as of December 31, 2015, amounts to NIS 78** million (December 31, 2014 – NIS 138* million).

* Restated in respect of the retroactive application of US accepted accounting principles regarding employee rights – see Section B(1) above and Note 1D (7) to the financial statements

** On April 28, 2015, a new wage agreement was signed between the Bank, the Federation of Labour and the Employee Representative Committee, whereby the liabilities of the Bank for the payment of jubilee awards were reduced by NIS 59 million – see Chapter 8C of the corporate governance report.

*** On October 11, 2015, a new wage agreement was signed between the Bank, the Federation of Labour and the Employee Representative Committee, whereby the liabilities of the Bank for the payment of post-retirement benefits were reduced by NIS 16 million (see Chapter 8C of the corporate governance report).

The balance of the provisions for the liability of the Bank as of December 31, 2015, for the payment of post-retirement benefits, amounts to NIS 44 million (December 31, 2014 – NIS 63*** 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
- Future increases in real-term payroll – at the average rate of 2.5% per year
- Discounting the anticipated future cash flows at rates of between 1.6% and 2.5% p.a., (which are based on US accepted accounting principles and guidelines of Bank of Israel in this respect, initially applied on January 1, 2015).

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 "Jubilee awards" and post-retirement benefits as of December 31, 2015:

	Increase in liabilities
Sensitivity test	**NIS millions**
• Reduction of 1% in rate of employee retirement	7
• Increase of 0.5% in the annual real-term payroll	4

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,	
	2015	2014	2015	2014
	NIS millions			
1. Available-for-sale securities				
Observable data				
• Traded on an active market (Level 1)	**2,513**	3,206	**76**	118
• Other (Level 2)	**585**	290	**10**	12
Unobservable data (Level 3)	**12**	14	**3***	-
Total	**3,110**	3,510	**89**	130
2. Derivative instruments				
Observable data				
• Traded on an active market (Level 1)	**-**	-	**-**	-
• Other (Level 2)	**(18)**	(25)	**(28)**	80
Unobservable data (Level 3)	**(70)**	(51)	**(21)**	(3)
Total	**(88)**	(76)	**(49)**	77

* Excluding a loss of NIS 9 million recognized in the item "loss on sale of available-for-sale shares", following the ruling of the Supreme Court (see Note 24B (6) (b) to the financial statements.

The changes during the reported period, 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 reduced the fair value of these instruments by NIS6 million;
- The effect of changes in the market interest rate prevailing in the various segments (non-linked shekel, CPI and foreign currency linked shekel), reduced the fair value of these instruments by NIS 9 million;
- Accrual of current interest, reduced the fair value of these instruments by 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.

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 1D (8) 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 letter requires the parent company (as well as the other member companies of the Group) to adopt these measurement rules as from the quarterly report as of June 30, 2015, and include them in its financial statements by way of retroactive application.

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.

The Bank applies as from April 1, 2015, the measurement rules determined in bank of Israel guidelines, reflecting them in the financial statements by way of retroactive application.

The said change in the measurement rules reduced the balance of assets reflected in the "Fixed assets" item as of January 1, 2015, by an amount of NIS 16 million.

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 (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, 2015, the balance of unrealized losses included in the available-for-sale securities portfolio amounted to NIS 4 million (December 31, 2014 – NIS 5 million), comprising0.1% of the cost of such securities (December 31, 2014 – identical). 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

On December 31, 2016, 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.

(2) Employee rights

On April 9, 2014, 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. The new measurement rules determined by the said amendment are applied by the Bank as from January 1, 2015 and thereafter.

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 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 affair 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 new 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 2015 by an amount of NIS 12 million.

(3) 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.

G. Differences in the realization of the guidelines and the critical accounting assessments

The Bank's provisions in respect of employee rights, measured on an actuarial basis, include, inter alia, assumptions as to future salary increases for Bank employees.

In accordance with existing wage agreements, the employment terms of the Bank's employees are linked to those existing at Bank Leumi. Accordingly, the forecast for the annual increase in salaries of employees of the Bank is based, among other things, on the rates of increases in salary agreed in recent years at Bank Leumi.

Following the new wage agreement signed by Bank Leumi at the beginning of 2015 (see Chapter 8C. in the corporate governance report), the Bank, the Federation of Labor and the representative committee of the employees signed on April 28, 2015, a special collective agreement, whereby the average wage increases at the Bank would be gradually reduced from 5% to 3.5%.

Notwithstanding the above, the expected reduction in wage increases did not result in a material change in the provisions made by the Bank for employee rights.

20. Disclosure regarding controls and procedures

A. Controls regarding disclosure in the financial statements

Proper Management 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 Management 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 2015, the Bank, with the assistance of external consultants, has 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.

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.

D. Changes in internal control

Following the integration of the structure model comprising a significant component in the computation of the provisions for credit losses, and the adoption of the new accounting principles in the matter of "employee rights" during 2015, the measurement rules applied by the Bank in this respect were changed. Adoption of the model and of the new accounting principles for the measurement of the said provisions, comprise a change in internal control over financial reporting, as follows:

(1) Integration of a structured model for the computation of the "adjustment coefficient" in the process of computing the provision for credit losses on a collective basis

Bank of Israel published on January 19, 2015, an amendment to the public reporting instructions in the matter of "provision for credit losses on a collective basis", requiring banks to implement a structured model for the purpose of determining the "adjustment coefficient", based on principles and parameters detailed in the amendment to the public reporting instructions.

During 2015, the Bank has developed a structured model based on the principles determined by Bank of Israel (and which was initially applied in the process of determining the "adjustment coefficient" as of December 31, 2015).

The model makes use of significant assessments and forecasts involving a considerable degree of uncertainty and relies on subjective estimates.

Accordingly, in the course of development of this model, the Bank installed means of control (including: applying simulations and initial validation of the model) designed to ensure its proper integration. Furthermore, whereas integration of the model required changes in work procedures for the determination of the "adjustment coefficient", control mechanisms have been installed in the new work procedures intended to ensure the reliability of the of the new process for the determination of the "adjustment coefficient".

(2) Integration of new computer systems regarding housing loans

As from January 1, 2015, the Bank implements the US accepted accounting principles in the matter of "employee rights".

The new measurement rules for the computation of the provision for employee rights and the assets of the plan covering it, stemming from these accounting principles, rely on subjective assessments (both as to the money price relevant to the Bank and to the forecasted period of employment of Bank employees) and on future forecasts (including the expected future rates of return on different assets on the capital market).

Accordingly, during the implementation of the new accounting principles, the Bank has adopted different means of control designed to ensure the appropriateness of the accounting measurement of provisions for employee rights and the assets of the plan relating to them, based on these accounting principles, and their impact on the balance sheet, profit and loss and comprehensive profit items.

Except as stated above, no other changes took place during the quarter ended December 31, 2015, in the internal control of the Bank over financial reporting, which had a material effect, or which are reasonably expected to have a material effect upon the internal control of the Bank over financial reporting.

21. Additional information

A. Extension of the "pricing agreement" for computer services provided by the parent company

The computer and operating services provided to the Bank by the parent company are based on annual agreements signed by the parties, which include an agreement of principles for an unspecified period and agreements for the pricing of these services, which are revised from time to time (hereinafter – "pricing agreements").
The validity of the prior pricing agreement expired on December 31, 2015.
On December 27, 2015, the parties agreed to extend the validity of the said agreement by one year, until December 31, 2016.

This agreement was approved by the Audit Committee of the Board of Directors on January 10, 2016.

For additional details regarding the agreements existing between the parties in this respect, see Chapter (A. of the corporate governance report.

B. Letter of Bank of Israel in the matter of operational efficiency of the banking sector in Israel

An analysis performed by Bank of Israel by use of different performance indices, indicates that the average efficiency level of the banking sector in Israel is lower than that of banking sector in advanced countries.

In view of concerns that the changing economic and regulatory environment in which the banking sector is operating in Israel, might impair the demand for banking services and reduce their price, while damaging the income of banking corporations and their financial results in the future, bank of Israel published on January 12, 2016, a letter requiring banking corporations to outline a multi-annual plan for increasing their efficiency, as detailed below:

- The Board of Directors is required to form a multi-annual efficiency plan that includes a specific line of action for the next five years, as well as efficiency principles for a longer time period.
  The plan should include defined interim goals, at least at yearly intervals, which have to be supervised by the Board of Directors.
- In order to facilitate the implementation of the efficiency plan by the banking corporation, Bank of Israel announced its intention to approve a deferment of the dates on which banking corporations have to attain the capital adequacy targets determined for them, with reference to the amounts that are to be deducted from the regulatory capital in respect of the efficiency plan.
  The deferment will be granted for a period of five years and will be gradually reduced by the "straight line" method, subject to compliance with the following terms:

  - The banking corporation has prepared an efficiency plan that includes defined costs
  - The relief granted in respect of capital adequacy, as stated, will be exclusively used by the banking corporation for the execution of the efficiency plan.

- The banking corporation complies with the interim efficiency goals determined by it.

- In accordance with the guidelines published by Bank of Israel in the matter of "employee rights" (based on US accepted accounting principles in the matter), banking corporations are required to create provisions in respect of their liabilities for the payment of severance compensation, based on the "actual substance liability", which includes estimates for the payment of severance compensation in amounts exceeding the contractual terms, based on experience gathered in the past and on the future plans of the banking corporation.
  However, as part of the relief mentioned in the letter, Bank of Israel permitted those banking corporation, which had implemented their efficiency plan as required, to assume that that the implications arising from this plan, do not necessarily represent the rates of the costs in respect of severance compensation applying to the banking corporation in the longer time period.

- The relief mentioned in the letter applies to efficiency plans approved until December 31, 2016.

The Bank is studying the requirements regarding the implementation of the efficiency plan, as detailed in the letter of Bank of Israel, and is preparing to implement it on the determined dates.

Lilach Asher-Topilsky	Joshua Burstein
Chairperson of the Board	General Manager

Appendix no.1 -Total credit risk classified by economic sectors on a consolidated basis

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**

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 21,170, 3420,52, 4,641 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 140 millions.

Appendix no.1 -Total credit risk classified by economic sectors on a consolidated basis (continued)

December 31, 2014[8]

	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	373	364	5	373	332	5	4	5	5	8
Mining & Quarrying	65	65	1	65	58	1	-	-	-	-
Industry	2,186	2,086	67	2,150	1,879	67	42	(8)	2	33
Construction and Real Estate - Construction	3,178	2,999	141	3,176	1,558	141	38	(5)	1	50
Construction and Real Estate - Real Estate Activity	1,855	1,819	35	1,840	1,752	35	31	-	-	8
Electricity and Water	404	401	2	122	103	2	-	1	1	1
Commerce	4,354	4,192	119	4,324	3,873	119	87	18	6	99
Hotels, Hotel Services and Food	272	250	13	268	236	13	10	-	-	2
Transportation and Storage	836	793	34	836	756	34	25	11	3	19
Communication and Computer Services	101	97	2	84	636	2	2	1	3	2
Financial Services	853	851	1	307	288	1	1	-	-	2
Other Business Services	1,151	1,076	40	1,149	908	40	29	5	7	21
Public and Community Services	885	866	7	880	707	7	5	-	-	5
Total Commercial	16,513	15,859	467	15,574	12,513	467	274	28	28	250
Private Individuals - Housing Loans	3,199	3,106	49	3,199	2,949	49	-	(1)	-	13
Private Individuals - Other	4,041	3,793	72	4,026	3,181	72	38	(8)	5	21
Total Public	23,753	22,758	588	22,799	18,643	588	312	19	33	317
Banks in Israel	447	447	-	434	434	-	-	-	-	1
Israeli Government	2,813	2,813	-	-	-	-	-	-	-	-
Total Landing Activity in Israel	27,013	26,018	588	23,233	19,077	588	312	19	33	318
Lending Activity Outside of Israel										
Industry	294	294	-	274	254	-	-	(1)	-	3
Construction and Real Estate - Construction	210	210	-	203	99	-	-	(1)	-	-
Commerce	123	123	-	123	109	-	-	1	-	2
Transportation and Storage	71	56	15	63	63	7	7	(3)	29	-
Private Individuals - Housing Loans	39	39	-	39	35	-	-	-	-	-
Private Individuals - Other	8	8	-	8	4	-	-	-	-	-
Other	44	19	25	29	27	25	25	-	-	12
Total Public	789	749	40	739	591	32	32	(4)	29	17
Banks	519	519	-	492	468	-	-	-	-	-
Governments	19	19	-	-	-	-	-	-	-	-
Total Lending Activity Outside of Israel	1,327	1,287	40	1,231	1,059	32	32	(4)	29	17
Total	28,340	27,305	628	24,464	20,136	620	344	15	62	335

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, guarantees and liabilities on account of clients in an amount of NIS 20,136,3,817,59, 4,328 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 94 millions and off – balance sheet credit risk in an amount of NIS 129 millions.

(8) The data included in this Table have been reclassified in order to agree the distribution of credit risk by economic sectors to the new classification of economic sectors determined by Bank of Israel on April 9, 2014, and which entered into effect on January 1, 2015.

(9) Restated

(10) Reclassified

Appendix no.2 –Exposure to Foreign Countries-Consolidated

A. Information Regarding The Exposure to Foreign Countries

	Across the border balance sheet exposure(3)							Balance sheet exposure(2)	
	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								
*									
December 31, 2015									
United States (1)	**97**	**161**	**96**	**354**	**-**	**-**	**6**	**180**	**174**
Other	**-**	**160**	**205**	**365**	**-**	**-**	**55**	**187**	**178**
Total(1)	**97**	**321**	**301**	**719**	**-**		**61**	**367**	**352**
Of which - Total exposure to LDC countries	**-**	**3**	**18**	**21**	**-**	**-**	**28**	**5**	**16**
*									
December 31, 2014									
United States	19	243	83	345	-	-	9	255	90
Other	-	241	188	429	2	1	60	267	162
Total exposure to foreign countries	19	484	271	774	2	1	69	522	252
Of which - Total exposure to LDC countries	-	4	16	20	-	-	26	4	16

Notes:

(1) Based on the final risk, net of the effect of guarantees, liquid collateral and credit derivatives.

(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) Restated

B. Information regarding countries the amount of exposure in respect of each amounts to between 0.75% and 1% of total consolidated assets or between 15% and 20% of capital, whichever is lower.

As of December 31, 2015 the Bank had no such exposure (31.12.2014- The same).

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, 2015, in an amount of Nis 5 millions (31.12.2014- Nis 6 millions).

Appendix no.3 –Exposure to Changes in inrerest rates - consolidated

	December 31, 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
					in NIS millions
Non linked Israeli currency					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets	**20,143**	**1,080**	**1,400**	**770**	**900**
Derivative financial instruments (except for options)	**487**	**369**	**167**	**22**	**3**
Options (in terms of base assets)	**5**	**4**	**10**	**24**	**4**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fait value	**20,635**	**1,453**	**1,577**	**816**	**907**
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities	**17,539**	**696**	**1,402**	**688**	**414**
Derivative financial instruments (except for options)	**859**	**572**	**1,707**	**21**	**4**
Options (in terms of base assets)	**5**	**3**	**2**	**8**	**1**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fait value	**18,403**	**1,271**	**3,111**	**717**	**419**
Financial instruments, net					
Exposure to changes in interest rates in the segment	**2,232**	**182**	**(1,534)**	**99**	**488**
Total fait value	**2,232**	**2,414**	**880**	**979**	**1,467**
CPI linked Israeli currency					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets	**36**	**75**	**574**	**1,269**	**590**
Derivative financial instruments (except for options)	**-**	**199**	**1,043**	**-**	**3**
Options (in terms of base assets)	**-**	**-**	**2**	**8**	**1**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fait value	**36**	**274**	**1,619**	**1,304**	**594**
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities	**34**	**310**	**808**	**989**	**647**
Derivative financial instruments (except for options)	**-**	**6**	**-**	**18**	**92**
Options (in terms of base assets)	**-**	**1**	**6**	**14**	**3**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fait value	**34**	**317**	**814**	**1,021**	**742**
Financial instruments, net					
Exposure to changes in interest rates in the segment	**2**	**(43)**	**805**	**283**	**(148)**
Cumulative exposure in the segment	**2**	**(41)**	**764**	**1,047**	**899**

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 duration 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.

Appendix no.3 –Exposure to Changes in inrerest rates – consolidated (continued)

December 31, 2014

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 duration In years	Total fair value	Internal rate of return In %	Effective average duration In years
376	113	11	85	24,878	3.07	0.46	22,709	3.38	0.52
-	-	-	-	1,048		0.21	574		0.07
-	-	-	-	47		-	32		-
-	-	-	-	-		-	-		-
376	113	11	85	25,973		0.45	23,315		051
179	188	-	-	21,106	0.16	0.36	18.854	0.30	0.41
93	-	-	-	3,256		0.56	2,610		0.13
-	-	-	-	19		-	13		-
-	-	-	-	-		-	8		0.64
272	188	-	-	24,381		0.39	21.485		0.68
104	(75)	11	85	1,592					
1,571	1,496	1,507	1,592				1,830		
333	36	9	2	2,951	1.44	2.76	3,804	1.13	2.98
21	7	-	-	1,273		0.79	529		0.93
1	-	-	-	12		-	2		-
-	-	-	-	-		-	-		-
355	43	9	2	4,236		2.16	4,335		2.73
949	39	-	-	3,776	0.51	3.25	4,178	0.36	3.50
55	-	-	-	171		3.86	170		4.73
-	-	-	-	24		-	5		-
-	-	-	-	-		-	6		0.73
1,004	39	-	-	3,971		3.26	4,359		3.54
(649)	4	9	2	265					
250	254	263	265				(24)		

Notes:

* Not including balances of derivative financial instruments and fair value of off-balance sheet financial instruments.

** Weighted average by fair value of average effective duration.

Appendix no.3 –Exposure to Changes in interest rates – consolidated (continued)

	December 31, 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
					in NIS millions
Foreign currency***					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets*	**910**	**119**	**138**	**265**	**338**
Derivative financial instruments (except for options)	**1,205**	**1,018**	**681**	**26**	**59**
Options (in terms of base assets)	**5**	**2**	**-**	**-**	**-**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fait value	**2,120**	**1,139**	**819**	**291**	**397**
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities*	**2,094**	**187**	**499**	**21**	**6**
Derivative financial instruments (except for options)	**673**	**502**	**223**	**244**	**63**
Options (in terms of base assets)	**5**	**3**	**4**	**9**	**1**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fait value	**2,772**	**692**	**726**	**274**	**70**
Financial instruments, net					
Exposure to changes in interest rates in the segment	**(652)**	**447**	**93**	**17**	**327**
Total fait value	**(652)**	**(205)**	**(112)**	**(95)**	**232**
Total exposure to changes in interest rates					
Financial assets and amounts receivable in respect of derivative instruments					
Financial assets*****	**21,089**	**1,274**	**2,112**	**2,331**	**1,828**
Derivative financial instruments (except for options)	**1,692**	**1,586**	**1,891**	**48**	**65**
Options (in terms of base assets)*****	**10**	**6**	**12**	**32**	**5**
Off-balance sheet financial instruments	**-**	**-**	**-**	**-**	**-**
Total fait value	**22,791**	**2,866**	**4,015**	**2,411**	**1,898**
Financial liabilities and amounts payable in respect of derivative instruments					
Financial liabilities*	**19,667**	**1,193**	**2,709**	**1,698**	**1,067**
Derivative financial instruments (except for options)	**1,532**	**1,080**	**1,930**	**283**	**159**
Options (in terms of base assets)*****	**10**	**7**	**12**	**31**	**5**
Off-balance sheet financial instruments*****	**-**	**-**	**-**	**-**	**-**
Total fait value	**21,209**	**2,280**	**4,651**	**2,012**	**1,231**
Financial instruments, net					
Exposure to changes in interest rates in the segment	**1,582**	**586**	**(696)**	**399**	**667**
Cumulative exposure in the segment	**1,582**	**2,168**	**1,532**	**1,931**	**2,598**

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 duration 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.

December 31, 2014

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 duration In years	Total fair value	Internal rate of return In %	Effective average duration In years
33	4	-	-	1,807	2.18	1.14	1,744	1.88	0.86
36	-	-	-	3,025		0.35	33,952		0.31
-	-	-	-	7		-	134		-
-	-	-	-	-		-	-		-
69	64	-	-	4,839		0.64**	5,830		0.47**
14	5	-	-	2,826	0.37	0.19	3,341	0.29	0.19
297	7	-	-	2,009		1.65	2,353		0.70
-	-	-	-	22		-	149		-
-	-	-	-	-		-	1		0.67
311	12			4,857		0.39**	5,844		0.39**
(242)	(8)	-	-	(18)					
(10)	(18)	(18)	(18)				(14)		
742	153	20	99	29,648	2.85	0.73	28,271	2.98	0.87
57	7	-	-	5,346		0.43	5,055		0.35
1	-	-	-	66		-	168		-
-	-	-	-	-		-	-		-
800	160	20	99	35,060		0.68	33,494		0.79
1,142	232	-	-	27,708	0.23	0.74	26,373	0.31	0.87
445	7	-	-	5,436		1.07	5,133		0.54
-				65		-	167		-
				16		-	29		0.68
1,587	239	-	16	33,225		0.79	31,702		0.81**
(787)	(79)	20	83	1,835					
1,811	1,732	1,752	1,835				1,792		

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"

February 25, 2016

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 2015 (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.
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:

[2] As defined in the Public Reporting Directives regarding "Directors and Management Report".

(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.

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Joshua Burstein
General Manager
February 25, 2016.

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 2015 (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[3] 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.
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:

[1] As defined in the Public Reporting Directives regarding "Directors and Management Report".

(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.

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Avi Rishpan
Deputy General Manager and
Chief Accounting Officer

February 25, 2016.

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, 2015, 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, 2015, 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, 2015 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 196, which includes an unqualified opinion regarding the effectiveness of the Bank's internal control over financial reporting as of December 31, 2015.

Lilach Asher-Topilsky	Joshua Burstein	Avi Rishpan
Chairperson of the Board of Directors	General Manager	Deputy General Manager and Chief Accounting Officer

February 25, 2016.

KPMG **BDO**

Somekh Chaikin **Ziv Haft**

February 25, 2016

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, 2015, 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, 2015, 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, 2015 and 2014 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 ofthe Bank - for each of the years in the three-year period ended on December 31, 2015, and our report dated February 25, 2016, expressed an unqualified opinion on the said financial statements.

Somekh Chaikin	Ziv Haft
Certified Public Accountants (Isr.)	Certified Public Accountants (Isr.)

KPMG
Somekh Chaikin

BDO
Ziv Haft

February 25, 2016

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, 2015 and 2014, 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, 2015. 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, 2015 and 2014, 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, 2015, 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, 2015, 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 25, 2016, expressed an unqualified opinion on the maintenance of an effective internal control over the financial reporting of the Bank.

Somekh Chaikin
Certified Public Accountants (Isr.)

Ziv Haft
Certified Public Accountants (Isr.)

Consolidated Statements of Profit and Loss for the Years Ended December 31

Reported amounts (NIS millions)

	Note	2015	2014	2013
Interest income	2	**974**	1,011	1,128
Interest expenses	2	**102**	211	406
Net interest income		**872**	800	722
Provision for credit losses	13,29	**67**	15	75
Net interest income after provision for credit debts		**805**	785	647
Non-interest income				
Non-interest financing income (expenses)	3	**37**	42	81
Fees	4	**310**	313	375
Other income (expenses)	5	**33**	1	(1)
Total non-interest income		**380**	356	455
Operating and other expenses				
Salaries and related expenses	6	**518**	(1) 585	(1) 527
Maintenance and depreciation of buildings and equipment	15	**152**	(1) 150	(1) 154
Other expenses	7	**171**	(1) 167	(1) 161
Total operating and other expenses		**841**	902	842
Profit before taxes		**344**	239	260
Provision for taxes on profit	8	**136**	(1) 94	(1) 85
Profit after taxes		**208**	145	175
Banks net share in the results of investee companies, after taxes	14	**2**	2	4
Net profit		**210**	147	179
Earnings per share (in NIS thousands)	9			
Stock per share of NIS 0.1		**1.69**	(1) 1.18	(1) 1.44
Stock per share of NIS 0.01		**0.17**	(1) 0.12	0.15

The notes to the financial statements are an integral part thereof.

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Note 1D (7-9).

Lilach Asher-Topilsky
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 25, 2016

Consolidated Statement of Comprehensive Profit

Reported amounts (NIS millions)

	Year ended December 31,		
	2015	**2014**	**2013**
Net profit	**210**	(2) 147	(2) 179
Other comprehensive profit (loss) before taxes**:**			
Adjustments in respect of presentation of available-for-sale securities at fair value, net	**(49)**	(27)	(28)
Adjustment of liabilities in respect of employee rights(1)	**13**	(2) (41)	(2) (5)
Other comprehensive loss before taxes	**(36)**	(68)	(33)
Related tax effect	**13**	(1) 25	(1) (2) 12
Other comprehensive loss after taxes	**(23)**	(43)	(21)
Total comprehensive profit	**187**	104	158

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.
(2) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Note 1D (7-9).

Consolidated Balance Sheets as at December 31

Reported amounts (NIS millions)

	Note	2015	2014
Assets			
Cash and deposits with banks	11	**5,502**	4,994
Securities [2],[3]	12	**3,432**	3,831
Credit to the public	13, 29	**20,754**	19,234
Allowance to the credit losses	13, 29	**(337)**	(319)
Credit to the public, net		**20,417**	18,915
Investments in investee companies	14	**7**	11
Buildings and equipment	15	**346**	[1] 397
Assets in respect of derivative instruments	26	**31**	30
Other assets	16	**341**	[1] 392
Total assets		**30,076**	28,570
Liabilities and shareholders' equity			
Deposits from the public	17	**25,388**	24,060
Deposits from banks	18	**459**	492
Deposits from the Government		**151**	139
Subordinated capital notes	19	**672**	681
Liabilities in respect of derivative instruments	26	**122**	109
Other liabilities [4]	20	**1,181**	[1] 1,173
Total liabilities		**27,973**	26,654
Shareholders' equity	22	**2,103**	[1] 1,916
Total liabilities and shareholders' equity		**30,076**	28,570

The notes to the financial statements are an integral part thereof.

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Note 1D (7-9).
(2) The balance includes securities pledged to lenders in the amount of NIS 384 million (2014 - NIS 595 million).
(3) The balance includes securities presented at fair value in the amount of NIS 3,120 million (2014 - NIS 3,514 million).
(4) The balance includes provision for credit losses in respect of off-balance sheet credit instruments in the amount of NIS 29 million (2014 - NIS 15 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, 2013-before the effect of initial application of new accounting principles (1)	51	152	203	94	(3) 1,585	1,882
Cumulative effect, net, of initial Application of US accepted accounting Principles regarding employee rights	-	-	-	(2) (52)	(2) (11)	(63)
Balance as at January 1, 2013-after the effect of initial application of new accounting principles (1)	51	152	203	42	1,574	1,819
Other comprehensive loss, net after tax effect	-	-	-	(2) (21)	-	(21)
Dividend paid	-	-	-	-	(120)	(120)
Net profit for the year	-	-	-	-	(3)(2) 179	179
Balance as at December 31, 2013	51	152	203	21	1,633	1,857
Other comprehensive los , net after tax effect	-	-	-	(2) (43)	-	(43)
Dividend paid	-	-	-	-	(45)	(45)
Net profit for the year	-	-	-	-	(3)(2) 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**

The notes to the financial statements are an integral part thereof.

(1) US accepted accounting principles in the matter of "employee rights".
(2) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" - see Note 1D (7).
(3) Restated in respect of the retroactive application of guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Note 1D (8).

Consolidated Statements of Cash Flows for the Years Ended December 31

Reported amounts (NIS millions)

	2015	2014	2013
Cash flows generated by operating activities			
Net profit for the year	**210**	(1) 147	(1) 179
Adjustments to reconcile net profit to net cash flows generated by operating activities (Appendix A)	**259**	(1) 235	(1) 319
Net cash inflow generated by operating activities	**469**	382	498
Change in asset activities, net:			
Deposits with banks, net	**(294)**	134	256
Credit to the public	**(1,658)**	(1,400)	(1,336)
Assets regarding derivatives	**(1)**	(6)	3
Securities held for trading, net	**(5)**	15	11
Other assets	**34**	(29)	6
Total change in asset activities	**(1,924)**	(1,286)	(1,060)
Change in liability activities, net:			
Deposits from the public	**1,328**	96	1,710
Deposits from banks	**(33)**	5	350
Deposits from the Government	**12**	(29)	1
Liabilities regarding derivatives	**13**	(31)	(110)
Other liabilities	**7**	(1) 20	(1) (13)
Total change in liabilities activities	**1,327**	61	1,938
Net cash from (for) operating activities:	**(128)**	(843)	1,376
Cash flows generated by investing activities:			
Proceeds from sale of investee company activities	**-**	1	7
Purchase of securities available for sale	**(2,748)**	(1,399)	(4,380)
Purchase of bonds held to maturity	**-**	(19)	-
Proceeds from sale of securities available for sale	**2,560**	1,512	2,762
Proceeds from redemption of securities available for sale	**848**	2,284	713
Acquisition of buildings, equipment	**(59)**	(1) (46)	(1) (54)
Proceeds from sale of buildings and equipment	**81**	-	3
Dividend received from an affiliated company	**6**	-	-
Cash net, from (used for)investing activities	**688**	2,331	(950)

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Note 1D (7-9).

The notes to the financial statements are an integral part thereof.

Consolidated Statements of Cash Flows for the Years Ended December 31 (Cont'd)

Reported amounts (NIS millions)

	2015	2014	2013
Cash flows generated by financing activities:			
Dividend paid to shareholders	**-**	(45)	(120)
Repayment of subordinated capital notes	**(28)**	(170)	(152)
Cash net, used for financing activities	**(28)**	(215)	(272)
Increase in cash	**532**	1,275	155
Effect of exchange rate changes on cash	**(6)**	54	(72)
Balance of cash at beginning of year	**4,881**	3,552	3,469
Balance of cash at end of year	**5,407**	4,881	3,552

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)

	2015	2014	2013
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)	(4)
Depreciation and other amortizations	**57**	(1) 59	(1) 65
Credit loss expenses	**169**	120	171
Net gain on sale of securities available-for-sale and held to redemption	**8**	20	(63)
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)	1
Loss (gain) on sale of buildings and equipment	**(33)**	-	1
Gain from sale of investee company	**-**	-	(8)
Deferred taxes, net	**36**	(1) (3)	(1) (15)
Increase (decrease) in provisions for severance compensation, net	**(1)**	(1) 70	(1) 47
Adjustment in value of subordinated capital notes	**19**	28	52
Exchange rate differences on cash	**6**	(54)	72
Total adjustments to cash generated by operating activities	**259**	235	319
Appendix B - Non-cash activities			
Acquisition of buildings and equipment	**7**	6	2
Lending of securities (return of securities on loan)	**(313)**	(114)	260
Sale of investee company	**-**	-	1

Appendix C – Information regarding interest and taxes received (paid)

	2015	2014	2013
Interest received	**1,047**	1,146	1,118
Dividends received	**6**	-	-
Interest paid	**(186)**	(371)	(409)
Taxes on income paid	**(104)**	(117)	(82)

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Note 1D (7-9).

The notes to the financial statements are an integral part thereof.

Notes to the financial statements as of December 31, 2015

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, 2015, 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 35.

(3) The Board of Directors of the Bank approved the financial statements for publication on February 25, 2016.

(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

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 and assumptions 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.

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 draft memorandum in the matter of "adoption of US accounting standards", published by bank of Israel on January 27, 2014 (see Section C1 (b) above), which includes an outline for the adoption of US accepted accounting principal by the banking sector in Israel, Bank of Israel published during the reported period amendments and draft amendments to the public reporting instructions in this matter, as follows:

(a) Amendment of the public reporting instructions regarding reporting in accordance with US accepted accounting principles in the matter of "intangible assets"

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, 2016, the accounting principles

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)

(a) Amendment of the public reporting instructions regarding reporting in accordance with US accepted accounting principles in the matter of "intangible assets" (cont'd)

accepted by US banks in this respect, including the measurement and disclosure rules prescribed by the US accounting and reporting standards.
The new guidelines shall be initially applied in accordance with the transitional instructions in the matter, including the retroactive restatement of the comparative data. In the opinion of the Bank, implementation of the new accounting rules will not have a material effect on the financial statements.

(b) 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 in this respect, including the measurement and disclosure rules prescribed by the US accounting and reporting standards.
The new guidelines will be applied in accordance with the transitional instructions in the matter, including the retroactive restatement of the comparative data. In the opinion of the Bank, implementation of the new accounting rules will not have a material effect on the financial statements.

(c) 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 December 28, 2015. The guidelines contained in the amendment to the instructions requires banking corporations to apply, as from January 1, 2019, the accounting principles accepted by US banks in this respect, including the measurement and disclosure rules prescribed by the US accounting and reporting standards.
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 (and not to profit and loss, as required by the present guidelines of the Supervisor of Banks).
At this stage, the Supervisor of Banks has not yet decided whether to apply the measurement rules as to the recognition of exchange differences on available-for-sale securities, as read, or adopt in the interim period, different transitional instructions.
The Bank is preparing to apply the new measurement rules as from their effective date.
Management of the Bank estimates (excluding that stated above, that the application of the new accounting rules will not have a material effect on the financial statements.

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 reporting of segments of operation"

In continuation of the reporting instructions in the matter of "reporting of segments of operation", published by Bank of Israel on December 23, 2011 (which required banking corporations to present their results of operations by "operating segments" in accordance with the structure of operations existing in each of the banks), and whereas the disclosure presented according to this instruction in the financial statements of the different banks is based on subjective and inconsistent definitions (therefore is not comparable system wise), Bank of Israel published on November 3, 2014, an amendment to the Public Reporting Instructions in the matter of "reporting segments of operation". The amendment to the instruction contains a new guideline, according to which banking corporations will be required to include in their financial statements additional information regarding their operations by "regulatory segments of operation" (in addition to the data presented hitherto in this respect, based on "Management's approach", to the extent that material differences exist between the two approaches).

The regulatory segments of operation have been defined by Bank of Israel in the amendment to the instruction, based on the characteristics of their customers, viz.: the nature of their operations (with respect to private customers), or business turnover (with respect to business customers), in a format that connects on a uniform and exclusive basis between the different customers in the banking sector as a whole, and the regulatory segments of operation, as follows:

- **"Households"**: private customers, whose volume of the financial asset portfolio is typical of that of households (less than NIS 3 million).
- **"Private banking":** private customers, whose volume of the financial asset portfolio exceeds NIS 3 million.
- **"Tiny businesses"**: business customers, the annual business turnover of which is less than NIS 10 million.
- **"Small businesses"**: business customers, the annual business turnover of which is between NIS 10 and NIS 50 million.
- **"Middle market businesses"**: business customers, the annual business turnover of which is between NIS 50 and NIS 250 million.
- **"Large businesses"**: business customers, the annual business turnover of which is over NIS 250 million.

In addition, the amendment to the instruction defines a new segment - "financial management" - which in principle includes banking operations not attributable to the other segments of operation (such as: trading operations, asset and liability management, nonfinancial investments, etc.).

Accordingly, the information presented in the financial statements in accordance with the above definitions, will include financial data on a uniform and comparable basis for each of the segments of operation stated as above. The disclosure required by the amendment to the instruction will be included in the periodic financial statements of all banking corporations and shall become gradually effective, as follows:

- Disclosure relating to balance sheet data of the "regulatory segments of operation" (as defined in the amendment to the instruction) shall be initially presented in the financial statements for the year 2015.
- The remaining disclosure requirements contained in the amendment to the instruction shall become effective on January 1, 2016.

The Bank applied the guidelines that took effect on December 13, 2015, and is preparing for the implementation of the remaining guidelines on their due date.

Notes to the Financial Statements as at December 31, 2015

2. Amendment to the public reporting instructions in the matter of "revision of the structure of the report to the public of a banking corporation"

A significant increase in the complexity of banking business has taken place in recent years, followed by increasing regulatory demands on the part of the supervisory authorities, including extension of the disclosure requirements of the Basel Committee on Banking Business and the Financial Stability Committee ("FSB"), stemming, inter alia, from the drawing of conclusion following the economic and global crisis, which developed in 2008.

The said extension in disclosure requirement resulted in an increase of the scope and complexity of the information contained in reports to the public of banking corporations. In the opinion of Bank of Israel, the mass of information contained in the past in reports by banking corporations, created a barrier to the optimal use of reports by their readers.

Accordingly, and in view of the changes made in the field of public disclosure by many banks around the world, Bank of Israel published on April 28, 2015, an amendment to the public reporting instructions in the matter of "revision of the structure of the report to the public of a banking corporation".

The new guidelines included in the said amendment, are designed to improve the quality of public reporting by making the information contained therein more useful and accessible, modifying it to the practice prevailing at leading banks around the world.

The amended instructions include many and significant changes as compared with the disclosure and reporting requirements applying in the past, as follows:

- The "Management review" report in its former format was cancelled, and the information contained therein was integrated into other parts of the report to the public (see wider discussion below).
- The content of the Directors' report has been changed and is now presented in a different format, named: Report of the Board of Directors and Management".
  Within the framework of the changes to the disclosure format made in the Board of Directors and Management report, banking corporations are required to integrate into this report a part of the information regarding to risk management included previously in the "Management review" report.
  On the other hand, deleted from the content of this report is qualitative information regarding risk management (integrated into a separate risk report - see wider discussion below), and information regarding corporate governance, which is included in a separate designated report (see discussion below).
- Heading the report to the public is a new document, named "Chairman's Statement", in which, in a summarized form, the Chairman of the Board refers to the relevant principles issues for the reported year, and to the goals and strategy of the Bank.
- The structure of the financial report has been change to present the statement of profit and loss at the head of the report (instead of the balance sheet). This order of presentation related also to the relevant notes.
  Moreover, the content of information presented in the Note of credit to the public has been reduced, and the remaining information included therein in the past, is now presented in a separate Note at the end of the financial statements (see discussion below).
- Two new Chapters have been added at the end of the financial statements:
  - "Corporate governance" – contains information relating to organs and processes included in the corporate governance of the bank, such as: the Board of Directors and Management, Internal Audit, general information regarding the banking corporation, etc. In the past, this information was included in the Directors' report.
  - "Appendices" – include a part of the financial information (not related to risk management) previously reported as part of the "Management review" report.

- Information regarding risk management of a bank, previously included in the Directors' report (as part of the information required by the third Pillar of the Basel Rules) has been extended and is now included in a new report: "Risk report". This report is published on the Internet website of the bank and includes detailed quantitative and qualitative information as to the classes of risk existing at the banking corporation and the manner of their management.

The "Risk report" integrates also certain disclosure requirements included in the recommendations for improvement of disclosure regarding risks at banking corporations, published by a task force for disclosure improvement ("EDTF"). The risk report is the responsibility of the risk manager of the banking corporation and is signed by him.

The new guidelines included in the amendment to the public reporting instructions, as detailed above, became effective as from the reporting for 2015 and thereafter, and have been implemented by the Bank on their effective date.

3. Amendment to the public reporting instructions in the matter of "collective provision for credit losses"

On January 19, 2015, Bank of Israel published an amendment to the public reporting instructions in the matter of "collective provision in respect of credit to private individuals", within the framework of this amendment, the public reporting instructions regarding the "collective provision for credit losses" have also been amended. According to the guidelines contained in the amendment to the instructions, the computation of the collective provision for credit losses is based on the multiplication of the stated balances of credit included in the "provisional instruction" (distributed by economic segments) by the "provisions for credit loss coefficient" (as described below), for each of the economic segments, as stated – while differentiating between troubled credit (classified as "substandard" or "under special supervision") and other credit ("performing"). The "provision for credit loss coefficients" have been determined for each of the economic segments and each class of credit, as stated above, based on the range of provision computed on the basis of annual "accounting write-offs" data reported by the Bank in respect of each economic segment in the past five years – and which represent the best assessment (within the "provision range"), for the unidentified loss rates inherent in the credit portfolio for each of the groups detailed above.

In addition to these guidelines, the amended instruction includes a requirement for creating a collective provision for credit losses in respect of "environmental factors", which, inter alia, reflects trends in credit volumes in each sector, industry conditions, macro-economic data, a general evaluation of the quality of credit granted to the sector, changes in volume and trend of troubled debt balances, credit concentration in the sector, etc.

The guidelines contained in the amendment to the instruction took effect on December 31, 2014, and were implemented by the Bank on that date. During 2015, the bank integrated a structured model for the computation of the collective provision for credit loss component in respect of "additional adjustment in respect of environmental factors", as required in that amendment. Implementation of the accounting measurement rules derived from this model is made by way of a "change in accounting assessment". The difference between the "additional adjustment" stemming from the implementation of the model and the balance computed in accordance with the methodology applied by the Bank in the past, amounted at December 31, 2015 to NIS 5 million, and increased the expense of the Bank in respect of credit losses by this amount.

4. Amendment to the public reporting instructions in the matter of "disclosure of interested and related parties"

The amendment to the public reporting instructions regarding this issue was published by Bank of Israel on June 10, 2015.
The guidelines determined by this amendment to the instructions require banks to enlarge the scope of the definitions of "interested parties" and "related parties" and modify them to the definitions stated in Proper Conduct of Banking Business Directive No. 312 in the matter of: "related parties". In addition banking corporations are required to modify the disclosure in this respect to accounting principles accepted by US banks.
The said guidelines are in effect as from the report for 2015, and have been implemented as from their effective date.
In accordance with guidelines included in the public reporting instructions, the comparative data for periods prior to the reported year have not been restated (since the Bank does not have available data for such periods).
Application of the new accounting rules did not have a material effect upon the financial statements, other than presentation and disclosure aspects included in the financial statements.

5. Amendment to Proper Conduct of Banking Business Directive No. 329 in the matter of "additional capital requirements"

In the wake of significant price increases recorded in the housing market in Israel (followed by an accelerated growth in the volume of housing loans and in their proportionate weight in the credit portfolios of banking corporations), and which, in Bank of Israel's opinion, increased the risks inherent in credit portfolios of the banking corporations, Bank of Israel published on September 28, 2014, an amendment to Proper Conduct of Banking Business Directive No. 329, in which an additional minimum equity capital requirement was determined for each banking corporation (over and above the restrictions applying under Proper Conduct of Banking Business Directive No. 201), at a rate of 1% of the volume of housing loans of each of the banking corporations.
The requirement for additional equity capital entered into effect on January 1, 2015, and is being applied gradually during eight consecutive quarters as from April 1, 2015 and until January 1, 2017.
Implementation of the new guidelines increased the minimum equity capital requirement and the minimum comprehensive capital requirement as of December 31, 2015 by a rate of 0.06% to 9.06% and 12.56%, respectively. Assessments made by the Bank, based on the housing loan portfolio as of December 31, 2015, indicate that the new guideline are expected to increase the minimum capital requirements of the Bank for January 1, 2017, by an additional rate of 0.10% to 9.16% and 12.66%, respectively.

6. Extension of the public reporting instructions in the matter of "capital adequacy, leverage and liquidity"

Following the reform introduced by the Basel Committee in the matter of "risk management", with a view of strengthening the rules governing the preservation of capital and liquidity in the banking sector, the Committee published new guidelines, which determined restrictions on exposure to "leverage surplus" and to "liquidity risk".
Following these guidelines, Bank of Israel published new proper conduct of banking business directives, which adopt the Basel Committee recommendations and determine new disclosure rules in these matters, as follows:

(a) Liquidity coverage ratio

On September 28, 2014, Bank of Israel published a new Proper Conduct of Banking Business Directive No. 221 in the matter of "liquidity coverage ratio". The guidelines prescribed in the Directive are designed to maintain at the banking corporation an inventory of high quality liquid

assets, that would suit their liquidity needs in case of a stress situation occurring during a period of thirty days.
Accordingly, banking corporations are required to maintain a "liquidity coverage ratio" (defined as the ratio of "quality liquid assets" to the total cash outflow in a future period of thirty days) – of not less than 100%.
The Directive states rules both as to the "quality liquid assets inventory" and to the "net cash outflow within a period of thirty days", as follows:

- **Quality liquid assets –** include very high quality liquid assets ("Level 1"), such as : cash on hand, deposits with Bank of Israel and Israel government securities (averaged at a weight of 100%), and of a high quality level ("Level 2"), such as: securities of a high quality rating (averaged at a weight of 50%-85%).
- **Net cash outflow for a period of thirty days** – defined as the expected net cash outflow under a possible stress test, during a future period not exceeding thirty days – including expected outflows in respect of retail deposits (averaged under a "recycling assumption" of a rate of 80%-95%), in respect of deposits by non-financial corporations (averaged under a "recycling assumption" of 60%), and in respect of deposits by financial corporations (averaged with no "recycling assumption").

In addition, the Directive includes guidelines in respect of possible reliance on cash inflows in respect of credit granted to non-financial bodies, which is being repaid on a regular basis (averaged at the rate of 50%), cash inflows in respect of credit granted to financial institutions (averaged at the rate of 100%), and cash outflows in respect of non-binding commitments for the granting of credit (averaged at rates of 5%-10%).

The said guidelines took effect on April 1, 2015. Notwithstanding the above, the Directive included transitional instructions, according to which, banking corporations may maintain upon the initial application of the Directive (April 1, 2015), a liquidity coverage ratio of not less than 60% only.

This relief will be gradually reduced until its cancellation in full on January 1, 2017.

At the same time, Bank of Israel published on September 28, 2014, an amendment to the public reporting instructions in the matter of "liquidity coverage ratio", which requires banking corporations to broaden, as from April 1, 2015, the disclosure included in the financial statements regarding the capital adequacy ratio, including therein additional information regarding the liquidity coverage ratio. The Bank applies the disclosure requirements as from their effective date, and the required information is presented in these financial statements (see Note 23 below).

(b) 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". The Directive adopts the guidelines of the Basel Committee in this matter, the essence of which is to impose restrictions on liquidity surplus in the banking sector, by determining a transparent leverage ratio, which is not risk based and may be simply and easily calculated. In accordance with the guidelines of the Directive, the "leverage ratio" is defined as the ratio between "capital measurement" and "exposure measurement", as follows:

- **Capital measurement** - defined as Tier I equity capital (including the implications of the application of the transitional instructions determined for the purpose of equity capital).
- **Exposure measurement** – defined as the combination of the following exposures:
  - Balance sheet exposure – defined as the total assets stated in the balance sheet (excluding adjustments in respect of derivatives and the financing of securities transactions).
  - Derivatives exposure – defined as the cost of exchanging the derivative agreement.
  - Exposure to the financing of securities transactions.

- Off-balance sheet items – measured by the "credit equivalent" conversion approach.

According to these guidelines, banking corporations are required to maintain a leverage ratio of not less than 5%, starting with January 1, 2018, at the latest.

At the same time, Bank of Israel published on April 28, 2015, an amendment to the public reporting instructions in the matter of "disclosure of leverage ratio", which requires banking corporations to broaden, as from April 1, 2015, the disclosure included in the financial statements regarding the capital adequacy ratio, including therein information regarding the leverage ratio and the scope of exposure, which comprise a component in the calculation of this ratio. The Bank applies the disclosure requirements as from their effective date, and the required information is presented in these financial statements (see Note 23 below).

7. Employee rights

Bank of Israel published on April 9, 2014, an amendment to the public reporting instructions, in which banking corporations are required to adopt as from January 1, 2015, the US accepted accounting principles in the matter of "employee rights". Following this amendment, Bank of Israel published on January 11, 2015, additional instructions regarding this issue, including the broadening of the disclosure requirement, as detailed below.

The amendments to the instructions include guidelines and clarifications providing details of measurement and disclosure rules required for the implementation of these instructions, including:

- Provisions in respect of liabilities for the payment of employee rights stemming from a "defined benefits plan" (such as: severance compensation), liabilities for payment of "other post-retirement benefits" as well as other long-term liabilities (such as: liability for the payment of "jubilee" awards), shall be measured on an actuarial basis and presented on the basis of fair value, by discounting the future payments in respect of these liabilities to their present value, based on discount rates derived from returns on Israeli government bonds, with the addition of the average spread between the returns on US government bonds and the returns on "AA" and above rated corporate bonds traded in the United States. According to accounting principles in practice until December 31, 2014, the fair value of the said liabilities was computed based on a fixed discount rate of 4%.
- Payments in respect of a defined deposit plan, within the framework of which another entity (such as: an insurance company or a pension fund) undertakes to accept the full liability for the payment of severance compensation to employees in consideration for regular periodic deposits – are recognized in the payroll expense item in profit and loss as incurred.
- Provisions in respect of liabilities for "absence entitling to compensation" (such as paid vacation allocation), are to be 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 profit and loss.
- Assets in respect of a defined benefits plan will be measured according to fair value.
- Changes in provisions for liabilities in respect of employee rights and changes in the fair value of assets of a defined benefit plan, will be recognized in profit and loss or in equity in the item "other comprehensive profit", as follows:
  - Current changes resulting from the "time value" of provisions in respect of benefits payable upon the termination of employment (or thereafter), 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), will be recognized in the payroll expense item in the statement of profit and loss.
  - Changes in the fair value of assets of a defined benefit plan, stemming from current changes in the "time value" of the forecasted return on assets of the plan at the beginning of the period, will be recognized in the payroll expense item in the statement of profit and loss.

- Changes in other provisions in respect of employee benefits (such as: paid vacation allocation), will be recognized in the payroll expense item in the statement of profit and loss, as incurred.
- Changes in provisions for liabilities in respect of employee rights measured on an actuarial basis, and changes in defined benefit plan assets, stemming from actuarial amendments (such as: changes in actuarial assumptions, changes in the discount rates, and changes in the fair value of the defined benefit plan assets stemming from changes in returns of these assets on the capital market), will be 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 defined benefit plan assets, will be recognized in equity in the item "other comprehensive profit", and amortized to profit and loss in future years by the "straight line" method, over the future average period of service of the relevant employees.
  - Other changes in provisions for liabilities in respect of employee rights measured on an actuarial basis (such as: liability for the payment of jubilee awards), will be recognized in the payroll expense item in the statement of profit and loss, as incurred.

Within the framework of the instructions, banking corporations are required to enlarge the disclosure presented in this respect, as follows:

- Disclosure regarding the balance of liabilities in respect of employee rights and the fair value of assets of plans relating to such rights, by the various classes of benefits existing at the banking corporation.
- Disclosure regarding the components of the change in the liabilities for payment of severance compensation and other post-retirement benefits.
- Disclosure regarding the components of the change in the assets of a defined benefit plan.
- Disclosure regarding the components of amounts charged to the "other comprehensive profits" item, or which have been deducted from this item.
- Disclosure regarding the components of amounts charged to the statement of profit and loss in respect of changes in provisions for employee rights regarding termination of employment and in respect of assets of the defined benefit plan in respect thereof.
- Banking corporations are required to assess the amounts expected to be charged to the statement of profit and loss in the following reporting year, in respect of the periodic amortization of the "other comprehensive profit" item, and disclose such assessment.
- Disclosure regarding the assumptions used by the banking corporation in computing the provisions for employee rights measured on an actuarial basis, including:
  - the discount rate
  - the rate of increase in the CPI
  - the rates of yearly retirement of employees
  - the rates of the future increase in employee rights
  - the expected annual return on assets of the plan.
- Sensitivity analysis (in respect of the defined benefit plan) with reference to the expected changes in the balance of provisions for employee rights due to a possible change (by one percentage point) in certain parameters used to computed employee rights, such as: the discount rate, the rate of increase in the CPI, the yearly retirement rates and the future rate of yearly increase in employee compensation.
- Disclosure of the balance of the assets of the defined benefit plan relating to employment termination benefits by various segments, such as:
  - Composition of the plan's assets by investment channels, their rate of total assets of the plan, and the expected future changes in their proportionate share of the said investment channels.
  - Distribution of the plan's assets by investment channels and the classification of the fair value of each in the investment channels by "quality groups" (in accordance with the level of quality determined for each of the method used in the computation of the fair value of these assets).

- Analysis of the changes in the plan's assets, the measurement of their fair value had been classified to the lowest quality group ("Level 3"), by investment channels, including: purchases, sales and income actually recognized.

The guidelines determined in the instruction took effect on January 1, 2915, and have been applied in the financial statements by way of retroactive application as from January 1, 2013 and thereafter. Concurrently with these guidelines, Bank of Israel published on January 11, 2015, transitional instructions, which include guidelines regarding the initial application of these instructions, as follows:

- Actuarial losses recognized as of January 1, 2013, due to the remeasurement of provisions in respect of a post-retirement defined benefit plan, as stated, stemming from the difference between the discount rate in effect in the past (4%) and the discount rate prescribed by the instruction, had been recognized in equity in the item "other comprehensive profit". These losses will be offset in future periods against actuarial profits resulting from changes in the discount rate, until their elimination in full, and shall not be taken to profit and loss in periods following January 1, 2013.
  Other actuarial profits or losses relating to these employee rights had been recognized in equity in the item "other comprehensive profit" and are being amortized to profit and loss in the years following January 1, 2013, by the "straight line" method, over the future average period of service of the relevant employees.
- Differences as of January 1, 2013, created at date of initial application of the instruction, relating to other employee rights (such as: jubilee awards. and paid vacation allocation) all changes in respect thereof, according to the new instruction, are recognized in profit and loss - had been recognized in equity in the item "retained earnings".
- For practical reasons, banking corporations are permitted to base the forecasted rates of return in respect of assets of a defined benefit plan for the years 2013 and 2014 on return rates actually recorded in respect of the plan's assets in those years.

The Bank applies the new measurement and disclosure rules in the matter of employee rights, including the relief stated in the transitional instructions, as from their effective date (January 1, 2015).

For additional details regarding the financial implications stemming from the implementation of the new measurement rules on certain balance sheet and profit and loss items reported in prior periods and included in the comparative data in the financial statements, see Section 9 hereunder.

8. Guidelines of the Supervisor of Banks regarding capitalization of in-house software development costs

Section "J" presents information regarding accounting principles applied by the Bank in the matter of "capitalization to fixed assets of certain costs in respect of in-house development of software", in accordance with rules prescribed by International Standard No. 38.

In view of the materiality of this subject and the wide range of discretion granted in this field, and whereas audits that had been performed by Bank of Israel at a number of banking corporations discovered deficiencies in internal control applied by them in the process of capitalization of software costs, Bank of Israel published on March 31, 2015, a letter, which required the parent company to apply uniform rules comprising guiding outlines for the process of capitalization of in-house software development costs (and which therefore apply to all members companies in the parent company's banking group),, including:

- Member corporations of the parent company's banking group are required to determine a minimum "materiality threshold" for software development that may be classified to fixed assets, in the range of between NIS 450 thousand and NIS 600 thousand.
  In-house software development costs in amounts lower than the "materiality threshold" shall to be recognized in profit and loss and may not be capitalized.

- The depreciation period of software development costs classified to fixed assets shall not exceed five years.
- Payroll costs capitalized to fixed assets shall take into consideration "economic inefficiency" and possible deviations in reporting hours worked by employees engaged in software development.
- Investment in projects for the in-house development of software that are capitalized to fixed assets, shall include only expenses in respect of employees, the majority of their time is devoted to the actual development of software.

In addition, the parent company has been asked to examine (on a consolidated basis) the possibility of any signs indicating a possible impairment in the investment in software development (whether completed or not yet completed) and the creation of a provision for the impairment of such investment, where required.

The letter required the parent company (as well as the other companies in the banking group) to apply these measurement rules as from the quarterly report as of June 30, 2015, and adopt them by way of retroactive application.

The principal computer systems serving the Bank are based on the core systems of the parent company, which provides computer services to the Bank (including software development), under agreements signed in the matter by the Bank and the parent company.

Accordingly, costs in respect of in-house development of software capitalized to assets in the books of the Bank, stem from investments of the parent company in the in-house development of software for the two banks.

The Bank applies the requirement of Bank of Israel since April 1, 2015, and has integrated the measurement rules determined by Bank of Israel, as stated, in these financial statements by way of retroactive application. For additional details regarding the financial implications stemming from the implementation of the new measurement rules on balance sheet and profit and loss items reported in prior periods and included in the comparative data in these financial statements – see Section 9 below.

9. Information regarding the financial implications stemming from the restatement of the financial data

The table below presents data regarding the financial implications stemming from the retroactive application of new measurement rules in the matters of "employee rights" (as detailed in Section 7 above) and of "capitalization of in-house software development costs" (as detailed in Section 8 above):

- **Balance sheet data** (in NIS millions):

	December 31, 2014		
	As previously reported	**Effect of new rules**	**Restated**
Assets			
Buildings and equipment	413	(16)	397
Other assets	326	66	392
Other	27,781	-	27,781
Total assets	28,520	50	28,570
Liabilities	26,494	160	26,654
Shareholders' equity	2,026	(110)	1,916
Composition of capital			
Capital and capital reserves	203	-	203
Retained earnings	1,766	(31)	1,735
Other comprehensive profit	57	(79)	(22)
Total capital	2,026	(110)	1,916

- **Profit and loss data** (in NIS millions);

	Year ended December 31, 2014		
	As previously reported	**Effect of new rules**	**Restated**
Statement of profit and loss			
Payroll and related expenses	571	14	585
Maintenance and depreciation of building and equipment	151	(1)	150
Other expenses	165	2	167
Provision for taxes on income	99	(5)	94
Net profit	157	(10)	147
Per share earnings (NIS thousands)	1.26	(0.08)	1.18
Statement of comprehensive profit			
Adjustment of employee benefits	-	(41)	(41)
Related tax effect	10	15	25

	Year ended December 31, 2013		
	As previously reported	**Effect of new rules**	**Restated**
Statement of profit and loss			
Payroll and related expenses	525	2	527
Maintenance and depreciation of building and equipment	152	2	154
Other expenses	160	1	161
Provision for taxes on income	87	(2)	85
Net profit	182	(3)	179
Per share earnings (NIS thousands)	1.46	(0.02)	1.44
Statement of comprehensive profit			
Adjustment of employee benefits	-	(5)	(5)
Related tax effect	8	4	12

E. 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.

F. Investments in Investee Companies

The investment in investee companies is stated by the equity method, based on their audited financial statements.

G. Foreign Currency and Linkage

(1) Assets (except for securities) and liabilities 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		
	2015	2014	2013	2012	2015	2014	2013
Consumer Price Index "in respect of" the month of December – points	**106.3**	107.4	107.6	105.7	**(1.0)**	(0.2)	1.8
"Latest known" Consumer Price Index in the month of December – points	**106.4**	107.4	107.5	105.5	**(0.9)**	(0.1)	1.9
Exchange rate of the U.S. dollar – in NIS	**3.902**	3.889	3.471	3.733	**0.3**	12.0	(7.0)

H. 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 are reflected in the Statement of Profit and Loss.

- **Securities held for trading** – Securities which, in principle, 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 M. below.

(1) **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.

I. 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 arrears" method), and other debts, the contractual balance thereof is lower than NIS 50 thousand.

(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 50 thousand (excluding housing loans the provision for credit loss in their respect is computed by the "extent of arrears" method), as well as "restructured troubled debts".

(4) 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.

(4) Impaired debts (cont'd)

- **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.

(5) 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.

(5) Accounting write-offs

- **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.

(6) 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 two 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.

(6) Provisions for credit losses (cont'd)

- **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 published on January 19, 2015 (see Section D (3) above), (hereinafter – "the amended instruction") 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).

  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.

For additional information regarding the implementation of the guidelines contained in the amended instructions and their implications on the financial results of the Bank in 2015, see Section D (3) above.

- 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.

J. 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.
For further information regarding guidelines published in this respect by Bank of Israel on March 31, 2015, and applied by the Bank in the reported period, see Section D (8) above.

(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.

K. 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.

L. Issuance Expenses

The expenses involved in the issue of subordinate debt notes are amortized annually proportionate to the outstanding balance of such instruments.

M. 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.

N. 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.

O. 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 (hereinafter – "the amended instructions") published by Bank of Israel on April 9, 2014, and which became effective on January 1, 2015 (see Section D (7) above).

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 (such as: liability for the payment of "jubilee awards"), are

measured on an actuarial basis and are stated at their fair value, by discounting to present value the expected future payments, using discount rates determined in the amended instructions.

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 are expected to 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.

For additional information regarding the implications stemming from the implementation of the amended instructions on the measurement and disclosure rules regarding liabilities and assets relating to employee rights, their classification to balance sheet items and the recognition of changes recorded in their value in balance sheet, profit and loss and other comprehensive profit items – see Section D (7) above.

P. 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 very 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 risk exposure to the claim materializing. Material claims that fall within such criteria have been separately reported in Note 24B (7).

Q. 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).

R. 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 S below.
- As regards the recognition of income from impaired debts – see Section I (4) 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 H above.

(4) Other income and expenses are recognized on the accrual basis.

S. 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.

T. 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".

U. 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) (b), above.

V. **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 based in principles 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.

W. 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.

X. 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.

Y. 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.

For additional details regarding the new reporting instruction in the matter of "Regulatory segments of operations" applied by the Bank as from December 31, 2015, and their implications upon the financial reporting of the Bank in 2015 and following years, see Section D (1) above..

Z. 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".

Note 2 - Interest income and expenses

Consolidated

	Year ended December 31,		
	2015	**2014**	**2013**
	NIS millions	**NIS millions**	**NIS millions**
A. Interest income from:			
Credit to the public	**931**	910	938
Deposits with Bank of Israel and cash	**4**	13	15
Deposits with banks	**4**	9	19
Bonds (see C below)	**35**	79	155
Other assets	-	-	1
Total interest income	**974**	1,011	1,128
B. Interest expense on:			
Deposits from the public	**(78)**	(175)	(345)
Deposits from the government	**(2)**	(3)	(4)
Deposits from banks	**(2)**	(4)	(5)
Subordinated debt notes	**(19)**	(29)	(52)
Other liabilities	**(1)**	-	-
Total interest expense	**(102)**	(211)	(406)
Total net interest income	**872**	800	722
C. Composition of accrual basis interest income from bonds			
Held to maturity	**10**	10	12
Available-for-sale	**25**	67	141
Trading	-	2	2
Total included in interest income	**35**	79	155

(1) As from January 1, 2014, the Bank implements the accounting principles accepted by U.S. banks in the matter of the measurement of interest income.

Notes to the Financial Statements as at December 31, 2015

Note 3 - Non-Interest Financing Income

Consolidated

	Year ended December 31,		
	2015	2014	2013
	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)	**(49)**	77	(23)
Gains on sale of available-for-sale bonds(5)	**63**	53	64
Loss on sale of available-for-sale bonds(5)	**(2)**	(6) (2)	-
Net exchange differences(7)	**31**	(86)	34
Gains on sale of available-for-sale shares	**3**	-	-
Loss on sale of available-for-sale shares(4)	**(9)**	-	(3)
Gain on sale of shares in affiliated companies	-	-	8
Total non-interest financing income in respect of non-trading operations	**37**	42	80
B. Non-interest financing income from trading operations(2) (3)			
Realized and non-realized gains (losses) on adjustment to fair value of trading bonds, net(5)	-	-	1
Total non-interest financing income		42	81

(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) For further information see note 24 b (6) (b), above.
(5) Reclassified from accumulated other comprehensive income.
(6) Comprising a provision for impairment.
(7) Except for exchange differences on transactions classified to the item "Non-interest financing income from trading activities"

Note 4 - Commissions

Composition (in NIS millions):

	Year ended December 31,		
	2015	**2014**	**2013**
Account management	**154**	168	171
Credit cards	**31**	29	28
Securities and certain derivatives transactions	**21**	19	18
Financial products distribution commission	**13**	10	7
Credit management	**17**	14	77
Conversion differences	**31**	30	28
Foreign trade activity	**10**	10	10
Financing transactions commissions	**26**	26	28
Other commissions	**7**	7	8
Total operating commissions	**310**	313	375

Note 5 - Other Income

Composition (in NIS millions):

	Year ended December 31,		
	2015	**2014**	**2013**
Capital gain from sale of equipment and buildings	**33**	-	4
Capital loss from sale of equipment and buildings	**-**	-	(5)
Other	**-**	1	-
Total other income	**33**	1	(1)

Note 6 - Salaries and Related Expenses

Composition (in NIS millions):

	Year ended December 31,		
	2015	**2014**	**2013**
Salaries	**365**	342	343
Other related expenses including further education fund, vacation and sick leave	**24**	17	15
Long-term benefits (jubilee awards)	**(45)**	(1) 21	(1) 17
National insurance and payroll taxes	**101**	97	90
Pension expenses (including severance pay and provident fund contributions) (see note 21):			
Defined Benefit	**32**	(1) 37	(1) 28
Defined deposit	**8**	8	6
Contributions expenses- defined deposit	**16**	11	11
Other post-retirement benefits and non-pension post-retirement benefits (see note 21)	**2**	(1) 3	(1) 4
Special benefits in respect of dismissal (see note 21)	**-**	(2) 33	-
Expenses regarding other employee benefits	**15**	16	13
Total salaries and related expenses	**518**	585	527

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, See Note 1 d (7).

(2) Comprises provision for enlarged severance compensation in respect of voluntary retirement of employees, which was approved in 2014.

Note 7 - Other Expenses

Composition (in NIS millions):

	Year ended December 31,		
	2015	**2014**	**2013**
Marketing and advertising	**11**	11	11
Transportation and Communications	**17**	16	16
Computer services	**61**	(1) 54	(1) 53
Office expenses	**4**	4	4
Insurance	**2**	2	2
Professional services	**30**	33	32
Training and further education	**4**	3	3
Directors' fees	**3**	3	3
Management fees to the parent company	**2**	2	2
Commissions	**2**	2	2
Other	**35**	37	33
Total other Expenses	**171**	167	161

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of capitalization of software development costs, see Note 1 d (8).

Note 8 - Provision for Taxes on Income

A. Composition (in NIS millions):

	Year ended December 31,		
	2015	**2014**	**2013**
Current taxes in respect of the current year	**98**	106	111
In respect of prior years (1)	**2**	(8)	(11)
Total current taxes	**100**	98	100
Deferred taxes			
In respect of the current year	**34**	(1) (14)	(1) (29)
In respect of prior years (2)	**2**	10	14
Total deferred taxes	**36**	(4)	(15)
Total provision for taxes	**136**	94	85
Movement in deferred taxes:			
Creation and reversal of temporary differences	**14**	(23)	(26)
Change in the tax rate	**4**	-	(13)
Deferred taxes reclassified from equity to the statement of income	**18**	19	24
Total deferred taxes	**36**	(4)	(15)

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,		
	2015	**2014**	**2013**
	NIS millions		
Amount of the tax on the basis of statutory tax rate	**129**	(1) 90	(1) 94
Tax (tax savings) in respect of:			
Non-deductible expenses	**2**	1	1
Adjustment differences on depreciation and capital gains	**(3)**	-	-
Prior year taxes(1)	**4**	2	3
Adjustment of deferred taxes due to changes in tax rates	**4**	-	(13)
Other	**-**	-	-
Provision for taxes on profits	**136**	94	85
Statutory tax rate (percent)	**37.58**	37.71	36.22

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, and in the matter of capitalization of software development costs, see Notes 1 D (7-9).

(2) 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 [(1)]:

	December 31,	
	2015	**2014**
	NIS millions	**NIS millions**
Current taxes	**(21)**	(8)
Deferred taxes	**8**	(17)
Total	**(13)**	(25)

Notes to the Financial Statements as at December 31, 2015

Note 8 - Provision for Taxes on Profit (cont'd)

D. The change in deferred tax assets and tax liabilities is attributed to the following items: (in NIS millions)

	December 31, 2015							
	Allowance for credit losses	Interest and securities	Adjustment of depreciable non-financial assets (1)	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**

Notes to the Financial Statements as at December 31, 2015

Note 8 - Provision for Taxes on Profit (cont'd)

D. The change in deferred tax assets and tax liabilities is attributed to the following items: (in NIS millions) (cont'd)

	December 31, 2014							
	Allowance for credit losses	**Interest and securities**	**Adjustment of depreciable non-financial assets** (1)	**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	126	(4) (7)	(3) (12)	(2) 79	(2) 74	-	(4) (1)	259
Changes recognized in Profit and Loss								
-Due to tax rate change	-	-	-	-	-	-	-	-
-Other	(15)	(7)	1	(2) 4	(2) 21	-	-	4
Changes recognized in other comprehensive income:								
-Due to tax rate change	-	-	-	-	-	-	-	-
-Other	-	10	-	(2) 2	(2) 13	-	-	25
Net balance at the end of the year*	111	(4)	(11)	85	108	-	(1)	288
* Of which:								
- Deferred tax asset	111	(4) 4	-	85	(2) 108	-	-	308
- Balances which can be offset	-	(8)	(3) (11)	-	-	-	(4) (1)	(20)
Net deferred tax asset	111	(4)	(11)	85	108	-	(1)	288

(1) Depreciable non-financial assets.
(2) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, see Note 1 D (7).
(3) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of capitalization of software development costs, see Note 1 d (8).
(4) Reclassified

Note 8 - Provision for Taxes on Profit (cont'd)

E. 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,	
	2015	2014	2015	2014	2015	2014
	NIS millions	NIS millions	%	%	NIS millions	NIS millions
Related to:						
Provision for vacation pay and other payroll benefits	**58**	(1)85	**37.18**	37.71	**23**	(1) (4)
Net provision for severance pay	**113**	(1)108	**37.18**	37.71	**(7)**	(1) (21)
securities	**2**	4	**37.18**	37.71	**2**	-
Adjustment of other non-monetary assets	**1**	-	**26.50**	-	**(1)**	-
Provisions for credit losses	**110**	111	**37.18**	37.71	**1**	15
Other timing differences	**1**	-	**41.37**	-	**(1)**	-
Total	**285**	308	**37.16**	37.71	**17**	(10)

Deferred tax liabilities

	Balances		Average tax rates		Recognized in profit and loss	
	December 31,		December 31,		December 31,	
	2015	2014	2015	2014	2015	2014
	NIS millions	NIS millions	%	%	NIS millions	NIS millions
Related to:						
Securities	**4**	8	**37.18**	37.71	**15**	7
Adjustment of depreciable non-monetary assets	**15**	(1)11	**36.45**	35.89	**4**	(1)
Adjustment of other non-monetary assets	**1**	1	**10**	10.00	-	-
Total	**20**	20	**31.55**	31.65	**19**	6

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, See Note 1 d (7).
(2) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of capitalization of software development costs, see Note 1 d (8).

F. Tax assessments

- The Bank has tax assessments considered as final for 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 2011.

Note 8 - Provision for Taxes on Profit (cont'd)

G. Changes in tax laws

(1) Reduction in the rates of profit tax and payroll tax

Following an updated evaluation of the State's tax revenues situation performed by the Ministry of Finance, the Value Added Tax rate has been reduced from 18% to 17%, as from October 1, 2015.

In continuation of the above, the Knesset approved on October 12, 2015, the Value Added Tax Order (The tax rate applying to not-for-profit organizations and financial institutions) (Amendment), 2015, which reduced the profit tax and payroll tax applying to financial institutions from 18% to 17%.

The Amendment to the order took effect retroactively on October 1, 2015. Following the said Amendment, the Bank has recalculated in the fourth quarter of 2015, the provisions for deferred taxes, in accordance with the revised statutory tax rates (which include profit tax), that would apply to it in the future.

The revision of the provisions for deferred taxes on the basis of the updated statutory tax rate, as stated, increased the tax expense of the Bank in the last quarter of the year by NIS 4 million.

(2) The Income ax Ordinance Amendment Act

The Knesset approved on January 4, 2016, the Income Tax Ordinance Amendment Act (216), 2016.

Within the framework of the Act, the tax rates applying to corporations in Israel have been reduced as from January 1, 2016, (hereinafter – "the determining date") from a rate of 26.5% to 25%. Accordingly, the statutory tax rate applying to the Bank is expected to decrease as from the determining date from 37.18% to 35.90%.

Following the said Amendment Act, as stated, the Bank is expected to revise in the first quarter of 2016 the provisions for deferred taxes based on the updated statutory rates applying to it in the future.

The said revision in tax rates is expected to increase the tax expense of the Bank in the first quarter of 2016, by an amount of NIS 8 million.

Notes to the Financial Statements as at December 31, 2015

Note 9 - Earnings per share

	Consolidated		
	2015	2014	2013
	NIS thousands	NIS thousands	NIS thousands
1. Earnings per share			
Share of NIS 0.1 par value	**1.69**	(2) (1)1.18	(2) (1)1.44
Share of NIS 0.01 par value	**1.17**	(2) (1)0.12	0.15
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

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, see Note 1 D (7).

(2) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of capitalization of software development costs, see Note 1 d (8).

Note 10 - Other cumulative comprehensive income (loss) before and after the tax effect

A. Changes in other comprehensive income (loss) after tax effect

	Adjustments in respect of		
	securities	employee benefits	Total
		NIS millions	
Balance at January 1, 2013	94	-	94
Effect of the initial implementation of generally accepted accounting principles [3]	-	(52)	(52)
Balance at January 1, 2013 after The effect of implementation of the new rules	94	(52)	42
Net change during the year	(20)	(1)	(21)
Balance at December 31, 2013	74	(53)	21
Net change during the year	(17)	(26)	(43)
Balance at December 31, 2014	57	(79)	(22)
Net change during the year	(30)	7	(23)
Balance at December 31, 2015	27	(72)	(45)

(1) Adjustments for presentation of available-for- sale securities at fair value.

(2) The balance presented in the past, prior to the application of US accepted accounting principles regarding "employee rights".

(3) The cumulative effect, net of tax, in respect of the initial application of US accepted accounting principles in the matter of "employee rights".

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

	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	**(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	**11**	**(5)**	**6**
Total net change from Employee benefits	**13**	**(6)**	**7**
Total net change during the period	**(36)**	**13**	**(23)**

	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:			
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)

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, 2013		
	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	36	(16)	20
Loss (income) on available-for-sale securities reclassified to the statement of income	(64)	24	(40)
Net change from adjustments for securities	(28)	8	(20)
Employee benefits:			
Net actuarial income (loss)	(5)	4	(1)
Loss (income) reclassified to the statement of income	-	-	-
Total net change from Employee benefits	(5)	4	(1)
Total net change during the period	(33)	12	(21)

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, see Note 1 D (7).

Note 11 - Cash and Deposits with Banks

Composition on a consolidated basis:

	December 31 2015	December 31 2014
	NIS millions	NIS millions
Cash and deposits with Bank of Israel	**5,086**	4,092
Deposits with commercial banks	**416**	902
Deposits with special banking corporations	-	-
Total cash and deposits with banks	**5,502**	4,994
Including cash and deposits with Bank of Israel and with banks for an initial period of up to three months	**5,407**	4,881

Notes to the Financial Statements as at December 31, 2015

Note 12 - Securities

	December 31, 2015				
			Adjustment to fair value		
	Stated value	Written-down cost*	Gains	Losses	Fair value**
	NIS millions				
Held for 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 [6]	**8**	**8**	**-**	**-**	**8**
▪ Of other - In Israel [3]	**291**	**280**	**11**	**-**	**291**
- Foreign	**8**	**8**	**-**	**-**	**8**
Shares [2]	**12**	**10**	**2**	**-**	**12**
Total Available-for-sale securities	**3,110**	**3,067**	[5]**54**	[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.

Notes to the Financial Statements as at December 31, 2015

Note 12 - Securities (cont'd)

	December 31, 2014				
			Adjustment to fair value		
	Stated value	Written-down cost*	Gains	Losses	Fair value**
	NIS millions				
Held for maturity [(1)]					
Bonds -					
▪ Israel Government	209	209	26	-	235
▪ Foreign governments	19	19	-	-	19
▪ Israel financial institutions	85	85	8	-	93
Total Held-for-maturity bonds	313	313	34	-	347
Available-for-sale Securities [(4)]					
Bonds [(1)] **-**					
▪ Israel Government	2,064	2,538	68	2	2,604
▪ financial institutions - In Israel	454	450	4	-	454
- Foreign	9	9	-	-	9
▪ Of other - In Israel [(3) (6)]	427	419	11	3	427
- Foreign	2	2	-	-	3
	3,496	3,418	83	5	3,496
Shares [(2)]	14	12	2	-	14
Total Available-for-sale securities	3,510	3,430	[(5)]85	[(5) (7)]5	3,510
Trading securities					
Bonds [(1)] **-**					
▪ Israel Government	1	1	-	-	1
▪ Foreign financial institutions	5	5	-	-	5
▪ Of foreign others	2	2	-	-	2
Total trading securities	8	8	-	-	8
Total securities	3,831	3,751	119	5	3,865

* 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 4 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 8 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) In the reported period, the Bank classified impairment provisions regarding available-for-sale bonds in the amount of NIS 2 million as "impairment having other than a temporary nature" and included them in the statement of profit and loss.

(7) 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.

Notes to the Financial Statements as at December 31, 2015

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, 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	**268**	**16**	**53**	**337**	**1**	**338**
credit losses						
	70	**-**	**2**	**72**	**-**	**72**

(1) Credit to the public, credit to governments, deposits with banks and other debts, excluding bonds.

Notes to the Financial Statements as at December 31, 2015

Note 13 - Credit to the Public and Provision for Credit Losses (cont'd)

A. Debts [1], credit to the public and the balance of allowance for credit losses (cont'd)

	December 31, 2014					
	Credit to public					
		Private individuals			Banks and	
	Commercial	Housing loans	Other	Total	Governments	Total
Recorded amount of debts [1]						
Examined on a specific basis	[2]12,889	-	[2]2,291	15,180	902	16,082
Examined on a collective basis, the allowance for which is computed by:						
- extent of arrears	94	2,984	-	3,078	-	3,078
- other	[2]82	-	[2]894	976	-	976
Total debts [1]	13,065	2,984	3,185	19,234	902	20,136
Impaired debts:						
-Restructured troubled debts	112	-	25	137	-	137
- Others	192	-	13	205	-	205
Total balance of impaired debts	304	-	38	342	-	342
Other problematic debts:						
Debts in arrears of 90 days or more	1	[2]13	6	20	-	20
- Others	136	36	27	199	-	199
Total others Problematic debts	137	49	33	219	-	219
Total Problematic debts	441	49	71	561	-	561
Allowance for credit losses in respect of debts [1]						
Examined on a specific basis	[2]249	-	[2]40	289	1	290
Examined on a collective basis, the allowance for which is computed by:						
- extent of arrears	-	3	-	3	-	3
- other	[2]5	10	[2]12	27	-	27
Total allowance for	254	13	52	319	1	320
credit losses	73	-	5	78	-	78

Notes:

(1) Credit to the public, credit to governments, deposits with banks and other debts, excluding bonds.

(2) Reclassified.

Notes to the Financial Statements as at December 31, 2015

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, 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**

	Year ended December 31, 2014					
	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

Notes to the Financial Statements as at December 31, 2015

Note 14 - Investee companies

A. Composition

	Year ended December 31, 2015	Year ended December 31, 2014
	NIS millions	
Affiliated companies		
Shares on equity basis including goodwill	**3**	3
Shareholders' loans	**2**	2
Accumulated profits since acquisition	**2**	6
Total investment in Affiliated companies	**7**	11

B. Bank's share in profits of affiliates companies

	2015	2014
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,					
			2015	2014	2015	2014	2015	2014
		%	NIS millions					
Affiliated companies								
Tafnit Discont – Investment Portfolio Management Ltd.	Investment Portfolio management	31.0	(2)**7**	(2)11	**2**	2	**6**	-
Golden Gate Bridge Fund	Venture capital fund	20.0	**-**	-	**-**	-	**-**	-
Consolidated companies								
Mercantile Properties Ltd.	Inactive	99.62	**-**	1	**-**	-	**1**	-
Mercantile Issuance Ltd.	Issuance company	100.0	**-**	-	**-**	-	**-**	-
Mercantile Investments Ltd.	Inactive	100.0	**-**	-	**-**	-	**-**	3
Marbit Insurance Agency (1996) Ltd	Insurance agency	100.0	**2**	1	**1**	-	**-**	3
B.M.D. Underwriting & investment Promotion Ltd.	Inactive	100.0	**8**	8	**-**	-	**-**	-
Total			**17**	21	**3**	2	**7**	6

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, 2014 – identical).

Notes to the Financial Statements as at December 31, 2015

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, 2013	416	332	[2]383	1,131
Additions	10	12	[2]28	50
Subtraction	-	-	-	-
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**
Accumulated depreciation [1] [2]				
Balance as at December 31, 2013	167	257	[2]301	725
Depreciation for the year	14	16	[2]29	59
Subtraction	-	-	-	-
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**
Depreciated balance as at December 31, 2015	**195**	**77**	**74**	**346**
Depreciated balance as at December 31, 2014	245	71	81	397
Depreciated balance as at December 31, 2013	249	75	82	406
Average rate of depreciation for 2015 (%)	5.0	11.8	18.7	9.7
Average rate of depreciation for 2014 (%)	4.1	11.3	[3]17.4	9.3

(1) The balance includes capitalized software development costs in the sum of about NIS 45 million (December 31, 2014 – NIS 50 million).

(2) The accumulated depreciation includes losses on impairment amounting to NIS 3 million (December 31, 2013 – the same).

(3) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of capitalization of software development costs, see Note 1 d (8).

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 2016 to 2044. The amortized balance of the said rights is as follows:

	December 31, 2015	December 31, 2014
	NIS millions	NIS millions
Capitalized lease	**27**	27
Protected tenancy and non-capitalized lease	**3**	3
	30	30

(2) Land and buildings, the depreciated cost of which amounted to NIS 3 million, are not in use by the Bank and comprise "investment property" (December 31, 2014 - NIS 14 million).

(3) Rights to real estate, the depreciated cost of which amounted to NIS 108 million, have not yet been registered in the name of the Bank at the Land Registry Office (December 31, 2014 - NIS 163 million), due to delays in formalities preceding registration on the part of the Director of the Israel Lands Authority (of which, NIS 116 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, 2015 amounted to NIS 8 million. For additional details respecting commitments for the sale of such buildings, see Note 24B(10) below.

Note 16 - Other Assets

Composition:

	Year ended December 31,	
	2015	2014
	NIS millions	NIS millions
Current taxes – Excess advance tax payments over tax provision	**22**	19
Deferred tax assets, net	**265**	(1)288
Prepaid expenses	**8**	5
Income receivable	**28**	22
Salary advances	**-**	24
Other debtors and debit balances	**18**	34
Total other assets	**341**	392

A. Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, and in the matter of capitalization of software development costs, see Notes 1 D (7-9).

Note 17 - Deposits from the Public

A. Composition [1]:

	December 31 2015	December 31 2014
	NIS millions	NIS millions
Of which:		
Demand deposits:		
Non-interest bearing	**5,146**	3,829
Interest bearing	**1,918**	2,117
Total demand deposits	**7,064**	5,946
Time deposits	**18,324**	18,114
Total deposits from the public	**25,388**	24,060

B. composition of public deposits according to depositors

	NIS millions	NIS millions
Of which:		
Private individuals	**11,730**	[2]11,379
Institutional entities	**4,489**	[2]3,991
Corporations and others	**9,169**	[2]8,690
Total public deposits	**25,388**	24,060

C. distribution of deposits by size of deposit of the depositor:

Deposit level			
Above	Up to	NIS millions	NIS millions
-	1	**10,866**	10,428
1	10	**6,247**	6,065
10	100	**2,604**	2,147
100	500	**3,877**	4,092
500	-	**1,794**	1,328
Total public deposits		**25,388**	24,060

(1) The deposits were raised from the public in Israel.
(2) Reclassified.

Note 18 - Deposits from Banks

Composition:

	December 31 2015	December 31 2014
	NIS millions	NIS millions
Banks in Israel		
Commercial banks:		
Demand deposits	**81**	65
Time deposits	**300**	351
Acceptances	-	-
Total deposits from banks in Israel	**381**	416
Banks outside of Israel		
Commercial banks:		
Demand deposits	**6**	12
Time deposits	**25**	25
Acceptances	**47**	39
Total deposits from foreign banks	**78**	76
Total deposits from banks	**459**	492

Note 19 - Subordinated Capital Notes

A. Composition:

	Interest Rate	Average Maturity *	Internal rate of return *	Consolidated and the Bank December 31 2015	Consolidated and the Bank December 31 2014
	%	Years	%	NIS millions	NIS millions
CPI-linked Israeli currency	3.3-6.9	**5.6**	**3.9**	**672**	681

* 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.

Note 20 - Other Liabilities

Composition:

	Year ended December 31,	
	2015	**2014**
	NIS millions	
Provision for "long service awards" (Note 21A)	**78**	(1)138
Provisions for payroll and related expenses	**131**	(1)133
Provisions for computer services	**24**	19
Excess liabilities in respect of employee benefits over assets of the plan (Note 21)	**304**	(1)285
Provision for doubtful debts in respect of off-balance sheet items (Note 4D)	**29**	15
Deferred income	**28**	26
Institutions	**11**	12
Creditors regarding credit card activity	**511**	465
Other creditors and credit balances	**65**	80
Total other liabilities	**1,181**	1,173

* Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, See Note 1 D (7).

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 1.7% (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")

In accordance with the labor agreements in effect at the Bank, 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.

The financial statements include 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 this award was discounted to present value at a discount rate of 1.6%, based on rules specified in instructions of Bank of Israel.

A new wage agreement was signed on April 28, 2015, by the Bank, the New Federation of Labor and the employees' representative committee, according to which, the liabilities of the Bank for the payment of jubilee awards and jubilee vacation have been reduced.

(3) Vacation

Employees of the Bank are entitled to paid annual vacation in accordance with labor 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 1.8%-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 2015	December 31 2014
	NIS millions	NIS millions
Liability for the payment of severance compensation	**537**	538
Deposits for the payment of severance compensation	**(233)**	(253)
	304	285
Liability for the payment of "jubilee awards"	**78**	138
Liability for the payment of sick leave	**27**	25
Liability for the payment of unutilized sick leave	**7**	-
Liability for the payment of post-retirement retiree benefits	**44**	63
Excess liabilities over deposits for benefits to employees	**460**	511
Included in the item "Other assets"	**-**	-
Included in the item "other liabilities"	**460**	511
Total	**460**	511

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:

	December 31 2015 NIS millions	December 31 2014 NIS millions
Fair value of the program's assets at the beginning of the year	**538**	455
Cost of service	**20**	24
Cost of interest	**17**	18
Actuarial loss (income)	**(8)**	33
Total accruals	**567**	530
Benefits paid	**(30)**	(25)
Reductions, settlements, special and contractual benefits in respect of dismissals	**-**	33
Fair value of the program's assets at the end of the year	**537**	538

	December 31 2015 NIS millions	December 31 2014 NIS millions
Fair value of the program's assets at the beginning of the year	**63**	58
Cost of service	**2**	1
Cost of interest	**3**	3
Actuarial loss (income)	**(6)**	8
Total accruals	**62**	70
Benefits paid	**(2)**	(6)
Reductions, settlements, special and contractual benefits in respect of dismissals	**(16)**	(1)
Fair value of the program's assets at the end of the year	**44**	63

Notes to the Financial Statements as at December 31, 2015

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

	December 31 2015	December 31 2014
	NIS millions	NIS millions
Fair value of the program's assets at the beginning of the year	**253**	263
Anticipated return on assts of the plan	**10**	5
Actuarial loss	**(12)**	-
Deposits by the Bank to the plan	**12**	10
Total accruals	**263**	278
Benefits paid	**(30)**	(25)
Fair value of the program's assets at the end of the year	**233**	253

***** According to Bank of Israel instructions, actual return on assets of the plan has been reported.

(c) Balance sheet data

	December 31		December 31	
	2015	2014	2015	2014
	NIS millions	NIS millions	NIS millions	NIS millions
Included in the item "Other liabilities"	**44**	63	**304**	285
Commitment in respect of anticipated benefits	**44**	63	**537**	538
Fair value of the program's assets	**-**	-	**(233)**	(253)
Net anticipated benefit	**44**	63	**304**	285

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 accumulated other comprehensive income, before tax effect

	December 31		December 31	
	2015	2014	2015	2014
	NIS millions	NIS millions	NIS millions	NIS millions
Assets at initial application date	**-**	8	**-**	53
Actuarial loss, net	**12**	16	*** 102**	50
Total	**12**	24	**102**	103

* Includes actuarial loss of NIS 12 million, in respect of assets of the defined benefits plan.

(e) Excess net liabilities in respect of severance compensation over assets of the plan

	December 31 2015	December 31 2014
	NIS millions	NIS millions
Commitment in respect of anticipated benefits	**537**	538
Fair value of the program's assets	**(233)**	(253)
Net liability	**304**	285

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		
	December 31		
	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Cost of service	**20**	24	22
Cost of interest	**17**	18	18
Total current accruals	**37**	42	40
Anticipated return on assets of the plan	**(10)**	(1) (5)	(1) (12)
Amortization of unrecognized amounts:			
Net actuarial loss	**5**	-	-
Other, including loss from reduction, settlements and special benefits upon retirement	**-**	(2) 33	-
Total net cost of benefits	**32**	70	28
Total expense regarding defined deposits pension plans	**8**	8	6
Total expenses	**40**	78	34

(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		
	December 31		
	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Cost of service	**2**	1	1
Cost of interest	**3**	3	3
Total current accruals	**5**	4	4
Amortization of unrecognized amounts:			
Net actuarial loss	**1**	-	-
Gain on reduction and settlements	**(4)**	(1)	-
Total net cost of benefits	**2**	3	4

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		
	December 31		
	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Net actuarial loss for the year	**57**	50	-
Amortization of actuarial loss	**(5)**	-	-
Total current changes	**52**	50	-
Amortization of an asset in respect of initial application	**(53)**	(17)	-
Total recognized in other comprehensive income	**(1)**	33	-
Total net cost of benefits	**32**	70	28
Total amount recognized in net cost of benefits and in other comprehensive income	**31**	103	28

	Post-retirement retiree benefits		
	December 31		
	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Net actuarial loss for the year	**2**	8	4
Amortization of actuarial loss	**(1)**	-	-
Total current changes	**1**	8	4
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	4
Total net cost of benefits	**2**	3	4
Total amount recognized in net cost of benefits and in other comprehensive income	**(10)**	11	8

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 accumulated other comprehensive income expected to be amortized to the statement of income in 2016:

	Provision for severance compensation December 31		Post-retirement retiree benefits December 31	
	2015	**2014**	**2015**	**2014**
	NIS millions	**NIS millions**	**NIS millions**	**NIS millions**
Net actuarial loss	**5**	3	**1**	1
Net assets recognized on 1.1.2013	**-**	-	**-**	-
Cost of previous service	**-**	-	**-**	-
Total	**5**	3	**1**	1

3. Assumptions and sensitivity tests

(a) Assumptions used in determining the commitment in respect of benefits (percentages):

	December 31 2015	**December 31 2014**
	%	**%**
Discount rate	**1.7-2.5**	1.7-2.4
CPI growth rate	**2.0-2.0**	2.0-2.0
Remuneration growth rate	**4.3-4.3**	4.5-4.5
Retirement rate	**0.0-23.5**	0.0-23.5

(b) Principal assumptions used in determining payroll costs (percentages):

	December 31		
	2015	**2014**	**2013**
	%	**%**	**%**
Discount rate	**1.0-2.7**	1.4-2.4	2.4-3.3
Anticipated long-term return on the plan's assets	**3.8**	*1.8	4.5
Remuneration growth rate	**4.3**	4.5	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		
	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Change in discount rate	**(62)**	(59)	(55)
Change in remuneration/CPI growth rate	**63**	63	56
Change in retirement rate	**21**	21	21

	Provision for severance compensation		
	Decrease of one percentage point		
	December 31		
	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Change in discount rate	**62**	59	55
Change in remuneration/CPI growth rate	**(63)**	(59)	(56)
Change in retirement rate	**(21)**	(21)	(21)

	Post retirement retiree benefits		
	Increase of one percentage point		
	December 31		
	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Change in discount rate	**(9)**	(13)	(10)
Change in remuneration/CPI growth rate	**-**	-	-
Change in retirement rate	**(1)**	(1)	(1)

	Post retirement retiree benefits		
	Decrease of one percentage point		
	December 31		
	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Change in discount rate	**9**	13	10
Change in remuneration/CPI growth rate	**-**	-	-
Change in retirement rate	**1**	1	1

Notes to the Financial Statements as at December 31, 2015

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, 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**

	December 31, 2014			
	Level I	Level II	Level III	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Cash and deposits with banks	7	-	-	7
Bonds:				
- Government	151	-	-	151
- Corporate	33	39	-	72
Shares	8	5	-	13
Other	-	6	(1) 4	10
Total assets of the plan	199	50	4	253

(b) Allotment target of the plan's assets by type of asset:

	Allotment target	Actual proportionate share	
	December 31	December 31	
	2016	2015	2014
	%	%	%
Cash and deposits with banks	**3**	**3**	3
Bonds:			
- Government	**14**	**24**	(1) 60
- Corporate	**50**	**40**	28
Shares	**27**	**27**	5
Other	**6**	**(1) 6**	(1) 4
Total assets of the plan	**100**	**100**	100

(1) Reclassified

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	
	2016	2015	2014
	NIS millions	NIS millions	NIS millions
Total eposits	**12**	**12**	10

(b) Benefits expected to be paid by the Bank in the future:

Year	NIS millions
2016	**49**
2017	**36**
2018	**30**
2019	**31**
2020	**31**
2021-2025	**135**
2026	**386**
Total	**698**

Note 22 - Shareholders' Equity

Composition:

	Balance as at December 31, 2015		Balance as at December 31, 2014	
	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 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, 2015, by 0.06%. An assessment performed by the Bank, based on data of its housing loan portfolio as of December 31, 2015, indicates that the new guidelines are expected to increase the minimum capital requirements of the Bank as of January 1, 2017, by an additional 0.10% to a rate of 9.16% (in respect of the Tier I equity capital ratio), and to 12.66% (in respect of the comprehensive capital ratio).

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

A. Capital adequacy (cont'd)

(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) 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)

(5) Financial information

(a) Capital components for calculating ratio of capital

	December 31 2015	December 31 2014
	NIS millions	NIS millions
Equity capital	**2,103**	(3) 1,916
Difference between equity capital and Tier 1 capital and regulatory adjustment	**25**	(4) 91
Total Tier 1 equity capital after adjustments and deductions	**2,128**	2,007
Tier 2 capital after deductions	**680**	730
Total comprehensive capital	**2,808**	(4) 2,737

(b) Weighted risk assets balance

	December 31 2015	December 31 2014
Credit risk	**18,111**	(3) (4) 17,023
Market Risk	**31**	15
Operational risk	**1,870**	1,837
Total weighted risk assets balance	**20,012**	18,875

(c) Ratio of capital to risk assets

	December 31 2015	December 31 2014
	%	%
Ratio of Tier 1 equity capital to risk assets	**10.63**	(4)10.63
Ratio of comprehensive capital to risk assets	**14.03**	(4)14.50
Ratio of minimum Tier 1 equity capital required by the Supervisor of Banks	**(1) (2)9.06**	7.50
Minimum comprehensive capital adequacy ratio required by the Supervisor of Banks	**(1) (2)12.56**	9.00

(1) The minimal capital requirement ratios determined by Bank of Israel took effect on January 1, 2015.

(2) 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% per quarter. According to these guidelines, this rate is expected to rise gradually, up to a maximum increment of 0.16% on January 1. 2017 (based on data of the Bank's housing loan portfolio as of December 31, 2015).

(3) Restated in respect of the retroactive application of US accepted accounting principles regarding "employee rights" and of the guidelines of the Supervisor of Banks regarding "capitalization of software development costs" (see Note 1D(7-9).

(4) In accordance with Bank of Israel instructions, the comparative data regarding the "capital adequacy ratio" as of December 31, 2014, are stated before adjustments stemming from the application of US accepted accounting principles regarding "employee rights".

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

A. Capital Adequacy (cont'd)

(5) Financial information (cont'd)

	December 31 2015	December 31 2014
	NIS millions	NIS millions
(d) Capital components for calculating ratio of capital		
1. Tier 1 capital		
Equity capital	**2,103**	(2) 1,916
Difference between equity capital and Tier 1capital	**49**	100
Total Tier 1 capital before regulatory adjustments	**2,152**	(3) 2,016
Regulatory adjustments:		
Deferred tax assets	**(20)**	(2) (6)
Investment in capital of financial corporations that are not consolidated in reports to the public	**(2)**	(2)
Other regulatory adjustments	**(2)**	(1)
Total regulatory adjustments	**(24)**	(9)
Total Tier 1 capital	**2,128**	(3) 2,007
2. Tier 2 capital		
Regulatory instruments	**453**	517
Provision and reserves	**227**	213
Total tier 2 capital before deductions	**680**	730
Deductions	**-**	-
Total tier 2 capital	**680**	730
Qualified comprehensive capita	**2,808**	(3) 2,737

(e) The effect of the transitional instructions on the Tier 1 capital adequacy ratio	December 31 2015	December 31 2014
	%	%
Ratio of Tier 1 capital before the effect of the provisional instructions	**10.25**	(2)9.64
Effect of the provisional instructions (1)	**0.38**	0.75
Other adjustments	**-**	(3)0.24
Ratio of Tier 1 capital after the effect of the provisional instructions	**10.63**	(3)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.

(2) Restated, in respect of the retroactive implementation of US accepted accounting principles in the matter of "employee rights" and of guidelines of the Supervisor of Banks in the matter of capitalization of software development costs, see Notes 1 D (7-9).

(3) In accordance with Bank of Israel instructions, the comparative data regarding capital adequacy ratio as of December 31, 2014, are stated before adjustments derived from the retroactive application of US accepted accounting principles in the matter of "employee rights".

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

B. Liquidity coverage ratio

Bank of Israel published on September 28, 2014, a new Proper Conduct of Banking Business Directive in the matter of "liquidity coverage ratio", based on guidelines of the Basel Committee, designed to reduce exposure of the banking sector to liquidity risks by means of maintaining an inventory of high quality liquid assets, providing response to liquidity needs stemming from a stress situation prevailing for thirty days.

Accordingly, 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).

The guidelines contained in the Directive entered into effect on April 1, 2015. In addition, 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, 2015
Liquidity ratio:	**%**
Liquidity coverage ratio	**120.4**
Minimal liquidity coverage ratio required by the Supervisor of Banks	**(1)60.0**

1. Until December 31, 2015; in 2016 – 80%; as from January 1, 2017 – 100%.

C. Leverage ratio

Bank of Israel published on April 28, 2015, a new Proper Conduct of Banking Business Directive (No. 218) in the matter of "leverage ratio", with a view of reducing leverage accumulation in the banking sector, by means of measuring a transparent "leverage ratio", which is not risk based and may be easily and simply calculated. The guidelines contained in the directive define the leverage ratio as the ratio between "capital measurement" and "exposure measurement", 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".

The guidelines contained in the Directive require banking corporations to maintain a leverage ration of not less than 5% as from January 1, 2018, at the latest. Following are data regarding the leverage ratio components at the Bank:

Note 23 - Capital Adequacy, leverage and liquidity (cont'd)

C. Leverage ratio (cont'd)

	December 31, 2015
Components of the computation:	NIS millions
Tier 1 capital	2,128
Total exposures	32,454

	December 31, 2015
Leverage ratio:	%
Leverage ratio	6.6
Minimal leverage ratio required by the Supervisor of Banks	(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, 2015	December 31, 2014
	NIS millions	NIS millions
In Israeli currency linked to the CPI	21	26

(2) Cash flow in respect of collection commission on such operations in NIS millions

	December 31,							
	2015							2014
	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(1)	-	-	-	-	-	-	-	-

(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 7 million (December 31, 2014 – NIS 8 million) are not included in this table.

* Total income anticipated in this period - Less than NIS 0.5 million.

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Contingent Liabilities and Special Commitments

(1) The following liabilities and other commitments exist as of balance sheet date:

	Consolidated and the Bank	
	December 31, 2015	December 31, 2014
	NIS millions	NIS millions
Commitments for investment in buildings and equipment	**30**	50
Long-term rental agreements	**301**	299
Following are the rental payments in the coming years:		
First year	**27**	27
Second year	**29**	27
Third year	**28**	27
Fourth year	**28**	26
Fifth year	**27**	26
Sixth year and thereafter	**162**	166
Total rental payable	**301**	299

Note 24 - Contingent Liabilities and Special Commitments (cont’d)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(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, similarly to the preceding year.

(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 3 million (December 31, 2014 – identical).

(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.
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, 2015, to NIS 7 million (December 31, 2014 – NIS 6 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, 2014 – identical), comprising 0.14% of the total Risk Fund at such date. The Bank is required to provide collateral in favor 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) 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.

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, 2015 to NIS 33 million (December 31, 2014 – NIS 19 million).

Following are details of the material actions that had been filed against the Bank:

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(6) (cont'd)

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 labor 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.

b. A borrower, who in the past had received a loan from a Consortium of banks in which the Bank participated (hereinafter – "the Consortium") to finance the purchase of shares in "Bezeq", filed a claim on October 20, 2009, against the Bank and the Consortium in respect of "excessive exceptional interest" in the amount of NIS 804 million (updated on February 11, 2010 to NIS 830 million), allegedly charged to him by the Consortium for not abiding by the terms of the loan.

   The Plaintiff argues that the exceptional interest should be viewed as "excessive interest" charged to him due to an unreasonable delay by the Receiver appointed by the Consortium in realizing the collateral for the loan (the Bezeq shares) over and above the reasonable time required for selling these shares. Therefore, the Plaintiff claims, no exceptional interest should have been charged to him in respect of the period in excess of the reasonable time required to realize the collateral.

   Furthermore, the Plaintiff claims that the parties never intended from the beginning to apply the mechanism of "exceptional interest" for such a long period, and accordingly, using this mechanism for the whole period in which the loan was outstanding, contradicts the intentions of the parties at the time the loan agreement was signed, and now it comprises an unreasonable compensation to the Consortium in respect of the damage suffered by it.

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(6) (cont'd)

b. (cont'd)

On July 21, 2013, the District Court decided to admit a part of the Plaintiff's arguments and reduced the rate of the contractual exceptional interest charged to the borrower from 3.0% to 2.5%, starting with January 1, 2007. On November 3, 2013, the Court added a supplementary ruling to its previous decision, according to which, the amount due to the Plaintiff was fixed at NIS 48 million (for all the member banks in the Consortium). In view of the above, the Bank included a provision of NIS 2 million in respect of its share in the reimbursement amounts due to the borrower in accordance with the decision of the Court. Following the ruling of the District Court, the parties (the Plaintiff as well as the Consortium) filed an appeal against this ruling with the Supreme Court. On August 23, 2015, the Supreme Court ruled for the dismissal of the appeal filed by the Consortium, and for the admittance in part of the request of the Plaintiff, charging the Consortium with a reimbursement to the Plaintiff of an amount of NIS 240 million, together with interest and linkage increments.

The Bank's share in the amount ruled by the Court in favor of the Plaintiff is NIS 11 million. Following the Court ruling, the Bank recorded in the reported period an additional expense in this respect of NIS 9 million.

c. A action was filed against the Bank on September 1, 2013, together with a motion for its approval as a class action suit, by a customer who in 2010 received a loan from the Bank within the framework of the "Small Business Fund" (partly secured by a State guarantee) and as part of the loan process had been required to provide an additional collateral in respect of that part of the loan not secured by the State guarantee.

The Plaintiff claims that the requirement of the Bank for the additional collateral as well as the determined risk ratio for the loan (excessive in his opinion), constitute acts and conditions "creating a banking transaction under unreasonable terms", which on the face of it contradict the provisions of the Banking Act (Customer service), 1981. According to the Plaintiff, all these acts and conditions form part of a determined form of action in practice by the Bank in respect of all the loans of this type.

The amount stated in the motion for a class action (which, according to the Plaintiff, reflects the excess costs caused to all Bank customers applying for this type of loan) is NIS 129 million. As known to the Bank, the same customer has filed similar class action suits in this matter against two additional banks.

On February 18, 2015, the Court decided to admit the request of the Plaintiff for withdrawal from the action, and ruled for the deletion of the action and the motion for its approval as a class action.

d. On October 30, 2013, a lawsuit was filed against the Bank and against four other banking corporations (hereinafter – "the defendant banks") , together with a motion for its approval as a class action suit, by a customer who had taken loans from the defendant banks at various dates and of various amounts, and which proximate to their repayment dates has applied for new loans of similar amounts and terms, without being asked to change the collateral provided by him in respect of the original loans.

According to the Plaintiff, despite the fact that the new loans granted to him in lieu of the original loans, comprise "renewed loans" within their meaning in the first Addendum to the Banking Rules (Customer service) (Commissions), 2008, (hereinafter – "the Banking Rules"), his accounts were charged by the defendant banks with a "credit and collateral administration commission" in respect of the new loans, in contradiction to the Banking Rules, which prohibit the charging of such a commission upon the "renewal" of a loan that does not involve a change in collateral.

The amount of the alleged excess commission charged by the defendant banks is assessed by the Plaintiff by NIS 2 billion, of which the share of the Bank amounts to NIS 195 million.

Note 24 - Contingent Liabilities and Special Commitments (cont’d)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(6) (cont'd)

d. (cont'd)

On March 5, 2015, the Court ruled for the dismissal of all claims of the Plaintiff including the motion for approval of the action as a class action. On May 3, 2015, the Plaintiff appealed to the Supreme Court against the ruling of the District Court. On June 15, 2015, the Supreme Court decided, with the consent of the parties, to dismiss the appeal by the Plaintiff.

e. 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).

f. 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.

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(6) (cont'd)

g. An action together with a motion for approval of the action as a class action suit was filed on August 5, 2014, against the Bank and against six additional banks by an Association requesting to represent the customers of the defendant banks, who had received services regarding foreign currency transactions in their accounts, including transfers of foreign currency and exchange of foreign currency to local currency (and vice versa). The Plaintiff alleges that the practice of the defendant banks is to charge a minimum "gradual" commission in respect of such transactions (based on the amount of the transaction), contrary to the Banking Rules (Commissions), which permit only the charging of a uniform amount for the minimum commission.
In addition, the Plaintiff claims that the mode of operation allegedly observed by it in this respect at all the defendant banks raises a suspicion of the existence at the said banks of a prohibited binding arrangement, contrary to the Antitrust Act, 1988.

The Plaintiff estimates, based on a review of the financial statements of the defendant banks, that the alleged excess costs paid by their customers in respect of the claimed mode of operation during the past seven years, amounts to NIS 1.5 billion (the motion for approval of a class action does not state the share of the Bank in the total amount of the claim).

Within the framework of "preliminary hearing" proceedings, held on March 8, 2015, the Court instructed the Plaintiff to submit a new condensed motion for approval of the class action. Accordingly, the Plaintiff filed on April 27, 2015, a condensed motion, amending therein the amount of the claim to NIS 10 million.

Whereas the determined guarantee had not been deposited, the Court ruled on August 25, 2015, for the dismissal of the motion for approval of a class action, with no order for expenses.

h. An action together with a motion for approval of the action as a class action suit was filed on July 1, 2014, against the Bank and against its parent company by two of the Bank's customers (and an additional customer of the parent company). The cause of action, as alleged by the Plaintiffs, are excess amounts of interest charged to their accounts deriving from a decision that had been taken by he Bank and by the parent company several years ago, to advance the periodic date on which the "credit allotment" commission charged to their accounts from the beginning of the calendar quarter (in respect of which the charge is made) to the end of the previous calendar quarter, this contrary to the set of agreements signed between the Bank and the customer, and contrary to the price list published by the Bank. The amount of the personal damage allegedly caused to the Plaintiff is assessed by him at NIS 101 (as of December 31, 2013).
The total amount stated in the motion for approval of the class action against the Bank, which according to the Plaintiff represents the excess cost suffered by all Bank customers in this respect, is assessed by him at NIS 15 million.

On August 3, 2015, the parties filed with the Court an agreed motion, which includes a proposal for the withdrawal from the motion for approval of a class action. On November 18, 2015, the Court decided to approve the motion for withdrawal.

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(7) 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 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.

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.

In view of the short period that has past since the filing of the action, it is not possible at this stage to assess its prospects.

b. 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).

In view of the short period that has past since the filing of the action, it is not possible at this stage to assess its prospects.

Notes to the Financial Statements as at December 31, 2015

Note 24 - Contingent Liabilities and Special Commitments (cont'd)

B. Other Contingent Liabilities and Special Commitments (cont'd)

(8) 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, renewable from time to time. The validity of the previous pricing agreement terminated on December 31, 2015. Therefore, the parties agreed on December 27, 2015 to extend the validity and terms of the previous agreement for one additional year, until December 31, 2016.

The agreement was approved by the Audit Committee of the Board of Directors on January 10, 2016.

9. 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.

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.

Note 24 - Contingent Liabilities and Special Commitments (cont’d)

B. Other Contingent Liabilities and Special Commitments (cont'd)

10. Sale of buildings:

a. As part of the efficiency measures adopted by the Bank, it has been decided to move a part of the head Office units of the Bank, from the buildings serving the Management offices in Tel Aviv, to the office compound in Holon serving, inter alia, the back office units. Accordingly, the Bank signed on July 16, 2015, an agreement for the sale of part of the office building, which had been used by the said units, in consideration for NIS 66 million with the addition of VAT.

   The pre-tax gains from the sale of the said premises amount to NIS 23 million, and were recognized in the reported period in profit and loss in the item "Other income"

b. In the reported period, the Bank merged the operations of two branches located in the Tel Aviv area, moving it to a more central place. Following which, the Bank signed in the reported period and subsequently to balance sheet date agreements for the sale of buildings, as follows:

- An agreement for the sale of the building used by one of the said branches, the operations of which had been moved, was signed on August 3, 2015, in consideration for NIS 13 million, with the addition of VAT. The pre-tax gains from the sale of the said building amount to NIS 10 million, and were recognized in the reported period in profit and loss in the item "Other income".
- On January 28, 2016, the Bank signed an agreement for he sale of rights in the building used by the other branch, the operations of which had been moved, in consideration for NIS 11 million, with the addition of VAT.
  The gain from the sale of the rights is estimated at NIS 6 million and will be recognized in profit and loss on the date of transfer of the rights in the building (February 28, 2016).

Note 25 - Liens

A. In accordance with the agreement entered into between the Bank and the Maof Clearing House, the Bank deposited security in favor 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 favor 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 favor 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, 2015	December 31, 2014
		NIS millions	
Securities deposited (1)	- Average balance	**296**	493
	- Year-end balance	**295**	492
	- Highest balance during the year	**297**	496

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):

	2015			2014
	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	**4,663**	**4,663**	**3,469**	(2) 3,716

In 2015, the Bank did not participate in any of the said tenders (2014 – the same).

Note 25 - Liens

E. Below are details of securities deposited in favour of the Maof Clearing House and the Stock Exchange Clearing House (in NIS millions):

	2015			2014
	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)]	**66**	**74**	**72**	**74**
Total	**68**	**76**	**74**	**76**
• Stock Exchange Clearing House				
- Cash	**2**	**2**	**2**	**2**
- Securities [(1)]	**10**	**10**	**10**	**10**
Total	**12**	**12**	**12**	**12**

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, 2015, amounted to NIS 1 million (the highest and average balance in 2015 – NIS 1 million).

1. The data reflect the value of the deposited securities for the entity in whose favor the securities have been pledged.
2. Restated.

Note 26 - Derivative Instruments

A. General

(1) 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.

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.

Note 26 - Derivative Instruments (cont'd)

A. General (cont'd)

(2) 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 fulfill 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.

(3) 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. Volume of activity (NIS millions)

	December 31, 2015					
	Interest rate contracts		Foreign currency contracts	Contracts on shares	Commodities and other contracts	Total
	CPI	Foreign currency				
(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**	**-**	**35**
Negative gross fair value	**-**	**-**	**-**	**-**	**-**	**-**
3. Total						
Positive gross fair value (4)	**-**	**-**	**27**	**8**	**-**	**-**
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).

Notes to the Financial Statements as at December 31, 2015

Note 26 - Derivative Instruments (cont'd)

B. Volume of activity (NIS millions) (cont'd)

	December 31, 2014					
	Interest rate contracts		Foreign currency contracts	Contracts on shares	Commodities and other contracts	Total
	CPI	Foreign currency				
(a) Par value of derivative instruments:						
1. ALM derivatives (1)(2)						
Forward contracts	502	-	307	-	-	809
Other option contracts (4):						
Options written	-	-	16	-	-	16
Options purchased	-	-	33	-	-	33
Swaps (3)	-	1,047	2,868	-	-	3,915
Total ALM derivatives	502	1,047	3,224	-	-	4,773
2. Other derivatives (1)						
Forward contracts	-	-	-	-	-	-
Marketable option contracts:						
Options written	-	-	18	1,435	-	1,435
Options purchased	-	-	18	1,435	-	1,435
Other option contracts:						
Options written	-	-	101	-	-	101
Options purchased	-	-	100	-	-	100
Total other derivatives	-	-	133	-	-	133
3. Foreign currency swap contracts (SPOT)	-	-	133	-	-	133
(b) Gross fair value of derivative instruments:						
1. ALM derivatives (2)						
Positive gross fair value	-	1	23	-	-	24
Negative gross fair value	7	22	71	-	-	100
2. Other derivatives						
Positive gross fair value	-	-	1	8	-	9
Negative gross fair value	-	-	1	8	-	9
3. Total						
Positive gross fair value (4)	-	1	24	8	-	33
Amounts offset in the balance sheet	-	-	-	-	-	-
Stated balance of assets in respect of derivative instruments	-	1	24	8	-	33
Negative gross fair value(4) (5)	7	22	72	8	-	109
Amounts offset in the balance sheet	-	-	-	-	-	-
Stated balance of liabilities in respect of derivative instruments	7	22	72	8	-	109

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 463 million, in which the Bank has agreed to pay a fixed interest rate:
5. Of which gross positive fair value of assets in respect of embedded derivative instruments amounting to NIS 5 million, and negative gross fair value of NIS 1 million.
6. Of which NIS 46 million constitutes the balance of the liabilities in respect of foreign currency contracts not subject to a net settlement agreement (as of December 31,2014, the Bank had no assets in respect of derivative instruments not subject to a net settlement agreement).

Notes to the Financial Statements as at December 31, 2015

Note 26 - Derivative Instruments (cont'd)

C. Derivative instrument credit risk, based on contract counterparty – consolidated (in NIS millions)

	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**

	December 31, 2014				
	Stock markets	Banks	Governments and central banks	Others	Total
Stated balance of assets in respect of derivative instruments	3	19	-	11	33
Gross amounts that are not offset in the balance sheet:					
Reduction in credit risk in respect of derivative instruments	(1)	(10)	-	(1)	(12)
Reduction in credit risk in respect of cash collateral received	-	-	-	-	-
Assets in respect of derivative instruments, net	2	9	-	10	21
Off-balance sheet credit risk in respect of derivative instruments(1)	-	7	-	22	29
Total credit risk in respect of derivative instruments	2	16	-	32	50
Stated balance of liabilities in respect of derivative instruments	4	49	-	56	109
Gross amounts that are not offset in the balance sheet:					
Financial instruments	(1)	(10)	-	(1)	(12)
Pledged cash security	-	(39)	-	-	(39)
Liabilities for derivative instrument, net	3	-	-	55	58

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, 2015				
	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	**201**	**1,049**	**8**	**-**	**1,258**
Other	**124**	**20**	**233**	**419**	**796**
Foreign currency contracts	**2,313**	**827**	**74**	**113**	**3,327**
Contracts on shares	**3,126**	**-**	**-**	**-**	**3,126**
Commodities and other contracts	**-**	**-**	**-**	**-**	**-**
Total	**5,764**	**1,896**	**315**	**532**	**8,507**
December 31, 2014	6,340	1,179	270	224	8,013

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 (cont'd)

B. Information regarding regulatory operating segments

	December 31, 2015							
	Households	Private Banking	Small and minute businesses	Medium businesses	Large businesses	Institutional bodies	Financial management	Total
Assets:								
Investee companies	-	-	-	-	-	-	7	7
Others	7,056	62	9,482	2,593	1,759	56	9,061	30,069
Total Assets	7,056	62	9,482	2,593	1,759	56	9,068	30,076
credit to the public:								
impaired debts	24	-	165	42	29	-	-	260
debts in arrear for over ninety days	31	-	1	-	-	-	-	32
Others	6,781	14	9,049	2,514	1,712	55	-	20,125
Total credit to the public	6,836	14	9,215	2,556	1,741	55	-	20,417
Liabilities:								
Deposits from the public	9,947	1,786	6,599	1,048	1,519	4,489	-	25,388
Others	192	44	234	32	16	1	2,066	2,585
Total Liabilities	10,139	1,830	6,833	1,080	1,535	4,490	2,066	27,973
Risk-assets	5,399	11	7,924	3,201	1,850	56	1,571	20,012
Assets under management	3,454	1,426	1,939	540	2,124	825	-	10,308

Note 27 - Regulatory operating segments (cont'd)

C. Information Private individuals – Households and Private banking

	December 31, 2015							
	Households sector				Private banking sector			
	Mortgages	Credit cards	Other	Total households	Mortgages	Credit cards	Other	Total private banking
Assets	3,313	424	3,319	7,056	8	2	52	62
credit to the public:								
impaired debts	-	-	24	24	-	-	-	-
debts in arrear for over ninety days	24	-	7	31	-	-	-	-
Others	3,262	424	3,095	6,781	8	2	4	14
Total credit to the public	3,286	424	3,126	6,836	8	2	4	14
Liabilities:								
Deposits from the public	-	-	9,947	9,947	-	-	1,786	1,786
Others	-	-	192	192	-	-	44	44
Total Liabilities	-	-	10,139	10,139	-	-	1,830	1,830
Risk-assets	2,900	345	2,154	5,399	5	2	4	11
Assets under management	-	-	3,454	3,454	-	-	1,426	1,426

Notes to the Financial Statements as at December 31, 2015

Note 27 - Regulatory operating segments (cont'd)

D. Small, minute, medium and large business

	December 31, 2015		
	Small and minute businesses		
	Construction and real estate	Other	total
Assets	2,824	6,658	9,482
credit to the public:			
impaired debts	52	113	165
debts in arrear for over ninety days	-	1	1
Others	2,722	6,327	9,049
Total credit to the public	2,774	6,441	9,215
Liabilities:			
Deposits from the public	1,197	5,402	6,599
Others	43	191	234
Total Liabilities	1,240	5,593	6,833
Risk-assets	2,217	5,707	7,924
Assets under management	502	1,437	1,939

	December 31, 2015		
	Medium businesses		
	Construction and real estate	Construction and real estate	Construction and real estate
Assets	600	1,993	2,593
credit to the public:			
impaired debts	7	35	42
debts in arrear for over ninety days	-	-	-
Others	585	1,929	2,514
Total credit to the public	592	1,964	2,556
Liabilities:			
Deposits from the public	275	773	1,048
Others	7	25	32
Total Liabilities	282	798	1,080
Risk-assets	1,151	2,050	3,201
Assets under management	381	159	540

Note 27 - Regulatory operating segments (cont'd)

D. Small, minute, medium and large business (cont'd)

	December 31, 2015		
	Large businesses		
	Construction and real estate	Construction and real estate	Construction and real estate
Assets	232	1,527	1,759
credit to the public:			
impaired debts	-	29	29
debts in arrear for over ninety days	-	-	-
Others	231	1,481	1,712
Total credit to the public	231	1,510	1,741
Liabilities:			
Deposits from the public	120	1,399	1,519
Others	1	15	16
Total Liabilities	121	1,414	1,535
Risk-assets	231	1,619	1,850
Assets under management	104	2,020	2,124

Note 28 - Financial Information According to Business Segments

1. General

The Bank has installed a management information system which provides the Bank's Management with information, on a current basis, regarding the Bank's operating results broken down by "business segments" defined by the Bank's Management, as follows:

Households – This includes banking services granted to private customers whose nature of activity is typical of households, including credit facilities not exceeding NIS 300 thousand and deposits not exceeding NIS 500 thousand.

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.

Commercial banking - This includes banking services granted to middle market business customers (the credit facilities granted to them by the Bank exceeds NIS 7 million and who are not included in the "corporate banking" segment) including institutional bodies.

Corporate banking - This includes banking services granted to the Bank's large customers (the credit facilities granted to such corporations generally exceeds NIS 40 million) and to public companies. The services given are mostly in the area of the granting of credit.
In addition, this segment includes also certain operations regarding risk exposure management mostly in respect of the raising of deposits from corporations (mainly institutional bodies). Until December 31, 2012, this activity was included in the private banking segment.

Note 28 - Financial Information According to Business Segments (cont'd)

A. General (cont'd)

Private banking - This includes banking services granted to customers (individuals and companies) having a medium to high financial wealth, excluding certain operations regarding risk exposure management mostly in respect of the raising of deposits from corporations (mainly institutional bodies). Until December 31, 2012, this activity was included in the operations of this segment.

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 and activity with other banks and institutional bodies).

The classification of the operating results according to the various business segments was made according to the following methodology:

Interest income– Each business segment is credited with an "interest spread", which constitutes the total of the following components:

- The difference between the interest income attributed to a segment (from credit activity), and the interest expense calculated according to the "transfer price"

- The difference between the cost of the interest (on deposits of customers) and the interest income on those deposits which is calculated according to the "transfer price".

"The transfer price" is set, based on the quoted price of deposits on the institutional market, and it closely reflects the marginal cost of the raising of deposits by the Bank.

According to this methodology, by which a specific transfer price is applied to each credit product or deposit in each of the linkage segments, the operating segments do not bear market risks but only credit risks.

Profits or losses from financing operations deriving from changes in market conditions are credited or charged to the asset and liability management center (ALM), to which the income from the management of the active capital of the Bank is also credited. Such profits or losses are stated in the "Financial management" segment.

Expenses in respect of credit losses – These are included in the various operating segments, depending on the segment, to which the customer, in respect of whom the expense was recognized, belongs.

Operating income – Commissions and other operating income are reflected in the various operating segments, depending on the segment to which the customer, in respect of whom the income was earned, belongs.

Operating expenses – Identifiable direct expenses are reflected in the appropriate operating segment. Indirect expenses or direct expenses which cannot be accurately attributed are allocated to the various operating segments based on estimates and valuations made in the various units of the Bank.

Return on capital – the allocation of capital for the purpose of the return on capital calculation of each operating segment, is based on the average of the risk assets of each segment.

Notes to the Financial Statements as at December 31, 2015

Note 28 - Financial Information According to Business Segments (cont'd)

B. Composition (in NIS millions)

	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	259	406	85	135	(41)	28	872
• Inter-segment	(25)	(14)	(2)	(12)	64	(11)	-
Total interest income	234	392	83	123	23	17	872
Non-interest financial income	1	-	-	3	1	32	37
Total financial income	235	392	83	126	24	49	909
Commission and other income	107	122	19	30	32	33	343
Total income	342	514	102	156	56	82	1,252
Income (expense) from credit losses	9	37	15	6	-	-	67
Operating and other expenses, excluding depreciation	281	306	48	62	63	24	784
Depreciation	21	22	4	4	4	2	57
Profit (loss) before taxes	31	149	35	84	(11)	56	344
Provision for taxes on income	15	61	14	34	(4)	16	136
Profit (loss) after taxes	16	88	21	50	(7)	40	208
Bank's share in net profits of equity-basis investee	-	-	-	-	-	2	2
Net profit (loss) for the year	16	88	21	50	(7)	40	208
Return on capital (percentage)	3.2	15.9	8.1	8.6	*	*	10.4
Average balance of assets	6,497	6,609	2,537	4,501	151	7,691	27,986
Of that: investment in affiliated companies	-	-	-	-	-	6	6
Average balance of credit to the public	6,259	6,349	2,496	4,449	98	-	19,651
Average balance of liabilities	5,927	3,809	1,567	5,136	7,064	-	23,503
Average balance of risk assets	6,124	4,024	1,601	5,179	7,109	1,973	26,010
Average balance of securities	4,736	5,364	2,556	5,625	205	1,095	19,581
	1,172	686	221	4,732	4,825	-	11,636
Components of interest income:							
Margin from credit granting activity	211	377	77	117	3		
Margin from deposit receipt activity	23	15	6	6	20		
Total interest income	234	392	83	123	23		

* Not relevant

Notes to the Financial Statements as at December 31, 2015

Note 28 - Financial Information According to Business Segments (cont'd)

B. Composition (in NIS millions) (cont'd)

	For the year ended December 31, 2014						
	Household	Small Business	Commercial Banking	Corporate Banking	Private Banking	Financial management	Total consolidated
Net interest income							
• From outsiders	224	376	80	116	(63)	67	800
• Inter-segment	(11)	(17)	(6)	1	94	(61)	-
Total interest income	213	359	74	117	31	6	800
Non-interest financial income	1	-	1	1	-	39	42
Total financial income	214	359	75	118	31	45	842
Commission and other income	(2)115	(2)121	18	28	31	1	314
Total income	329	480	93	146	62	46	1,156
Income (expense) from credit losses	(9)	(15)	14	25	-	-	15
Operating and other expenses, excluding depreciation	(1)298	(1)328	(1)52	(1)68	(1)69	28	843
Depreciation	21	24	4	(1)4	4	2	59
Profit (loss) before taxes	19	143	(1)23	49	(1) (11)	16	239
Provision for taxes on income	(1)7	(1)56	9	19	(1) (4)	7	94
Profit (loss) after taxes	12	87	14	30	(7)	9	145
Bank's share in net profits of equity-basis investee	-	-	-	-	-	2	2
Net profit (loss) for the year	12	87	14	30	(7)	11	147
Return on capital (percentage)	(1)2.7	(1)18.2	(1)5.4	(1)5.3	*	*	(1)7.8
Average balance of assets	5,726	5,938	2,376	4,261	123	(1)8,986	27,410
Of that: investment in affiliated companies	-	-	-	-	-	10	10
Average balance of credit to the public	5,580	5,775	2,350	4,228	89	-	18,022
Average balance of liabilities	5,808	3,687	1,307	4,973	7,309	2,514	25,598
Average balance of risk assets	4,071	4,670	2,515	5,405	192	(1)1,392	18,245
Average balance of securities	1,068	593	609	5,294	4,746		12,310
Components of interest income:							
Margin from credit granting activity	177	336	70	109	3		
Margin from deposit receipt activity	36	23	4	8	28		
Total interest income	213	359	74	117	31		

* Not relevant

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, and in the matter of capitalization of software development costs, see Notes 1 D (7-9).

C. Reclassified.

Note 28 - Financial Information According to Business Segments (cont'd)

B. Composition (in NIS millions) (cont'd)

	For the year ended December 31, 2013						
	Household	Small Business	Commercial Banking	Corporate Banking	Private Banking	Financial management	Total consolidated
Net interest income							
• From outsiders	175	355	74	107	(110)	121	722
• Inter-segment	21	(42)	(16)	2	147	(112)	-
Total interest income	196	313	58	109	37	9	722
Non-interest financial income	1	1	(1)	7	1	72	81
Total financial income	197	314	57	116	38	81	803
Commissions and other income	120	169	23	33	30	(1)	374
Total income	317	483	80	149	68	80	1,177
Income (expense) from credit losses	(6)	24	18	39	-	-	75
Operating and other expenses, excluding depreciation	(1)279	(1)295	48	(1)62	66	27	777
Depreciation	(1)23	(1)25	4	5	6	2	65
Profit (loss) before taxes	21	139	10	43	(4)	51	260
Provision for taxes on income	(1)5	(1)47	3	16	(3)	17	85
Profit (loss) after taxes	16	92	7	27	(1)	34	175
Bank's share in net profits of equity-basis investee	-	-	-	-	-	4	4
Net profit (loss) for the year	16	92	7	27	(1)	38	179
Return on capital (percentage)	4.1	19.5	3.0	4.9	*	*	(1)9.9
Average balance of assets	5,120	5,656	2,084	4,367	124	9,750	27,101
Of that: investment in affiliates companies	-	-	-	-	-	6	6
Average balance of credit to the public	4,966	5,490	2,057	4,332	87	-	16,932
Average balance of liabilities	5,656	3,754	1,253	4,482	7,695	(1)2,533	25,373
Average balance of risk assets	3,593	4,536	2,153	5,495	194	(1)1,423	17,394
Average balance of securities	852	378	868	6,972	3,770	-	12,840
Components of interest income:							
Margin from credit granting activity	147	283	53	101	3		
Margin from deposit receipt activity	49	30	5	8	34		
Total income from financing activities before provision for doubtful debts	196	313	58	109	37		

* Not relevant

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, and in the matter of capitalization of software development costs, see Notes 1 D (7-9).

Note 29 - 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, 2015					
	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						
Credit loss expense (income)	**267**	**13**	**54**	**334**	**1**	**335**
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**

	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

Notes to the Financial Statements as at December 31, 2015

Note 29 - 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, 2013					
	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	275	9	73	357	-	357
Credit losses expense (income)	81	5	(12)	74	1	75
Accounting write offs	(108)	-	(38)	(146)	-	(146)
Collection of debts written off in previous years	52	-	44	96	-	96
Net accounting write-offs	(56)	-	6	(50)	-	(50)
Balance of allowance for credit losses at end of year*	300	14	67	381	1	382
* Of which – in respect of off-balance sheet credit instruments	14	-	2	16	-	16

(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 the debts and regarding the debts for which the allowance is computed

	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**					

Notes to the Financial Statements as at December 31, 2015

Note 29 - 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, 2014					
	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]	[4] 12,889	-	[4] 2,291	15,180	902	16,082
- Examined on a collective basis:						
by extent of default period	94	2,984	-	3,078	-	3,078
other	[4] 82	-	[4] 894	976	-	976
Total debts[1]	13,065	2,984	3,185	19,234	902	20,136
Provision for credit loss in respect of debts[1]						
- Examined on a specific basis	[4] 249	-	[4] 40	289	1	290
- Examined on a specific basis						
by extent of default period	-	3	-	3	-	3
other	[4] 5	10	[4] 12	27	-	27
Total provisions for credit loss	254	[2]13	52	319	1	320

(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, 2014 – identical), and which computed on a collective basis amounts to NIS1 2 million (December 31, 2014 – NIS 10 million).
(3) Including credit examined on a specific basis and found to be performing in the amount of NIS 16,200 million (December 31, 2014 – NIS 15,740 million).
(4) Reclassified.

Notes to the Financial Statements as at December 31, 2015

Note 29 - Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts (1)

1. Credit quality and arrears (in NIS millions)

	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**	**-**	**3**
Real estate	**1,842**	**36**	**-**	**1,878**	**-**	**-**
Financial services	**333**	**6**	**-**	**339**	**-**	**-**
Other	**9,313**	**202**	**94**	**9,609**	**1**	**12**
Total commercial	**13,111**	**275**	**118**	**13,504**	**1**	**15**
Private individuals:						
Housing loans	**3,214**	**-**	**(6)57**	**3,271**	**24**	**20**
Other loans	**3,453**	**26**	**42**	**3,521**	**7**	**14**
Total public in Israel	**19,778**	**301**	**217**	**20,296**	**32**	**49**
Banks in Israel	**106**	**-**	**-**	**106**	**-**	**-**
Total lending activity in Israel	**19,884**	**301**	**217**	**20,402**	**32**	**49**
Lending activity outside of Israel						
Public – commercial:						
Construction and real-estate	**19**	**-**	**63**	**82**	**-**	**-**
Commercial - other	**302**	**31**	**-**	**333**	**-**	**-**
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**	**49**
Total Banks	**416**	**-**	**-**	**416**	**-**	**-**
Total	**20,558**	**332**	**280**	**21,170**	**32**	**49**

(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.

Note 29 - 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, 2014					
		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	1,463	36	59	1,558	-	2
Real estate	1,720	31	1	1,752	-	-
Financial services	287	1	-	288	-	-
Other	8,634	204	77	8,915	1	12
Total commercial	12,104	272	137	12,513	1	14
Private individuals:						
Housing loans	2,935	-	[6]49	2,984	12	10
Other loans	3,110	38	33	3,181	6	10
Total public in Israel	18,149	310	219	18,678	19	34
Banks in Israel	434	-	-	434	-	-
Total lending activity in Israel	18,583	310	219	19,112	19	34
Lending activity outside of Israel						
Public – commercial:						
Construction and real-estate	99	-	-	99	-	-
Commercial - other	425	32	-	457	-	-
Total public outside of Israel	524	32	-	556	-	-
Banks outside of Israel	468	-	-	468	-	-
Total lending activity outside of Israel	992	32	-	1,024	-	-
Total public	18,673	342	219	19,234	19	34
Total Banks	902	-	-	902	-	-
Total	19,575	342	219	20,136	19	34

(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 22 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 - 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, 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**

	December 31, 2014			
		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)	0.1
Ratio of impaired debts to the balance of credit to public	2.3	-	1.2	1.8
Ratio of troubled debts to the balance of credit to public	3.4	1.6	2.2	2.9
Ratio of debts in arrears for over 30 days to the balance of credit to public	0.1	0.7	0.5	0.3

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. An increase in credit loss expense was recorded from 0.1% in 2014 to 0.3% in 2015. Nevertheless, and whereas other parameters indicate stability or even a decrease (such as: the rate of impaired debts), Management of the Bank estimates that no deterioration in the quality of the credit portfolio occurred in the reported period.

(1) Credit to the public, credit to governments, deposits in banks and other debts excluding bonds.

Notes to the Financial Statements as at December 31, 2015

Note 29 - 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, 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 [1]	**180**	**72**	**152**	**332**	**1,182**
Total banks	**-**	**-**	**-**	**-**	**-**
Total [1]	**180**	**72**	**152**	**332**	**1,182**
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 - 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, 2014				
	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	19	11	17	36	226
Real estate	16	1	15	31	36
Financial services	-	-	1	1	5
Other	127	49	77	204	634
Total commercial	162	61	110	272	901
Private individuals					
Housing loans	-	-	-	-	-
Other loans	14	5	24	38	214
Total public in Israel	176	66	134	310	1,115
Banks in Israel	-	-	-	-	-
Total leading activity in Israel	176	66	134	310	1,115
Lending activity outside of Israel					
Public – commercial:					
Construction and real estate	-	-	-	-	-
Other	25	12	7	32	32
Total public lending activity outside of Israel	25	12	7	32	32
Foreign banks	-	-	-	-	-
Total lending activity outside of Israel	25	12	7	32	32
Total public [1]	201	78	141	342	1,142
Total banks	-	-	-	-	-
Total [1]	201	78	141	342	1,142
Of which:					
Measured according to present value of cash flows	190	74	115	304	408
Restructured debts	40	8	97	137	160

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Allowance for credit losses on an individual basis.

Notes to the Financial Statements as at December 31, 2015

Note 29 - 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, 2015			For the Years Ended December 31, 2014		
		Interest income recorded[3]			Interest income recorded[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	**42**	**-**	**-**	41	-	-
- Real estate	**45**	**1**	**1**	24	-	1
Financial services	**6**	**-**	**-**	1	-	-
Other	**268**	**3**	**3**	186	3	2
Total commercial	**361**	**4**	**4**	252	3	3
Private individuals						
- Housing loans	**-**	**-**	**-**	-	-	-
- Other loans	**42**	**-**	**-**	42	-	1
Total public in Israel	**403**	**4**	**4**	294	3	4
Banks in Israel	**-**	**-**	**-**	-	-	-
Total lending activity in Israel	**403**	**4**	**4**	294	3	4
Lending activity outside of Israel						
Public - commercial:						
- Construction and real estate	**-**	**-**	**-**	-	-	-
- other	**31**	**-**	**-**	52	1	-
Total commercial	**31**	**-**	**-**	52	1	-
Foreign banks	**-**	**-**	**-**	-	-	-
Total lending activity outside of Israel	**31**	**-**	**-**	52	1	-
Total public	**434**	**4**	**4**	346	4	4
Total Banks	**-**	**-**	**-**	-	-	-
Total	**434**	**4**	**4**	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 2015 to NIS 18 million (2014 – NIS 20 million).

Note 29 - 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, 2013		
	Average balance of impaired debts(2)	On a cash basis	Other
Lending Activity in Israel:			
Public - commercial:			
Construction and real estate:			
- Construction	66	-	1
- Real estate	21	-	1
Financial services	4	-	-
Other	303	2	2
Total commercial	394	2	4
Private individuals			
- Housing loans	-	-	-
- Other loans	64	1	1
Total public in Israel	458	3	5
Banks in Israel	-	-	-
Total lending activity in Israel	458	3	5
Lending activity outside of Israel			
Public - commercial:			
- Construction and real estate	1	-	-
- other	75	-	-
Total lending activity outside of Israel	76	-	-
Foreign banks	-	-	-
Total lending activity outside of Israel	76	-	-
Total public	534	3	5
Total Banks	-	-	-
Total	534	3	5

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 2013 to NIS 27 million.

Notes to the Financial Statements as at December 31, 2015

Note 29 - 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, 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 - 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, 2014				
		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	9	-	-	4	13
- Real estate	4	-	-	11	15
Financial services	-	-	-	1	1
Other	32	-	1	43	76
Total commercial	45	-	1	59	105
Private individuals - other	14	-	-	11	25
Total public lending activity in Israel	59	-	1	70	130
Banks	-	-	-	-	-
Total lending activity in Israel	59	-	1	70	130
Leading activity outside of Israel					
Public - commercial:					
- Construction and real-estate	-	-	-	-	-
- other	7	-	-	-	7
Total public outside of Israel	7	-	-	-	7
Total Banks	-	-	-	-	-
Total lending activity outside of Israel	7	-	-	-	7
Total public	66	-	1	70	130
Total Banks	-	-	-	-	-
Total	66	-	1	70	137

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Included in impaired debts.

Notes to the Financial Statements as at December 31, 2015

Note 29 - 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, 2015			Restructuring of debts during the year ended December 31, 2014		
		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	**68**	**9**	**5**	78	10	7
Real estate	**6**	**3**	**3**	6	7	7
Financial services	**1**	**-**	**-**	5	-	-
Other	**315**	**60**	**58**	396	90	60
Total commercial	**390**	**72**	**66**	485	107	74
Private individuals:						
Housing loans	**-**	**-**	**-**	-	-	-
Other loans	**1,000**	**16**	**15**	1,211	23	22
Total public in Israel	**1,390**	**88**	**81**	1,696	130	96
Banks in Israel	**-**	**-**	**-**	-	-	-
Total lending activity in Israel	**1,390**	**88**	**81**	1,696	130	96
Lending activity outside of Israel						
Public - commercial:						
- Construction and real estate	**-**	**-**	**-**	-	-	-
- other	**-**	**-**	**-**	2	7	7
Total public outside of Israel	**-**	**-**	**-**	2	7	7
Foreign banks	**-**	**-**	**-**	-	-	-
Total lending activity outside of Israel	**-**	**-**	**-**	2	7	7
Total public	**1,390**	**88**	**81**	1,698	137	103
Total Banks	**-**	**-**	**-**	-	-	-
Total	**1,390**	**88**	**81**	1,698	137	103

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Included in impaired debts.

Notes to the Financial Statements as at December 31, 2015

Note 29 - 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, 2013		
		Recorded debt balance	
	Number of contracts	Before restructuring	After restructuring
Lending activity in Israel			
Public - commercial			
Construction and real-estate			
- Construction	79	12	10
- Real estate	4	1	1
Financial services	3	3	3
Other	411	51	45
Total commercial	497	67	59
Private individuals:			
Housing loans	-	-	-
- Other	1,093	25	22
Total public lending activity in Israel	1,590	92	81
Banks	-	-	-
Total lending activity in Israel	1,590	92	81
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	1,590	92	81
Total Banks	-	-	-
Total	1,590	92	81

(1) Credit to the public, to governments, deposits with banks and other debts (excluding bonds).
(2) Included in impaired debts.

Notes to the Financial Statements as at December 31, 2015

Note 29 - 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, 2015		Failed restructured debts[3] during the year ended December 31, 2014	
	Number of contracts	Recorded debt balance	Number of contracts	Recorded debt balance
Lending activity in Israel				
Public - commercial				
Construction and real estate:				
- Construction	**9**	**-**	9	-
- Real estate	**1**	**-**	1	-
Financial services	**1**	**-**	2	-
Other	**72**	**3**	78	4
Total commercial	**83**	**3**	90	4
Private individuals:				
- Housing loans	**-**	**-**	-	-
- Other loans	**261**	**2**	231	2
Total public in Israel	**344**	**5**	321	6
Banks in Israel	**-**	**-**	-	-
Total lending activity in Israel	**344**	**5**	321	6
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	**344**	**5**	321	6
Total Banks	**-**	**-**	-	-
Total	**344**	**5**	**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 - 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, 2013	
	Number of contracts	**Recorded debt balance**
Lending activity in Israel		
Public - commercial		
Construction and real-estate		
- Construction	15	-
- Real estate	1	-
Financial services	1	-
Other	112	7
Total commercial	129	7
Private individuals:		
Housing loans	-	-
- Other	311	4
Total public lending activity in Israel	440	11
Banks	-	-
Total lending activity in Israel	440	11
Leading activity outside of Israel		
Public - commercial:		
- Construction and real-estate	-	-
- other	1	-
Total public outside of Israel	1	-
Total Banks	-	-
Total lending activity outside of Israel	1	-
Total public	441	11
Total Banks	-	-
Total	441	11

(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 - Credit to the Public and Provision for Credit Losses (cont'd)

B. Debts[1] (cont'd)

4. Additional disclosure regarding housing loans:

		December 31, 2015				
		Balance of housing loans				
	Financing ratio[2]	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**

		December 31, 2014				
		Balance of housing loans				
	Financing ratio[2]	With no balloon terms	With balloon terms	Total	Of which: Variable interest	Off-balance sheet credit risk
First degree pledge	Up to 60%	2,151	72	2,223	1,751	331
	Over 60%	801	3	804	652	49
Second degree pledge or without pledge		51	-	51	1	-
Total		3,003	75	3,078	2,404	380

(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.
(3) Reclassified.

Notes to the Financial Statements as at December 31, 2015

Note 29 - 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, 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**

Credit level (NIS thousands)		December 31, 2014		
From	to	Number of borrowers(4)	Credit(1) (2)	Credit risk(2) (3)
			NIS millions	
-	10	74,148	194	186
10	20	31,169	323	173
20	40	27,256	603	225
40	80	22,099	1,011	240
80	150	12,345	1,228	218
150	300	7,461	1,461	244
300	600	5,305	2,039	254
600	1,200	2,831	2,114	260
1,200	2,000	953	1,288	168
2,000	4,000	662	1,656	210
4,000	8,000	289	1,401	172
8,000	20,000	201	2,191	353
20,000	40,000	77	1,688	487
40,000	200,000	52	2,339	1,136
200,000	400,000	2	677	2
		184,850	20,214	4,328

(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 220 million (December 31, 2014 – NIS 366 million).

Note 29 - 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, 2015		December 31, 2014	
	Balance (1)	Provision (2)	Balance (1)	Provision (2)
Transactions in which the balance represents credit risk:				
Letters of credit	**68**	**-**	87	-
Credit guarantees	**299**	**10**	315	4
Guarantees for home purchasers	**984**	**2**	919	1
Other guarantees and obligations	**677**	**5**	648	2
Unutilized credit line facilities for credit cards *	**686**	**1**	575	1
Unutilized revolving credit account facilities and other credit facilities in on-call accounts	**1,229**	**4**	1,133	3
Commitment to issue guarantees	**753**	**-**	745	1
Irrevocable commitments to extend credit approved but not yet granted (3)	**945**	**7**	879	3

***** 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 (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**
Subordinated capital 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.

Notes to the Financial Statements as at December 31, 2015

Note 30 - Assets and Liabilities - According to Linkage Basis (cont'd)

Consolidated (NIS millions)

	December 31, 2014					
	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	4,274	190	357	173	-	4,994
Securities	2,151	1,457	189	20	14	3,831
Net credit to the public	15,906	2,013	691	305	-	18,915
Investment in Associates	-	2	-	-	9	11
Buildings and equipment	-	-	-	-	413	413
Assets in respect of derivative instruments	3	2	17	1	7	30
Other assets	314	6	-	-	6	326
Total assets	22,648	3,670	1,254	499	449	28,520
Liabilities						
Deposits from the public	17,620	3,208	2,511	721	-	24,060
Deposits from banks	441	-	41	10	-	492
Deposits from the government	108	-	31	-	-	139
Subordinated capital notes	-	681	-	-	-	681
Liabilities in respect of derivative instruments	24	46	11	21	7	109
Other liabilities	(1) 1,112	14	18	3	26	1,013
Total liabilities	19,145	3,949	2,612	755	33	26,494
Difference	3,503	(279)	(1,358)	(256)	416	2,026
Non Hedging Derivative Instruments:						
Derivative instruments (excluding options)	(2,016)	402	1,357	257	-	-
Options in the money, net (in terms of underlying asset)	13	-	(13)	-	-	-
Options out of the, money net (in terms of underlying asset)	-	-	-	-	-	-
Total	1,500	123	(14)	1	416	2,026
Options in the money, net (present value of nominal amount)	16	-	(16)	-	-	-
Options out of the money, net (present value of nominal amount)	(1)	-	1	-	-	-

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, and in the matter of capitalization of software development costs, see Notes 1 D (7-9).
(2) Including Israeli currency linked to foreign currency.
(3) Including balances in respect of derivative instruments, the basis thereof is not a financial item.

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Notes to the Financial Statements as at December 31, 2015

Note 31 - Assets and Liabilities - According to Maturity Periods and Linkage Basis

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)**	
Options (in terms of underlying asset)	**(8,319)**	**1,024**	**79**	**2,122**	**2,036**	**1,609**	**1,340**	**2,198**	**1,362**	**228**	**3,679**	**-**	**2,006**	
Israeli currency - linked to the CPI[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**	
Options (in terms of underlying asset)	**(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**
Total as at December 31, 2013														
Assets	8,120	3,581	4,214	3,033	2,307	2,066	1,613	3,422	1,568	278	30,202	[6]559	28,138	3.66
Liabilities	15,457	2,496	5,631	1,213	470	375	210	884	346	102	27,184	-	26,622	0.75
Difference	(7,337)	1,085	(1,417)	1,820	1,837	1,691	1,403	2,538	1,222	176	3,018	559	1,516	2.91

Note 31 - Assets and Liabilities - According to Maturity Periods and Linkage Basis (cont'd)

Notes:

* Reclassified

(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 (2014- NIS 83 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 the 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 mortgage 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 an economic 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 22 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 47 million.

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)

(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.

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

C. Composition on a consolidated basis

	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**
Subordinated capital 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, 2015

Note 32 - Balances and Fair Value Estimates of Financial Instruments (cont'd)

C. Composition on a consolidated basis (cont'd)

		December 31, 2014			
		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	4,994	4,409	-	607	5,016
Securities[(4)]	3,831	3,535	316	14	3,865
Credit to the public	18,915	23	3	19,264	19,290
Assets in respect of derivative instruments	30	8	20	2	30
Loan to affiliated company	2	-	-	2	2
Other financial assets	98	-	5	93	98
Total financial assets	[(5)] 27,870	7,975	344	19,982	28,301
Financial liabilities					
Deposits from the public	24,060	-	16,880	7,441	24,321
Deposits from banks	492	-	490	-	490
Deposits from the Government	139	-	109	39	148
Subordinated capital notes	681	-	6	787	793
Liabilities in respect of derivative instruments	109	8	48	53	109
Other financial liabilities	621	-	-	621	621
Total financial liabilities	[(5)]26,102	8	17,533	8,941	26,482
Off balance financial instruments:					
Transaction balances representing credit risk	14	-	-	14	14

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 8,173 million and liabilities in the amount of NIS 6,892 million, the stated balance of which is equal or proximate to their fair value.

Notes to the Financial Statements as at December 31, 2015

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, 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	-	-	-	-	-
- in foreign currency	-	-	-	-	-
- 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
- in foreign currency	-	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, 2015

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, 2014				
	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	317	-	-	-	317
Available-for-sale securities:					
- Bonds – Government	2,471	133	-	-	2,604
- Israel financial institutions	454	-	-	-	454
- other	281	157	-	-	438
Trading securities:					
- Bonds – Government	1	-	-	-	1
- other	-	7	-	-	7
Total securities	3,207	297	-	-	3,504
Credit to the public:					
Securities lending	23	-	-	-	23
Embedded derivatives	-	3	-	-	3
Total credit to the public	23	3	-	-	26
Other financial assets	-	5	-	-	5
Assets regarding derivative Instruments:					
- Shekel/ CPI	-	-	-	-	-
- in foreign currency	-	1	-	-	1
- Foreign currency contracts	-	19	2	-	21
- Share contracts	8	-	-	-	8
Total assets regarding derivative instruments	8	20	2	-	30
Total assets	3,555	325	2	-	3,882
Liabilities					
Liabilities regarding derivative instruments:					
- Interest contracts					
- Shekel/ CPI	-	-	7	-	7
- in foreign currency	-	22	-	-	22
- Foreign currency contracts	-	26	46	-	72
- Share contracts	8	-	-	-	8
Total liabilities regarding derivative instruments	8	48	53	-	109

Notes to the Financial Statements as at December 31, 2015

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, 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)(3)
			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)**

	December 31, 2014				
	Fair value at beginning of year	Profits (losses) realized and unrealized	Settlements	Fair value at end of year	Balance of unrealized profits (losses)(1)(3)
			NIS millions		
Liabilities, net, in respect of derivative instruments:					
- Interest contracts	-	(10)	3	(7)	(7)
- Foreign currency contracts	(92)	7	41	(44)	3
Total	(92)	(3)	44	(51)	(4)

(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, 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)**

	December 31, 2014				
	Fair value based on:				
	"Level 1"	"Level 2"	"Level 3"	Total	Profit(loss)
Impaired credit where collection depends on collateral	-	-	34	34	(7)
Securities	-	-	14	14	(1)2
Total	-	-	48	48	(5)

1. Recognized in the item "other comprehensive earnings" in shareholders' equity.

Notes to the Financial Statements as at December 31, 2015

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, 2015

	Fair value NIS millions	Valuation technique	Unobservable data	Quantitative information Range (%)	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	**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**

December 31, 2014

	Fair value NIS millions	Valuation technique	Unobservable data	Quantitative information Range (%)	Average (%)
Impaired credit where collection depends on collateral	34	Quoted fair value	Estimated value of collateral		
Securities	14	valuation	Company value		
Liabilities in respect of derivative instruments:					
Shekel/CPI interest contracts	(7)	Discounted cash flows	Inflationary expectations	(1.6)-0.2	(0.9)
Foreign currency contracts	(44)	Discounted cash flows	Inflationary expectations(2)	(1.2)-(1.2)	(1.2)
		Rating model	Counterparty credit risk	0.1-0.3	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, 2015							
	Shareholders				Other interested parties			
	Parent company		Others		Directors and executives		Others	
	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								
Indemnification letter received	24	24	-	-	-	-	-	-

Note 33 - Interested and Related Parties (cont'd)

Consolidated

A. Balances (in NIS millions) (cont'd)

* 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)

A. Balances (cont'd) (in NIS millions)

	December 31, 2014							
	Shareholders				Other interested parties			
	Parent company		Others		Directors and executives		Others	
	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	376	1,446	-	-	-	-	-	*12
Credit to the public	-	-	-	-	1	2	46	46
Allowance to the credit losses	-	-	-	-	-	-	(1)	(1)
Net credit to the public	-	-	-	-	1		45	45
Other assets	-	2	-	-	-	-	12	*12
Investment in affiliated companies	-	-	-	-	-	-	11	11
Liabilities								
Deposits from the public	-	-	-	-	10	11	7	12
Deposits from Banks	-	302	-	-	-	-	1	1
Other liabilities	22	22	-	-	14	22	465	465
Subordinated debt notes	85	86	-	-	-	-	-	-
Shares (included in shareholders' equity)	*1,916	*1,916	-	-	-	-	-	-
2. Contingent liabilities include balances with related parties in respect of:								
Guarantees given	-	15	-	-	-	-	4	5
Unutilized credit facilities	-	-	-	-	1	1	-	-
Off-balance sheet credit risk regarding transactions in derivatives	-	-	-	-	-	-	-	*-
3. Letters of guarantee received								
In respect of credit to customers	21	22	-	-	-	-	-	2
Indemnification letter received	-	8	-	-	-	-	-	-

* Reclassified

Note 33 - Interested and Related Parties (cont'd)

Consolidated (NIS millions)

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)	-	1
2. Commission income	4	-	-	29
3. Operating and other expenses* (See also "C" below)	**(26)	-	(16)	(19)
Profit (loss) before taxes	(27)	(4)	(16)	5
4. Bank's share in profits after taxes of equity-basis investees	-	-	-	2
* Including - computer expenses	(22)	-	-	(19)

** Reclassified

Note 33 - Interested and Related Parties (cont'd)

Consolidated (in NIS millions)

B. Summary results of transactions with interested and related parties (cont'd):

	Year ended December 31, 2013			
	Shareholders		Other interested parties	
	Parent company	Others	Directors and executives	Others
1. Interest income, net				
Deriving from assets				
Deposits with banks	11	-	-	-
Credit to the public	-	-	-	1
Total interest income	11	-	-	1
Deriving from liabilities				
Deposits from the public	-	(11)	-	-
Deposits from banks	(1)	-	-	-
Subordinated debt notes	(5)	-	-	-
Total interest expense	(6)	(11)	-	-
Total net interest income (expense)	5	(11)	-	1
Non-interest financing expenses	(12)	-	-	(8)
Total financing expenses, net	(7)	(11)	-	(7)
2. Commission income	3	-	-	15
3. Operating and other expenses* (See "C" below)	(23)	-	(23)	(18)
Loss before taxes	(27)	(11)	(23)	(10)
4. Bank's share in profits after taxes of equity-basis investee	-	-	-	4
* Including - computer expenses	(21)	-	-	(18)

Note 33 - Interested and Related Parties (cont'd)

Consolidated (in NIS millions)

B. Operating and other expenses included benefits to interested parties, as follows:

	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

	Year ended December 31, 2013			
	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	20
Remuneration of Directors not employed by the Bank Group	3	-	9	3

* Of which, short-term employee benefits of NIS 14 million, postretirement benefits of NIS 2 million and long-term employee benefits of a negligible amount, (2014 – NIS 12 million, NIS 1 million and negligible amount respectively: 2013 – NIS 16 million, NIS 2 million and NIS 2 million, respectively)

Note 33 - Interested and Related Parties (cont'd)

Consolidated (in NIS millions)

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 (8) regarding the engagement with the parent company relating to computer services.
- See Note 24B (9) regarding the commitment of the Bank to grant exemption in advance and to indemnify Directors and Officers of the Bank.
- With respect to the commitment of the Bank to grant exemption in advance and indemnity to Directors and Officers of the Bank – see Note 24B (9).
- 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 favor 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 - Condensed Financial Statements in Historical Values - For Tax Purposes (Bank only)

A. Statements of profit and loss

	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Interest income			
Interest income	**974**	1,011	1,128
Interest expenses	**102**	211	406
Interest income, net	**872**	800	722
Allowance for credit losses	**67**	15	75
Net interest income after allowance for credit debts	**805**	785	647
Non-interest income			
Non- interest financing income (expenses)	**38**	42	81
Commissions	**308**	312	373
Other income	**37**	1	1
Total non-interest income	**383**	355	455
Operating and other expenses			
Payroll and related expenses	**518**	*585	*527
Maintenance and depreciation of buildings and equipment	**152**	*150	*152
Other expenses	**171**	*166	*161
Total operating and other expenses	**841**	901	840
Profit before taxes	**347**	239	262
Provision for taxes	**135**	*94	*84
Profit after taxes	**212**	145	178
Bank's equity in the results of investee companies, net	**3**	2	5
Net profit for the year	**215**	147	183

* Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, and in the matter of capitalization of software development costs, see Notes 1 D (7-9).

Note 34 - Condensed Financial Statements in Historical Values - For Tax Purposes (Bank only) (cont'd)

B. Balance sheets

	December 31 2015	December 31 2014
	NIS millions	NIS millions
Assets		
Cash and deposits with banks	**5,502**	4,994
Securities	**3,432**	3,829
Credit to the public	**20,754**	19,234
Allowance for the credit losses	**(337)**	(319)
Credit to the public, net	**20,417**	18,915
Investment in investee companies	**17**	21
Buildings and equipment	**315**	*362
Assets in respect of derivative instruments	**31**	30
Other assets	**342**	*394
Total assets	**30,056**	28,545
Liabilities and shareholders' equity		
Deposits from the public	**25,397**	24,069
Deposits from banks	**459**	492
Deposits from the Government	**151**	139
Subordinated capital notes	**672**	681
Liabilities in respect of derivative instruments	**122**	109
Other liabilities	**1,181**	*1,173
Total liabilities	**27,982**	26,663
Shareholders' equity	**2,074**	*1,882
Total liabilities and shareholders' equity	**30,056**	28,545

* Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, and in the matter of capitalization of software development costs, see Notes 1 D (7-9).

Note 34 - Condensed Financial Statements in Historical Values - For Tax Purposes
(Bank only) (cont'd)

C. Statement of changes in shareholders' equity

	Share capital	Share premium	General reserve[1]	Other cumulative comprehensive earnings [2]	Retained earnings	Total shareholders' equity
	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions	NIS millions
Balance as at January1, 2013	*	70	95	(3) 42	(3) 1,574	1,781
Adjustments, net, in respect of presentation of Available-for-sale securities at fair value	-	-	-	(3) (33)	-	(33)
Related tax effect	-	-	-	(3)12	-	12
Dividend paid	-	-	-	-	(120)	(120)
Net profit for the year	-	-	-	-	(3)183	183
Balance as at December 31, 2013	*	70	95	21	1,637	1,823
Adjustments in respect of presentation of available-for-sale securities at fair value	-	-	-	(3) (68)	-	(68)
Related tax effect	-	-	-	(3)25	-	25
Dividend paid	-	-	-	-	(45)	(45)
Net profit for the year	-	-	-	-	(3)147	147
Balance as at December 31, 2014	*	70	95	(22)	1,739	1,882
Adjustments in respect of presentation of available-for-sale securities at fair value	-	**-**	-	**(36)**	**-**	**(36)**
Related tax effect	**-**	-	-	**13**	**-**	**13**
Net profit for the year	-	**-**	-	**-**	**215**	**215**
Balance as at December 31, 2015	*****	**70**	**95**	**(45)**	**1,954**	**2,074**

* Less than NIS 1 million.

1. The general reserve consists of current earnings and is intended for distribution of dividend under certain circumstances and for covering of unexpected losses.
2. This item constitutes adjustments in respect of the presentation of available-for-sale securities at fair value.
3. Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, and in the matter of capitalization of software development costs, see Notes 1 D (7-9).

Note 35 – Financial Statements

A. Statements of profit and loss

	2015	2014	2013
	NIS millions	NIS millions	NIS millions
Interest income	**974**	1,011	1,128
Interest expenses	**102**	211	406
Interest income, net	**872**	800	722
Allowance for credit losses	**67**	15	75
Net interest income after allowance for	**805**	785	647
Non-interest income			
Non- interest financing income (expenses)	**37**	42	81
Commissions	**308**	312	373
Other income	**33**	1	(1)
Total non-interest income	**378**	355	453
Operating and other expenses			
Payroll and related expenses	**518**	(1) 585	(1) 527
Maintenance and depreciation of buildings and equipment	**152**	(1) 150	(1) 154
Other expenses	**171**	(1) 166	(1) 161
Total operating and other expenses	**841**	901	842
Profit before taxes	**342**	239	258
Provision for taxes	**135**	(1) 94	(1) 84
Profit after taxes	**207**	145	174
Bank's equity in the results of investee companies, net	**3**	2	5
Net profit for the year	**210**	147	179
Earnings per share (in NIS thousands)			
Stock per share of NIS 0.1	**1.69**	(1) 1.18	(1) 1.44
Stock per share of NIS 0.01	**0.17**	(1) 0.12	0.15

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs".

Note 35 - Financial Statements (cont'd)

B. Balance sheets

	December 31 2015	December 31 2014
	NIS millions	NIS millions
Assets		
Cash and deposits with banks	**5,502**	4,994
Securities	**3,432**	3,830
Credit to the public	**20,754**	19,234
Allowance for the credit losses	**(337)**	(319)
Credit to the public, net	**20,417**	18,915
Buildings and equipment	**17**	21
Buildings and equipment	**346**	(1) 397
Assets in respect of derivative instruments	**31**	30
Other assets	**340**	(1) 392
Total assets	**30,085**	28,579
Liabilities and shareholders' equity		
Deposits from the public	**23,397**	24,069
Deposits from banks	**459**	492
Deposits from the Government	**151**	139
Subordinated capital notes	**672**	681
Liabilities in respect of derivative instruments	**122**	109
Other liabilities	**1,181**	(1) 1,173
Total liabilities	**27,982**	26,663
Shareholders' equity	**2,103**	(1) 1,916
Total liabilities and shareholders' equity	**30,085**	28,579

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs" – see Note 1D (7-9).

Mercantile Discount Bank - Corporate Governance Report 2015

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

Ms. Lilach Asher-Topilsky

Chairperson of the Board; acts as member of the Board of the Bank and as Chairperson of the Board since March 3, 2014.

In addition, serves as President and CEO of Israel Discount Bank Ltd. (as from February 2014); as Chairperson of the Board of Discount Bancorp Inc. and as director of Israel Discount Bank of New York (as from March 2014).

In the period from 2009 to 2013, served as Deputy President and member of Management in charge of the Retail Division of Bank Hapoalim Ltd.; in the period from 2007 to 2009 served as Deputy president in charge od the Strategy Division of bank Hapoalim Ltd.; in the period from 2011 to 2013 as chairperson of the board of Hapoalim Mortgages Insurance Agency (2005) Ltd., and as chairperson of the board of Poalim Ofakim Ltd.; in the period from 2003 to 2013 served as director of IsraCard Ltd. And director of Europay (Eurocard) Israel Ltd.; in the period from 2010 t0 2011 served as chairperson of the board of Teuda Financial Company Ltd.

She has a Bachelor Degree in Economics and Management from the Tel Aviv University and a Master Degree in Business Administration from Kellogg School of Management, Northewstern University, Chicago, USA.

Has "banking experience" as defined in Bank of Israel instruction.

Mr. Yair Avidan

Acts as member of the Board of Directors since January 12, 2016.

Serves as VP, Chief Risk Manager and Head of the risk management group of Israel Discount Bank Ltd. since June 9, 2010; 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. In the years 2006-2010 served as manager of the foreign extensions group and of management information at Israel Discount Bank Ltd.; in the years 2008-2010 served as deputy head of the Corporate Division of Israel Discount Bank Ltd. and in the years 1998-2010 acted as director of Discount Mortgage Bank Ltd.

Mr. Shlomo Avidan

Acts as member of the Board of the Bank since June 10, 2010.

In the period from 2010 to 2014, served as member of Management, VP Operations and Logistics and in charge of business continuity at Israel Discount Bank Ltd.; served as chairman of the board of Discount Gemel Ltd. And of Nidbach Real Estste and Investments Ltd.,; In the period from 2009 to2010 served as chairman of the board of Automatic Bank Services Ltd. and of the Central Bank Settlement Ltd.

He holds a Bachelor Degree in Economics and Business Administration from the Bar-Ilan University and a Master Degree in Business Administration from the Tel Aviv University.

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 administartion committee and chairman of the *ad-hoc* committee for board of directors' procedures.

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. Serves as Chairperson of the audit 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. and in 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. 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 (as 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. and of Reblaze Technologies 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, risk management committee and of the compensation and administration committee.

Since 2014, heads the Law Office of Zalinger, Konfino, Ben-Tzvi, Leuchtenstein & Co., a private law office specializing in commercial and corporate law. 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. Holds a Bachelor Degree in Law from the Tel Aviv University and a Master Degree in Law from the New York University.

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(*) 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.
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.

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 Engineering from the Haifa Technion.

Mr. Nahum Langental (*)

Acts as member of the Board of the Bank since June 25, 2007. Serves as Chairman of the compensation and administration committee and of the risk management committee.

In addition, serves as from 2003 as President of Umantra Investments Ltd. and Samsera Investments Ltd., co-chairman of the board of Elhar Engineering and Construction Ltd., member of the borad oif Algomeiser Ltd. (formerly – Maariv). Holds a Bachelor Degree in Law and a Master Degree in History from the Bar-Ilan University.

(*) External Director

Mr. Shmuel Massenberg (*)

Acts as member of the Board of the Bank since January 16, 2007. Chairman of the credit committee and member of the risk management committee.

In addition, acts as a business consultant, President of Masrag-Business Development Ltd.; member of the board of Naphta the Israeli Oil Company Ltd., I.I. S. Investments Ltd., Direct Finance of the Direct Insurance Group Ltd., and managing partner of Sigma City Fund, Limited Partnership.

In the years 1993-2006 acted as Vice President and member of Management of Mizrahi Tephachot Bank Ltd. (manager of the corporate division). Holds a Bachelor Degree in Economics and a Master Degree in Business Administration from the Tel Aviv University.

Has "banking experience", as defined in Bank of Israel instructions.

(2) Changes in membership of the Board of Directors

- Mr. Shnuel Ziv-Sussman* terminated his office as Director on October 23, 2015.
- Me Shauki Khatib was appointed Director of the bank on May 26, 2015.
- Mr. Yair Avidan was appointed Director of the Bank on January 12, 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:

(*) External Director

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 a 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.

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 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 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 2015, the Board of Directors held fifteen meetings. In addition, committees of the Board of Directors held sixty 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, and as acting Head of the Retail Division since January 1, 2016.

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 Lttd., and in the years 2008-2009 served as human resources manager of the business divisions of this group.

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 Corporate-Business 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 members of Management of the Bank.

- On August 16, 2015, Mr. Uri Baruch terminated his office as General Manager of the Bank. The Board of Directors thanks Mr. Baruch for his considerable contribution to the bank during his term of office.
- On August 17, 2015, Mr. Joshua Burstein entered office as General Manager of the Bank.
- The Board of Directors, in its meeting of March 31, 2015, decided to appoint Mr. Shmuel Berman to the office of Manager of the Strategy Group, with the status of VP and member of Management. The appointment took effect on June 1, 2015.

- On October 20, 2015, Mr. Allon Biron, VP and Manager of the Retail Division, informed of his decision to terminate his office with the Bank. His retirement took effect on December 31, 2015.
  Mr. Joshua Burstein, in addition to his duties as General Manager of the Bank, serves also, as from January 1, 2016, as acting Manager of the Retail Division.

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 2015 included the examination of a material transaction (as defined by Bank of Israel directives) as regards "the feasibility of moving certain units from the Head Office of the Bank to another area".

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 reported year, the average number of employees engaged in internal audit (including the internal auditor herself) totaled 17.6 positions (2041 – 18 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 2015 1.9 positions (2014 – 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 0.6 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 2014, was discussed by the Audit Committee on February 17, 2015 and by the Board of Directors on February 24, 2015.

- Report summarizing the activities of the internal audit group for the first half of 2015, was discussed by the Audit Committee on August 4, 2015 and by the Board of Directors on August 16, 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:

	2015	2014
	NIS thousands	
Salary	**798**	834
Awards	**234**	-
Related benefits	**254**	441
Total payroll expense	**1,286**	1,275

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	
	2015	2014	2015	2014
	NIS thousands			
Audit of the financial statements	**1,633**	2,042	**1,578**	1,975
Audit-related services (1)	**95**	45	**95**	45
Tax services	**101**	101	**101**	101
Total professional fees	**1,828**	2,188	**1,773**	2,121

(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) (in reported amounts):

2015

		Remuneration for service (1)					Loans granted on benefit terms (3)		
Name of Officer (4)	**Position**	**Salary (1)**	**Awards (1)**	**Social Benefits (2)**	**Other benefits**	**Total**	**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**	**-**	**-**	**1**
Shmuel Berman	Head of 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-Business Division	**764**	**276**	**166**	**64**	**1,270**	**-**	**-**	**-**
Alon Biron***	Head of retail Division								

2014

		Remuneration for service (1)					Loans granted on benefit terms (3)		
Name of Officer (4)	**Position**	**Salary (1)**	**Awards (1)**	**Social Benefits (2)**	**Other benefits**	**Total**	**Outstanding loans**	**Repayment period**	**Annual benefit**
Uri Baruch**	General Manager	1,320	-	478	107	1,905	-	-	-
Avi Rishpan	Chief Accounting Officer	1,043	-	283	77	1,403	148	2.37	6
Zion Becker	Head of Finance Division	822	-	397	61	1,280	40	2.68	1
Tziona Cohen	Internal Auditor	834	-	365	76	1,275	-	-	-
Amir Klibanov	Head of Corporate-Business Division	726	-	334	64	1,124	-	-	-
Alon Biron***	Head of retail Division	822	-	239	62	1,123	53	2.68	2

* As from August 17, 2015.

** Terminated his office on August 16, 2015

*** Retired from the Bank on December 31, 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(9) 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. Uri Baruch** – The former General Manager of the Bank has been employed according to a personal contract terminated on November 11, 2015. At the end of his engagement, and as stated in the employment agreement, Mr. Baruch received severance compensation amounting to 200% of his last monthly salary, as well as a special award of six monthly salaries. In terms of the retirement agreement signed by the parties, Mr. Baruch may not undertake any occupation which is in competition with the Bank for a period of six months.

   Mr. Baruch's salary was linked to the CPI, and in addition, he was entitled to vacation pay, sick pay, recreation pay, a motor vehicle at the expense of the Bank, social benefits (including severance pay, provident fund an further education fund contributions and loss of work ability insurance) as well as additional benefits.

3. **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.

4. **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.

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.

7. **Mr. Shmuel Berman –**Vice General Manager and Head of Strategy Group, 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.

   Upon termination of his employment, Mr. Berman will be entitled to the amount of the severance compensation accumulated to his credit since the date of his personal employment agreement (hereinafter – "the agreement date"), as well as to severance compensation under the Labor Charter of the Bank, in respect of the period from the initial date of his employment with the Bank and until the agreement date. In addition, Mr. Berman will be entitled to a special award of between four and six monthly salaries. Subsequent to termination of office, Mr. Berman is not entitled to undertake any occupation which is in competition with the Bank for a period of three months.

   The salary of Mr. Berman 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 compensation, provident fund, loss of work ability insurance and further education fund) as well as additional benefits.

14. Transactions with controlling shareholders and related parties

A. 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.

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 applying at 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, including 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 2015 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 Section 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, 2015, are as follows:

	Land and buildings[2]	Equipment furniture and vehicles	Software costs	Total
	NIS millions	NIS millions	NIS millions	NIS millions
Cost	380	366	429	1,175
Accumulated Depreciation	185	289	355	829
Depreciated cost at December 31, 2016	195	77	74	346

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 24 to the financial statements.

B. Land and buildings

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.
In view of the above, the Bank recognized in 2015, a provision in respect of impairment of properties intended for sale in the amount of NIS 1 million (2014 – identical).

Following are details of land and building in use by the Bank at December 31, 2015, (in square meters):

	Freehold or leasehold	Protected rental	Free rental	Total
	Square meters	Square meters	Square meters	Square meters
Branches[1]	6,699	396	19,225	26,320
Office premises[1]	6,776	-	6,338	13,114
Auxiliary space (storage etc.)	-	-	1,169	1,169
Area not in use by the Bank[2]	1,931	-	1,507	3,438
Total	15,406	396	28,239	44,041

1. For additional details regarding engagement by the Bank for the sale of buildings – see Note 24B (10) 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.

8. Human capital

A. Developments in the organizational structure

(1) Changes in management of the Retail Division

On December 31, 2015, Mr Alon Biron, Vice General Manager and Head of the Retail Division terminated his employment and retired from the Bank. In view of this, Mr. Joshua Burstein, the General Manager of the Bank assumed temporarily the office of Head of the Retail Department, until the appointment of a permanent head of this Division.

(2) Enlarging the operations of the back office operating unit

As part of the plan for business focusing and efficiency, the Bank continued in 2015 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 2015, 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).

B. Workforce

(1) General

The number of employees engaged by the Bank and its consolidated subsidiaries in full-time positions, decreased by eight employees totaling at the end of 2015, 1,603 employees in comparison with 1,611 employees at the end of 2014. On an average, the number of employees decreased by 19 positions totaling in 2015, 1600 positions, as compared with 1,619 positions in 2014.

	2015	2014
Number of positions at end of year	1,603	1,611
Average number of positions	1,600	1,619

This data shows that in 2015, the workforce of the Bank, employed on the basis of the average number of positions, decreased by 1.2%. This reduction in the number of positions stems, inter alia, from the voluntary retirement program introduced in 2014.

(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*:

	Average positions
	2015
Households	636
Small businesses	628
Middle market banking	77
Corporate banking	89
Private banking	130
Financial management	40
Total	1600

* 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").

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.

For additional details regarding the revised labor agreement stemming from the Labor Charter, see (2) hereunder.

(2) Revision of the wage agreement

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. It is noted, in this respect that on January 29, 2015, Bank Leumi signed a new wage agreement with its employees (hereinafter – "the Leumi agreement") in effect for a period of four years, starting on 2015. The agreement includes several changes as regards the previous agreement, including:

- The rate of "advancement" of the average wage shall be reduced gradually from 5% to 4% in the years 2015-2016, and to 3.5% in the years 2017-2018.
- The maximum "seniority increment" was raised from 37 years to 38 years.

- The rate of employer contribution for provident payments to employees included in the "cumulative pension" arrangement is raised to 7.5% (instead of 5% or 6%, as the case may be).
- Jubilee awards were reduced at all seniority levels, as follows:
  - the monetary component of the award was reduced from 5-7.5 monthly salaries to 3-4 monthly salaries.
  - the vacation component was reduced from 1-1.5 monthly salaries to 0.5-0.75 monthly salaries.

  The reduced award rates apply to all awards payable as from February 1, 2016 and thereafter.
- Employees will have the right to convert sick leave days accumulated to their credit until January 29, 2015 (and not utilized) into vacation days, at a conversion rate of up to two vacation days for each thirty sick leave days, under the following limitations:
  - The conversion rate will be based on the rate of sick leave days utilized in the past.
  - Conversion of sick leave days into vacation days, as stated, would be possible only in the last year of employment of the employee, on condition that his retirement date shall be in accordance with the date determined by law.
- Permanent employees will be entitled to a one-time award equal to a one monthly salary.

Following the signing of the Bank Leumi agreement, as states, and whereas the existing the terms of wage agreements of the Bank are linked to those of Bank Leumi, a new special collective agreement was signed on April 28, 2015, by the Bank, the Federation of Labor and the employee representative committee revising the previous wage agreement, in effect for a period of four years starting on January 1, 2015.

The revised wage agreement adopts the agreements relevant to the Bank contained in the Bank Leumi wage agreement, and the modification of other components to the Labor Charter in effect at the Bank.

The financial statements as of December 31, 2015, include appropriate provisions stemming from the revised agreement, as above.

The recording of these provisions, resulted in 2015 in a one-time reduction in payroll expenses (due to the expected reduction in the liabilities for payment of jubilee awards, on the one hand, and to the recording of provisions in respect of unutilized sick leave days, and the payment of a one-time award, on the other hand), in the net amount of NIS 30 million.

On the other hand, the implementation of all components contained in the new wage agreement, increased the current payroll expenses of the Bank in 2015, by an amount of NIS 9 million.

(3) Revision of the Bank's liabilities for payment of certain post-retirement benefits

In accordance with the Labor Charter, Bank employees are entitled to certain benefits upon retirement, including subscription to a daily newspaper at the expense of the Bank.

On October 11, 2015, the Bank, the Federation of Labor and the employee representative committee signed an agreement whereby Bank employees forego their right to a daily newspaper upon retirement in consideration for receiving a one-time amount of NIS 7 million. The reduction in the liability of the Bank in respect of the said post-retirement benefit amounted at December 31, 2015 to NIS 16 million.

The reduction in the said liability of the Bank net of the said one-time payment was recognized in part (NIS 4 million) in the "payroll and related expenses" item and in part (NIS 5 million) in the "other comprehensive profit" item.

D. Branches of the Bank

At the end of 2015, the Bank operates 79 branches (2014 – 80 branches). As part of the policy for an ongoing examination of the branch disposition, the Bank opened in 2015 one branch specializing in providing banking services to the retail sector, while during the reported year the Bank merged the operations of two nearby branches.

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 NIS63 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, 2015.

The extension of the agreement was approved by the Audit Committee of the Board on January 10, 2016.

(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.

B. 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 2015, which, in Management's opinion, the implications thereof on the operations of the Bank or on its business results, are not considered immaterial:

A. Legislation regarding Bank commissions

(1) Declaring the service of "delivery of notices to customers" as a "controlled service"

Bank of Israel amended on July 28, 2015, the Banking Order (Customer service) (Control over notices and warning letter services), 2015, whereby this service was defines "Controlled service", limiting the maximum charge in respect thereof to only NIS 5.

The amendment took effect on July 1, 2015 and was applied by the Bank on that date. Based on experience gathered in 2015, Management of the Bank estimates that this amendment of the Order is expected to reduce the income of the Bank from current account ledger fees by an amount of between NIS 10-15 million per year.

(2) Amendment of the Banking Rules (Customer service) (Commissions)

Amendments to the Banking Rules (Customer service) (Commissions) were published on July 28, 2015, whereby amounts of certain fees had been reduced as follows:

- Banks are not permitted to charge a fee in respect of returned checks to the customer who had deposited these checks.
- Banks are not permitted to charge "card fees" in respect of "immediate debit" cards issued to customers who hold already charge cards issued by those banks.

The amendments to the commission rules, as above, took effect gradually in the months of February- July 2015, and have been implemented by the Bank of their due dates. Data collected to date do not provide a complete picture regarding the full impact of these changes. However, preliminary assessments made by Management of the Bank indicate that the new rules may reduce the Bank's income from commissions by amounts of between NIS 3-5 million, per year.

B. Legislation regarding "bank customer relations".

(1) The Pledge Bill, 2015

The Bill was approved in first reading by the Knesset on May 27, 2015, and it contains material changes in relation to existing pledge laws, including:

- It is proposed to allow debtors to register additional pledges on a pledged asset, without obtaining the consent of the initial pledge holder
- It is proposed to abolish the creation of "floating pledges".

At this stage it is unclear whether the provisions of the Bill will be approved as read at the end of the legislation process. Accordingly, it is not possible to assess at this stage the implications that the new guidelines contained in the Bill might have on the operations of the bank in the future.

(2) Insolvency and economic recovery Bill, 2015

The Ministers' Committee on legislation Matters approved on January 17, 2016 the Bill Memorandum in the matter of "insolvency and economic recovery", comprising a "comprehensive reform in insolvency proceedings" of individuals and of corporations. The Bill Memorandum includes material changes in the rules prevailing at present in this matter, including:

- It is proposed to abolish most preferential debts.

- A creditor secured by a floating pledge, shall be entitled to receive consideration that shall not exceed 75% of the value of the pledged assets. The balance of the pledged assets will serve as a source for payments due to the unsecured creditors.
- The changes included in the Bill Memorandum, shall apply only to credit granted subsequently to date of approval of the Act.

The legislation proceedings regarding the proposals included in the Bill Memorandum have not yet been completed, and no date has been proposed for their entry into effect.
Not withstanding the above, Management is of the opinion that approval of the proposed Bill in its present format may cause both an increase the Bank's expenses in respect of credit losses and changes in the process of credit underwriting.

C. Legislation measures regarding competition in the banking sector

The Minister of Finance and the Governor of Bank of Israel appointed on June 3, 2015, a committee for increasing competition in banking and prevalent financial services (the "Strom Committee") (hereinafter – "the committee").

On December 14, 2015, the committee published its recommendations. Inter alia, the committee recommended to severe the ownership and control relations between most of the credit card companies and the banking corporations owning them. In addition, it is recommended that banking corporation will not be allowed to issue credit cards for a period of four years.

To date, no discussions have been held with respect to the recommendations of the committee and no legislation proceedings have begun in the matter. Accordingly, at this stage, it is not possible to estimate the implications that the recommendations of the committee might have on the operations of the Bank in this field.

For detailed information as to developments in matters of legislation and regulation relating to the banking sector in the year 2015, see Chapter 6B to the Report of the Board of Directors and Management.

11. Credit rating

The Bank is being rated by S&P-Ma'alot (hereinafter – "the rating agency"). On December 23, 2015, the rating company decided to ratify the rating awarded to the liabilities of the Bank last year of "AA" (with a stable rating horizon). The deferred debt notes of the bank were rated by the rating agency at "AA-" (identical to the rating awarded to these debt notes last year), 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

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, shall include 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 will be included in the periodic financial statements of all banking corporations, and will take effect gradually, as follows:

- The disclosure relating to balance sheet data of the "regulatory operating segments" (as defined in the amendment) is effective as from December 31, 2015, and is presented in the financial statements for the year 2015.
- Other disclosure requirements included in the amendment, will take effect as from January 1, 2016.

For additional information regarding the distribution of credit and deposits at the Bank as of December 31, 2015, 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 Chapter 9 of the Report of the Board of Directors and Management and Note 28 to the financial statements.

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

	2015			2014			2013		
	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]	**19,593**	**[6]931**	**4.75**	18,022	[6]910	5.05	16,955	[6]938	5.54
Deposits with banks	**567**	**4**	**0.63**	907	9	0.91	1,587	19	1.18
Deposits with central banks	**3,194**	**4**	**0.13**	2,323	13	0.58	1,034	15	1.52
Bonds held for redemption and available for sale[4]	**3,001**	**35**	**1.17**	4,620	77	1.66	6,052	153	2.53
Trading bonds	**23**	**-**	**1.52**	30	2	5.94	57	2	3.01
Other assets	**-**	**-**	**-**	-	-	-	5	1	17.3
Tota interest bearing assetsl	**26,378**	**974**	**3.69**	25,902	1,011	3.90	25,690	1,128	4.39
Debtors in respect of credit card operations	**372**	**-**	**-**	341	-	-	327	-	-
Other non-interest bearing assets[5]	**1,236**	**-**	**-**	*1,157	-	-	*1,090	-	-
Total assets	**27,986**	**974**	**3.69**	27,400	1,011	3.90	27,107	1,128	4.39
Liabilities bearing assets*:									
Deposits from the public -On call*	**2,094**	**(1)**	**(0.02)**	1,871	(2)	(0.13)	1,665	(5)	(0.31)
Deposits from the public – Time deposits	**16,864**	**(77)**	**(0.46)**	18,166	(173)	(0.95)	18,837	(340)	(1.81)
Deposits from the Government	**154**	**(2)**	**(1.34)**	160	(3)	(1.79)	167	(4)	(2.24)
Deposits from banks	**467**	**(2)**	**(0.35)**	380	(4)	(0.95)	314	(5)	(1.49)
Subordinated debts notes	**674**	**(19)**	**(2.90)**	755	(29)	(3.79)	897	(52)	(5.84)
Other liabilities	**-**	**(1)**	**-**	-	-	-	-	-	-
Total interest bearing liabilities	**20,253**	**(102)**	**(0.50)**	21,332	(211)	(0.99)	21,880	(406)	(1.86)
Non-interest bearing deposits from the public	**4,545**	**-**	**-**	3,047	-	-	2,337	-	-
Non-interest bearing creditors in respect of credit card operation	**371**	**-**	**-**	341	-	-	327	-	-
Other non-interest bearing liabilities[7]	**841**	**-**	**-**	*877	-	-	*827	-	-
Total liabilities	**26,010**	**(102)**	**(0.50)**	25,597	(211)	(0.99)	25,371	(406)	(1.86)
Total capital resources	**1,976**	**-**	**-**	1,803	-	-	1,736	-	-
Total liabilities and capital resources	**27,986**	**(102)**	**(0.50)**	27,400	(211)	(0.99)	27,107	(406)	(1.86)
Interest margin	**-**	**-**	**3.19**	-	-	2.91	-	-	2.53
Net return[8] on interest bearing assets	**26,378**	**872**	**3.31**	3.09	800	3.09	25,690	722	2.81

* Restated

** 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

	2015			2014			2013		
	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	**21,500**	**879**	**4.09**	19,947	*873	4.38	18,694	*887	4.75
Total interest bearing liabilities	**13,829**	**(67)**	**(0.48)**	14,906	(129)	(0.86)	15,216	(227)	(1.49)
Interest margin			**3.61**			3.52			3.26
CPI-linked shekels:									
Total interest bearing assets	**3,155**	**54**	**1.71**	4,261	*100	2.33	4,676	*202	4.34
Total interest bearing liabilities	**3,755**	**(29)**	**(0.77)**	4,046	(74)	(1.82)	4,105	(166)	(4.06)
Interest margin	**-**	**-**	**0.94**	-	-	0.51	-	-	0.28
Foreign Currency (including foreign currency-linked shekels):									
Total interest bearing assets	**1,723**	**41**	**2.37**	1,694	38	2.19	2,320	39	1.65
Total interest bearing liabilities	**2,669**	**(6)**	**(0.24)**	2,380	(8)	(0.35)	2,559	(13)	(0.50)
Interest margin	**-**	**-**	**2.13**	-	-	1.84	-	-	1.15
Total operations in Israel:									
Total interest bearing assets	**26,378**	**974**	**3.69**	25,902	1,011	3.90	25,690	1,128	4.39
Total interest bearing liabilities	**20,253**	**(102)**	**(0.50)**	21,332	(211)	(0.99)	21,880	(406)	(1.86)
Interest margin	**-**	**-**	**3.19**	-	-	2.91	-	-	2.53

* Reclassified

** In percentage

*** 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

	2015 Compared to 2014			2014 Compared to 2013		
	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	**75**	**(54)**	**21**	54	(82)	(28)
Other interest bearing assets	**(57)**	**(1)**	**(58)**	(46)	(43)	(89)
Total interest income	**18**	**(55)**	**(37)**	8	(125)	(117)
Interest bearing liabilities:						
Deposits from the public	**6**	**91**	**97**	6	164	170
Other interest bearing liabilities	**(1)**	**13**	**12**	(1)	26	25
Total interest expenses	**5**	**104**	**109**	5	190	195

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 75 million; (2014 - NIS 121 million; 2013- NIS 41 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 118 million (2014 - NIS 103 million, 2013- NIS 114 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)

	2015 Q4	2015 Q3	2015 Q2	2015 Q1	2014 Q4	2014 Q3	2014 Q2	2014 Q1
Interest income	**236**	**263**	**283**	**192**	242	266	276	227
Interest expenses	**8**	**43**	**76**	**(25)**	35	61	79	36
Net interest income	**228**	**220**	**207**	**217**	207	205	197	191
Provision for credit losses	**57**	**20**	**(8)**	**(2)**	33	(1)	(3)	(14)
Net interest income after provision for credit debts	**171**	**200**	**215**	**219**	174	206	200	205
Non-interest income								
Non-interest financing income (expenses)	**3**	**(13)**	**4**	**43**	10	18	2	12
Fees	**79**	**76**	**77**	**78**	85	76	74	78
Other income (expenses)	**-**	**33**	**-**	**-**	1	-	-	-
Total non-interest income	**82**	**96**	**81**	**121**	96	94	76	90
Operating and other expenses								
Salaries and related expenses	**128**	**139**	**129**	**122**	**(1)**139	(1)165	(1)140	(1)141
Maintenance and depreciation of buildings and equipment	**39**	**40**	**37**	**36**	38	(1)38	36	38
Other expenses	**41**	**46**	**44**	**40**	44	(1)45	(1)40	38
Total operating and other expenses	**208**	**225**	**210**	**198**	221	248	216	217
Profit before taxes	**45**	**71**	**86**	**142**	49	52	60	78
Provision for taxes on profit	**24**	**24**	**34**	**54**	(1)18	(1)21	(1)24	(1)31
Profit after taxes	**21**	**47**	**52**	**88**	31	31	36	47
Banks net share in the results of investee companies, after taxes	**-**	**1**	**1**	**-**	1	-	-	1
Net profit	**21**	**48**	**53**	**88**	32	31	36	48
Earnings per share (in NIS thousands)								
Stock per share of NIS 0.1	**0.17**	**0.39**	**0.43**	**(1)0.71**	(1)0.25	(1)0.25	(1)0.29	(1)0.39
Stock per share of NIS 0.01	**0.02**	**0.04**	**0.04**	**0.07**	(1)0.03	(1)0.02	(1)0.03	0.04

(1) Restated, in respect of the retroactive implementation of the guidelines of the Supervisor of Banks in the matter of employee rights, and in the matter of capitalization of software development costs, see Notes 1 D (7-9).

Appendix No. 3: Consolidated Balance Sheets as at December 31

Reported amounts (NIS millions)

	2015				2014			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Assets								
Cash and deposits with banks	**5,502**	**5,282**	**4,894**	**3,734**	4,994	4,310	3,880	3,851
Securities	**3,432**	**2,777**	**2,868**	**3,296**	3,831	3,786	4,988	5,331
Credit to the public	**20,754**	**20,580**	**20,399**	**19,857**	19,234	18,808	18,441	18,339
Allowance to the credit losses	**(337)**	**(312)**	**(299)**	**(310)**	(319)	(310)	(324)	(352)
Credit to the public, net	**20,417**	**20,268**	**20,100**	**19,547**	18,915	18,498	18,117	17,987
Investments in investee companies	**7**	**7**	**6**	**5**	11	10	10	10
Buildings and equipment	**346**	**353**	**405**	**420**	(1)397	(1)399	(1)397	(1)401
Assets in respect of derivative instruments	**31**	**29**	**21**	**33**	30	42	16	19
Other assets	**341**	**396**	**341**	**360**	(1)392	(1)352	(1)375	(1)343
Total assets	**30,076**	**29,112**	**28,635**	**27,395**	28,570	27,397	27,783	27,942
Liabilities and shareholders' equity								
Deposits from the public	**25,388**	**24,081**	**23,774**	**22,779**	24,060	22,786	23,492	23,424
Deposits from banks	**459**	**790**	**714**	**461**	492	539	190	467
Deposits from the Government	**151**	**157**	**156**	**159**	139	161	161	167
Subordinated capital notes	**672**	**672**	**672**	**670**	681	676	787	787
Liabilities in respect of derivative instruments	**122**	**120**	**149**	**114**	109	161	147	135
Other liabilities	**1,181**	**1,201**	**1,120**	**1,229**	(1)1,173	(1)1,183	(1)1,145	(1)1,103
Total liabilities	**27,973**	**27,021**	**26,585**	**25,412**	26,654	25,506	25,922	26,083
Shareholders' equity	**2,103**	**2,091**	**2,050**	**1,983**	(1)1,916	(1)1,891	(1)1,861	(1)1,859
Total liabilities and shareholders' equity	**30,076**	**29,112**	**28,635**	**27,395**	28,570	27,397	27,783	27,942

(1) Restated in respect of the retroactive application of US accepted accounting principles in the matter of "employee rights" and in respect of the retroactive application of the guidelines of the Supervisor of Banks in the matter of "capitalization of software development costs"

1. 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 fulfillment 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 1 and Tier 2) to the Bank's total risk weighted assets.
Recorded 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 instructions	The instructions for the management of banks risks that have been prescribed by the Basel Committee that deals with supervision and the setting of standards for the supervision of the world's banks.
Subordinated debt notes	Debt notes, in which the rights conferred thereunder are subordinate to claims by the rest of the Bank's creditors, except for other debt notes of the same class.

2. GLOSSARY (CONTINUED)

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 fulfills 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 fulfill 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”.
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.